

**2006 ROYAL MAIL PRICE  
AND SERVICE QUALITY  
REVIEW**

**MUA Response to Postcomm's Consultation**

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## **2006 ROYAL MAIL PRICE AND SERVICE QUALITY REVIEW**

### **1. OVERVIEW**

MUA members thank Postcomm for the opportunity to respond to its consultation on initial proposals for Royal Mail's Price and Service Quality Review from April 2006.

As Postcomm will be aware from discussions with an MUA delegation on 23<sup>rd</sup> August 2005, members do have a number of issues they would wish to raise with regard to the Regulator's initial proposals. These issues are summarised in this paper. However, due to the extensive and in-depth nature of the subject matter, members would request a further meeting with Postcomm to discuss these matters in more detail at an appropriate stage in the consultation.

### **2. INTRODUCTION**

MUA members would wish to state from the outset that irrespective of their technical concerns with Postcomm's proposals, they fully support the Regulator in its endeavours to put in place a further four year price control for Royal Mail, believing the market is insufficiently developed to face the removal of regulation at this time. Members believe it will take at least the 4 years of this price control before competition has developed sufficiently for the Regulator to consider relinquishing such safeguards on customer interests.

MUA would also wish to raise at an early stage in this document, its concerns regarding the sheer scope of change in 2006. Not only is the market facing full liberalisation, but customers also have to consider the implications of the new PIP pricing structure, Royal Mail's proposed new product portfolio, and other factors such as the bedding down of changes to the licensing framework, and industry's acceptance of Codes of Practice for common operational procedures and mail integrity. Many of these issues will have a bearing on the appropriateness of certain criteria in Postcomm's proposals for the price control. Members therefore consider it is extremely difficult for customers, operators and Regulator alike, to second guess circumstances in the postal market post-2006, and how the price control will be affected by other factors.

Members would therefore strongly urge Postcomm to fully review the permutations of individual initiatives and how each will impact on the whole, prior to making its final price control proposals.

However at this initial stage in the consultation process, MUA members would wish to make the following observations, on the basis that they form a skeleton for future discussion with Postcomm, and members would request the Regulator retains an open dialogue with business customers in the run up to its final proposals.

### **3. COVERAGE OF THE PRICE CONTROL**

MUA recognises Postcomm's desire to encourage competition in the market through deregulation of products where 'competition is providing genuine choice and protecting the interests of customers'<sup>1</sup>. MUA continues to support this premise, on the basis that over time such deregulation will offer real choice and value for money to customers.

Members do however remain extremely sceptical of some of the arguments Postcomm has so far put forward to substantiate their proposals to deregulate certain products in this price control, believing that far from protecting the interests of customers, the proposals may actually stand to compromise certain customers' ability to access a guaranteed national network of business and residential addresses.

#### **3.1 Deregulation of Existing Products**

##### **3.1.1 Presstream**

MUA is extremely concerned Postcomm has not taken full account of circumstances in the magazine market, before putting forward the proposals to deregulate Presstream 1+2 products. MUA would make the following points in respect of the magazine publishers its represents through association with PPA:

- Membership discussions with competing postal operators have indicated they do not intend taking up the challenge of competing with Royal Mail in the provision of a next day business to business delivery in the foreseeable future, irrespective of market liberalisation in January 2006.
- Research carried out by a member company indicates that where there are postal operators currently offering a 2-3 day delivery service, this coverage is still very limited, even to business addresses in city centres.

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<sup>1</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 9 – S27

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- In this research one postal operator stated they were able to provide a very limited coverage to residential properties. However, all other major existing magazine postal operators have indicated that delivery to residential addresses is not part of their future strategy.
- 97% of all magazine postal traffic is still delivered by Royal Mail, and whilst the development of competition is potentially possible, member discussions with service providers indicate this will be very limited for the foreseeable future, and certainly not on a significant scale during the course of the forthcoming price control.

MUA members would therefore state they do not believe the magazine market is developed enough at this time to face the deregulation of its mailing lifeline. Indeed, members would argue that if Postcomm remains adamant that the magazine market is developed sufficiently to justify product deregulation, it should revisit the fifth criterion of its Competition Test, i.e. Postcomm ‘should consider whether there are compelling, probably universal service, reasons to maintain a price control even where competition is well developed’<sup>2</sup>.

### 3.1.2 Special Delivery

Whilst MUA recognises the extent of the arguments put forward in support of the deregulation of Special Delivery, i.e. ‘that there is evidence that large and medium sized businesses have a wide range of alternatives to choose from, with a variety of different delivery times, and “track and trace” facilities offered’<sup>3</sup>, members again do not believe Postcomm has provided a convincing enough argument for deregulation at this point in time. Members agree with Postcomm that there is competition in the Special Delivery market, but would argue this is predominantly in the business-to-business sector, and far less so in the business-to-consumer market. Here, competition remains a challenge, and members question whether Postcomm’s analysis has taken into account the geographic areas (particularly remote rural locations) in which existing providers are prepared to offer their services.

MUA would also note Postcomm’s premise that ‘the distinction between large and medium sized business customers on the one hand and residential and small business customers on the other, is determined by the payment method’<sup>4</sup>, on the basis that Royal Mail can distinguish between those paying

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<sup>2</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 38 – 3.15

<sup>3</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 42 – 3.33

<sup>4</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 42 – 3.35

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at the post office (residential and small businesses), and those paying on account, members believe to be incorrect. MUA has been led to believe that circa £100m worth of Special Delivery revenue is generated through the meter channel, which is either collected from business addresses via the normal Royal Mail collection process, or is taken to a post office.

Members would therefore conclude that whilst it recognises the Regulator's desire to demonstrate its 'commitment to removing regulation, where possible'<sup>5</sup>, in the present market conditions, it is in customers' best interests to retain Special Delivery and Presstream 1 + 2 services within the regulated services portfolio.

### **3.2 Regulation/Deregulation of New Products**

MUA continues to believe all new products should automatically fall within the regulated area, until such time as competition can be demonstrated to have developed sufficiently to protect customer interests. Members are extremely concerned that were this not to be the case, it would be possible for Royal Mail to develop new, more attractive services by reinventing old products, thereby circumventing Postcomm's regulatory control. These new 'substitute products' would naturally encourage customer migration to a point where Royal Mail could then build a case for the withdrawal of an established 'price controlled' product on the basis that it is financially unsustainable, not being used by customers and therefore should be abolished.

The fact that a customer's decision making process does not simply revolve around price is a pertinent issue here. Irrespective of whether Royal Mail charges an excessive price for the new substitute product, it may be that the customer is restrained from returning to the price controlled product, because its quality of service is so poor. A situation that would be greatly exacerbated by the introduction of Postcomm's aggregated product baskets, whereby Royal Mail could allow the performance of a particular product to drag, on the basis that the overall performance of the basket it sits within, will carry it above target.

MUA recognises Postcomm's arguments relating to the benefits Royal Mail will bring to the market by being innovative. Indeed, members would expect the new more customer focussed Royal Mail to be innovative in accordance with the needs and wants of its customers, irrespective of whether a said product sits within the price controlled area or not. However, in this under-

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<sup>5</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 45 – 3.52

developed market, members continue to believe a regulated environment is the safest place for products and services to develop, until such time as it can be proven that real competition has developed in each and every product scenario.

## **4. ACCESS PRODUCTS**

### **4.1 Price Controlling Access Products**

MUA fully supports Postcomm in their proposal to bring downstream access products within the price control. Members believe this will help promote competition, particularly in upstream activities, by ensuring that downstream access products are offered on reasonable terms by Royal Mail.

MUA is not surprised Royal Mail has so far not come forward with a proposed access code, believing that any organisation in a similar position would strive to retain this gift within its control. Members have for some time been pressing Postcomm to become involved in formalising an access code to speed up the process, and consequently support the view that ‘the current negotiated approach to agreeing access terms and conditions, including price, gives Royal Mail the power to delay the development of competition, and this power could be (and in MUA’s view is) to the detriment of customers’<sup>6</sup>

### **4.2 Options for Price Control Implementation**

In respect of how Postcomm brings access products into the price control, MUA would recommend a two phase approach. In the interim period, members would subscribe to the adoption of Option 1 – for Postcomm to price control the ‘margin’ between access and retail products, whereby it would stipulate a minimum margin, as a pence per item or percentage, between access and retail prices that Royal Mail must maintain.

However, ultimately members recognise Postcomm’s argument that ‘the major risk with this option is that if costs move over time the differential might no longer be cost reflective, which could either stifle the development of upstream competition (if the differential was too low) or prevent Royal Mail from recovering its reasonable cost’<sup>7</sup>. Member would therefore only consider this should be an interim measure. In the longterm, members believe the most appropriate way to achieve non-discriminatory downstream access, is for Postcomm to begin the regulatory process to separate the network pipeline

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<sup>6</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 51 – 4.11 Please note this quotation does not include the words (and in MUA’s view is).

<sup>7</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 56 – 4.22

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elements of Royal Mail from all other facets of the business, thereby achieving clear lines of demarcation and accounting separation. Members believe this will ultimately maximise customer certainty (both for upstream suppliers and the customers they serve), and drive forward the development of competition in this area of the UK postal market.

#### **4.3 Quality of Service for Regulated Access Products**

MUA members would support Postcomm's proposals that the current quality of service target in the downstream access agreements of 95% next day delivery, and a compensation regime similar to the business compensation scheme for retail customers, should remain in place for regulated access products.

MUA would also strongly support the fact that postal operators using access products have every right to receive information regarding the quality of service Royal Mail has achieved in delivering their mail. Members consider the issue of extra cost for this performance evaluation is a mute point, given that Royal Mail should be collecting such information in the course of its normal business activities anyway. Members would also state as an adjunct to this that they believe Postcomm should adopt the principle of better information provision from Royal Mail as a major theme throughout the course of this price control.

### **5. FORM AND DURATION**

#### **5.1 Form of Control**

MUA continues to support Postcomm in its proposal to retain the RPI-X form of control into the next price control. Members believe Royal Mail's proposals for adoption of a mechanism that allows them to retain efficiency savings on a rolling basis is inappropriate, given their belief that customers deserve to see the benefits of efficiency savings today, not tomorrow.

#### **5.2 Re-opening of the Price Control**

MUA would again support Postcomm in its decision to maintain the current price control re-opening mechanism.

#### **5.3 Duration**

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MUA supports Postcomm in its proposal to set a four year price control. In deliberation over the appropriate duration of the price control, members have recognised the fact that a shorter period than four years would fail to sufficiently incentivise Royal Mail, but would better accommodate the uncertainty of how competition might develop in the short to medium term. Whilst, a longer period than four years would provide strong incentives for Royal Mail to make efficiency savings in areas unlikely to be exposed to strong competitive pressures, but might not turn out the customer's best interests. On balance members therefore think that Postcomm's proposal is the best way forward.

## **6. MAIL VOLUME ASSUMPTIONS**

### **6.1 Mail Forecasts - 1st Class Mail Volumes**

MUA would state that the consultation documents from Postcomm and LECG show that Royal Mail will retain virtually all 1<sup>st</sup> Class mail because the new entrants will find it difficult to develop competing networks. Members do not believe that this hypothesis is correct – whilst MUA believes that there is unlikely to be products that directly compete with next day delivery, many large mailers presently using 1<sup>st</sup> Class mail are weighing up the benefits of moving to a 2 day Downstream Access product, in view of the cost savings that can be achieved over the comparable 1<sup>st</sup> Class Royal Mail products.

Customers that have already moved to access products - and these are some of the largest members of MUA for bulk mail – and are not only considering how to move their 1<sup>st</sup> Class bulk mail, but also their standard tariff PPI and metered mail (as many large customers use a wide variety of payment channels), to achieve the maximum levels of discount that access provides. With the new entrants also now targeting the unsorted mail market down to 250 items per day in a mailing, competition will now be available to the small and medium sized business user, the majority of which are now using standard tariff 1<sup>st</sup> Class.

MUA would therefore disagree with the assumptions from Postcomm and LECG that 1<sup>st</sup> class mail is “captive” and is therefore under threat, and believe that the forecasts put forward by LECG need to be reworked based not only on 1<sup>st</sup> Class mail but also in respect to the volumes of mail already switching to access products, which appear higher than in the LECG forecasts.

## **7. STRUCTURE**

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## **7.1 'Captive' versus 'Non Captive' Baskets.**

MUA would question Postcomm's thinking on the introduction of captive and non-captive baskets firstly on the basis of the arguments of 1<sup>st</sup> Class mail that have already been outlined in this response (see Section on Volume Mail Assumptions). If that argument is seen by Postcomm as rational and logical, then the rationale of the way that the tariff baskets is structured becomes questionable because 1<sup>st</sup> Class PPI and Metered mail would then move to the non –captive baskets leaving only stamped mail, standard parcels, response services, airmail and surface mail within the captive basket. The ability of Royal Mail to then rebalance prices based on cost reflectivity is negated, and as such MUA recommends that the existing one basket approach is retained.

## **8. QUALITY OF SERVICE REGULATION**

### **8.1 Compensation**

MUA members strongly object to Postcomm's proposals for the development of a bulk mail compensation scheme that will be paid on the basis of the performance of a basket of products, rather than by single product. Members do not agree with Postcomm's premise that the performance of certain baskets of products share anything but the most scant correlation - in particular the grouping of stamps and metered mail, nor do they consider it appropriate in any way to recompense (or not to recompense) customers utilising a product for anything but the performance of that particular product.

Members believe this is sending the wrong message to Royal Mail. In any particular basket where certain products are performing well, but others are performing badly such a scheme would potentially be open to abuse, in the sense that it offers no incentive for Royal Mail to improve the performance of poor performing products, so long as other products can 'carry' the basket above target.

### **8.2 Loss and Damage**

MUA recognises the intrinsic difficulties in measuring 'lost in post' mail, and would state that until such time as a more robust quality of service monitoring system is put in place, Postcomm's proposals to ensure adequate redress is available to customers who experience loss and damage through Royal Mail's statutory schemes, is probably the most appropriate way forward.

MUA would also support Postcomm in its proposals to include a measure/standard for the subset of 'Misdelivery' in the 'C' factor calculation from April 2006 onwards. Members would be keen to contribute to debate around a proposed level for this standard.

### **8.3 Delivery**

MUA continues to maintain timeliness of delivery is an essential criteria for many business customers who over the years have developed (and since the introduction of Single Day delivery, have now had to redesign) their own organisational systems and work patterns to accommodate Royal Mail. Members do not believe Postcomm is acting in a sufficiently robust manner, to imply this issue does not rate highly enough to impose a target for the percentage of deliveries completed each day by their stated delivery times.

MUA would also state it is not acceptable for Royal Mail to argue the case for not doing so on the basis that the setting of a Standard for delivery times 'would be too rigid, and might prevent it introducing efficiencies in circumstances where it is in the customers' best interests to do so'<sup>8</sup>. All businesses have deadlines against the backdrop of having to continually improve efficiency, and it should be within the gift of any organisations' management to overcome the challenges set before it. Members would therefore argue that Postcomm has a duty on behalf of users to ensure Royal Mail delivery times do not disrupt the activities of other UK businesses.

### **8.4 Tail of Mail**

Whilst MUA recognises the arguments for withdrawing the 'Tail of Mail' target, members would strongly argue that Postcomm should maintain an obligation for Royal Mail to measure and publish information relating to this facet of delivery. Many businesses would wish to analyse this type of information when devising multi-media marketing campaigns.

### **8.5 Measurement and Audit**

MUA continues to believe there is a conflict of interests in Royal Mail contracting out its own performance evaluation, and would strongly recommend responsibility for this activity be removed from Royal Mail and placed with either Postwatch, or an independent data capture body set up by Postcomm.

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<sup>8</sup> Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals – Page 161 – 9.36

Although not directly the subject of this consultation, MUA also attaches a proposal from a new and arguably more statistically robust quality of service monitoring system (Please see Appendix A). Members would strongly urge Postcomm to consider this proposal alongside the quality of service aspects of the proposed price control.

## **APPENDIX A**

### **POSTAL MONITORING IN THE 21<sup>ST</sup> CENTURY**

#### **1. Introduction**

For a considerable length of time MUA has been stressing its belief in the need to update and hand over the responsibility for the Universal Service Provider's performance monitoring, to an independent body set up for the specific purpose.

MUA fundamentally believes that whilst the results of performance monitoring should remain the gift of Royal Mail management, in terms of the utilisation of results as a diagnostic tool to continually improve the network pipeline, as a national asset the overall duty for monitoring UK plc's Universal Service Provision, should remain the responsibility of Postcomm/Postwatch, or a independent body set up by them.

Members have taken this stance because they believe in an increasingly competitive market a more robust, technology led approach to monitoring will be required, particularly in a multi-operator environment where performance accountability will need to be more scientifically proven. They also believe that in the lead up to full market opening, at a time when Royal Mail is addressing many out dated facets of its business in readiness for competition, the time is right to move this dialogue forward.

MUA members are aware of the cost implications such a move will have, and are not underestimating the substantial capital investment that will be required to implement a sufficiently robust electronically based monitoring system. However, it is their belief, with the co-operation of the shareholder (H M Treasury), for instance in the re-provision of funds so far taken from Royal Mail as financial penalties for poor performance, a long-term strategy can be developed that will not overly burden Royal Mail in its implementation.

Furthermore, following an initial capital investment outlay MUA believes the year on year operation of an electronically based system will reduce operating costs, and may even have a revenue generating capacity in the longterm.

With this in mind, MUA members would wish to provide a future performance monitoring scenario for consideration.

#### **2. Electronically Based Postal Monitoring – In Theory**

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As the affordability of technological solutions for monitoring movement of anything from supermarket produce to airline baggage becomes more affordable, so does the viability of utilising it to monitor postal performance across the UK. Many sectors of the market now utilise technology such as Radio Frequency Identification Systems (RFID) to track and trace all types of items through varying systems and networks, not least of all in the express parcel delivery market. MUA would argue this is where the future of postal quality of service monitoring lies.

Although the capital investment outlay in purchasing the hardware to set up a nationwide system should not to be underestimated, MUA believes the advantages of eradicating human error from the process, and the inherent flexibility of the system, coupled with reduced year-on-year operating costs outweigh the disadvantages in the long term.

### **3. A Potential Implementation Strategy**

MUA would therefore propose that decision makers consider the following building blocks for an electronic monitoring system, which can be set up and run in parallel with the existing monitoring process, until such time as it is acknowledged and proved as being scientifically valid:

- Postcomm/Postwatch would look to set up an independent monitoring office where data capture via an internet interface would take place. This office would be funded on an on-going basis by the Universal Service Provider(s), and information gathered through it would remain continually accessible in real time, to USP providers via a secure electronic interface.
- Postcomm/Postwatch's self appointed monitoring team would purchase and install a server capable of gathering information from multiple sources via a number of secure internet sites. They would also be responsible for sourcing, developing and trialling appropriate electronic reader systems to eventually be installed into the premises of seeded addresses, and at agreed insertion points. These readers would eventually be electronically linked to the server via a broadband connection<sup>9</sup>.

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<sup>9</sup> It is technologically possible to either install gateway antennae around a letterbox, or enclosed in a doormat configuration, thereby making it easy to install and re-locate, as and when necessary.

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- The designated independent monitoring team would then confidentially source and engage a network of seeded addresses with Broadband capability, covering all 124 Postcode areas<sup>10</sup>.
- The independent monitoring team with the co-operation of Royal Mail would then compile a list of registered insertion points (at least one in every Postcode area, covering all major trunking routes, into Inward Distribution Centres), where electronic readers would eventually be installed. For the monitoring of stamped mail, registered Post Offices would be selected. For the monitoring of bulk mail, mail consolidation houses, printers or similar sites would be chosen.
- The independent monitoring team would also establish from Royal Mail all gateways for downstream access, with a view to installing gateway readers to register when items from other carriers are injected into Royal Mail's system.
- The monitoring team would source the co-operation of other competitors for the eventual installation of electronic readers at relevant premises.
- The independent monitor team would also confidentially be given access to Royal Mail's Re-direction service records, in order to set up a roving network of seeded addresses for the measurement of Redirection mail.
- Electronic Reader Systems would then be purchased in bulk by the independent monitoring team and installed at all designated network entry and delivery points.
- The system would then be trialled extensively to remove start up problems.
- The new monitoring system would then go live alongside the existing monitoring process, until such time as it is acknowledged to be scientifically proven. At which time, the electronic system would take over from the existing system.

#### **4. Electronically Based Postal Monitoring - in Practice**

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<sup>10</sup> As each Postcode area has approximately 20 Districts, the recommendation would be that 2 seeded addresses are sort in each District initially with a view to increasing this number to 4-6, in the long term. This would initially provide approximately 5000 data sources nationwide (40 in each Postcode area), potentially rising to 15,000 (120 in each Postcode Area).

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MUA envisages residents of potential seeded addresses would be approached by the independent monitoring team, and asked if they would be prepared to be part of the UK Postal Service monitoring system. This would involve them having an electronic reader system installed in their homes (depending on the technology chosen, either as a gateway antenna around the letterbox, or contained within a door mat configuration) for a set period of time, that would register the arrival of test mail items, and relay this information to a central data capture point via their broadband connection<sup>11</sup>. All participants would need to do in return, is to send back the Test letters in reply paid envelopes provided to them<sup>12</sup>.

Address details of those willing to participate would then be held on a secure database by the independent monitoring team, and utilised to send mail items from varying locations around the UK. Test letters could then be prepared in any one of many formats, incorporating highly disguisable RFID transponder technology, and injected into the pipeline across the Postcode network. Injection of test items into the network would be registered by electronic gateways at point of entry, and the unique information contained on each transponder relayed back to the central data capture point.

Test items containing RFID transponders would then pass through the network in the usual way. Information registered on each transponder would be configured in such a way, as to render it null and void should any attempt be made to detect them prior to final delivery.

As and when each test item finally falls to ground, the reader device at each seeded address would register the time and date of its arrival, and transmit this information to the data capture centre via the host's Broadband connection. This information would then be processed by appropriate software in order to marry it with relevant information on when the test item was injected into the pipeline, and compared with the delivery date target of the relevant mailstream.

## 5. Potential Additional Benefits

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<sup>11</sup> A necessary incentive for doing so, perhaps being free internet access for the household.

<sup>12</sup> Each transponder utilised in test pieces can be re-used in excess of 10,000 times, and presently costs approximately 2p.

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MUA would envisage that a system such as described above would have a number of added benefits to existing provision:

- test items carried by multiple operators could be configured to electronically register when passing through downstream access gateways, accurately ascertaining where delays may have occurred in the pipeline. An important factor when considering the apportioning of compensation for delay.
- calculation of 'Lost in Post' through mis-delivery could be more accurately assessed.
- redirected mail monitoring would take place in the same way, only using electronic reader devices at a series of roving seeded addresses, which could be moved as and when necessary.
- and, rather than Individual companies financing their own performance monitoring activities, they could arrange to have their own seeds planted on the more statistically robust electronic measurement system.

## **6. Cost Evaluation**

At this early stage in dialogue, MUA has not carried out any extensive research into the evaluation of cost, or accurately assessed how economies of scale in bulk buying might effect overall prices. However, through the brief research it has carried out into the available technology, and taking into account the additional research and development costs of fine tuning applications to meet identified needs, MUA would suggest that provision of a budget of approximately £8-10 million, would see the installation of a comprehensive electronic monitoring system.

MUA members would also suggest that the lion's share of such a budget should be born by the shareholder, in recognition of the £7.5 million remuneration H.M Treasury received on behalf of customers, for financial penalties imposed on Royal Mail, for poor performance in 2003.