

## POSTCOMM CONSULTATION INTO THE 2006 ROYAL MAIL PRICE & SERVICE QUALITY REVIEW

### Response from the Periodical Publishers Association (PPA)

September 2005

#### SUMMARY

Presstream is a work share delivery service for magazines to all locations where the charge reflects periodicity, volume and destination. All these factors point to the fact that the charge for the service closely reflects the cost and benefit of supplying it unlike Royal Mail's other services where the charge does not take account of these factors. However, where there is competition, at present competitors charge less than Presstream, even when discounted to reflect the distribution profile of the publication, so their presence does not appear materially to be operating as a constraint on the charges made by Royal Mail. Historically there has been little competition with Royal Mail for business to business, customer and much consumer magazine distribution because, as Postcomm has previously acknowledged, on its own the business does not have sufficient critical mass without other currently regulated business to justify the investment to be universally competitive.

Whilst PPA recognises the wish of the Regulator not to "price control products where competition is providing genuine choice and protecting the interests of customers", **PPA does not understand why:**

- o Postcomm **needs** to remove the control and what effect Postcomm expects such removal to have on services to magazine publishers
- o Postcomm has chosen to modify this criterion to take account of competition which is "developing to protect the interests of consumers" – i.e. is **not yet protecting** those interests, unlike, for example Ofgem which only removed a price cap when competitive forces were "protecting consumers more effectively than price controls" ( Postcomm's Frontier Economics report)
- o if Postcomm has chosen to modify this criterion, it is not proposing to remove price control from those other products referred to in its proposals where "the prospects for competition developing over the next 5 years are reasonable"
- o Postcomm has now decided to change its control of Presstream when, as Postcomm's Frontier Economics report says "the conclusions reached on the basis of current evidence are **similar** to those reached by Arthur Andersen (2001) " ("The potential for effective competition is higher for the delivery of periodical subscriptions – i.e. the Presstream product – but there is limited entry to date.")

PPA has consistently urged Postcomm to retain Presstream within the regulated area since we do not believe that competition is established sufficiently to protect the interests of publishers.

- Publishers rely on Royal Mail to deliver a minimum of 97% of all postal magazine traffic.
- A critical requirement for the majority of business-to-business magazines is next day delivery. Discussions with alternative mail providers have indicated that the opening of the market for mailing on 1 January 2006 will not result in Royal Mail facing competition for universal next day delivery services in the foreseeable future. Royal Mail is therefore in the unique position of being able to set its own market price, with a complete lack of realistic competition or alternative providers.
- Even where alternative providers currently offer a 2-3 day delivery service, the coverage is still very limited, even to business addresses in some city centres. One alternative provider is able to offer very limited coverage to residential addresses. To date, all other major existing service providers have indicated to PPA that delivery to residential addresses is not part of their future strategy.
- The lack of delivery to residential addresses has an impact on business as well as consumer magazine publishers since an increasing number of subscribers to business to business magazines are choosing to receive their copy at home.
- Whilst PPA accepts that there are some prospects for the development of competition, we believe, based on discussions with service providers, that this will be on a very limited scale during the 2006 to 2010 price control period. As Postcomm will be aware, the evidence from other countries that have deregulated their postal systems is that new entrants do not necessarily remain in the market leaving the incumbent freedom to set its own prices unless regulated. Thus control should only be removed when competition is established not just when it is present or, indeed, only proposed.
- The attractiveness of the downstream access service offering is severely reduced for publishers as a result of its 2-3 day delivery timescale.
- The competitive market for the Presstream service is set within the context of the postal delivery of magazines. An analysis of the characteristics and dynamics of the consumer magazine industry offers irrefutable evidence that other non-postal channels of distribution, such as the newstrade supply chain, cannot be regarded as competitors.
- Supply to retailers through the newstrade supply chain is not an option for the majority of business to business titles (controlled circulation) and customer magazines as the reader does not pay the retailer to receive them.
- PPA rejects the Postcomm assertion that Mailsort products offer a safe harbour for Presstream customers should Presstream prices rise excessively as this ignores the historic and well-founded bases for differences between the two services.
- If Presstream is to be placed outside of the regulated area, this means that the service provided to magazine publishers will not benefit from the current monitoring of performance against agreed quality of service targets. There is a very real danger that publishers will be faced with increased prices and declining quality of service levels.

- In the above circumstances, uniquely exposing important sections of the Press to a deregulated environment would pose a serious threat to its continued existence and be discriminatory for those reasons outlined above.

## **INTRODUCTION**

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According to Postcomm's consultation document published in June 2005, it has based its decision for withdrawing Presstream from the regulated area on two main assumptions for which it has provided very little evidence:

- (i) Postcomm believes that competition is developing sufficiently to protect the interests of customers; and
- (ii) It believes that a combination of non-postal and post-on-post competition for Presstream products means that customers' interests can be protected without a price control:

*"Publishers already have alternatives to Royal Mail for delivering their product to customers. Two thirds of publications are sold through retailers, suggesting that non-postal competition is significant".*

*"In addition to non-postal options, Presstream customers could switch to Royal Mail's Mailsort 1 or 2 products if Royal Mail sought to raise Presstream prices excessively. This is a good example of where alternative price-controlled products can offer a similar level of customer protection to that of external competition." [Postcomm consultation, June 2005].*

In the following submission, we have outlined why PPA believes that Postcomm's assessment of the market as stated above is incorrect and therefore why Presstream should remain within the regulated area.

## **PPA RESPONSE**

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PPA has consistently urged Postcomm to retain Presstream within the regulated area, most notably in our submissions of February 2003 and December 2004.

### **SCALE & NATURE OF POSTAL COMPETITION**

#### **Limitations in terms of scale and service offering**

Whilst PPA accepts, on the experience of the last 10 years, that there are some prospects for the development of competition, we understand from discussions with existing operators, that this will continue to be on a very limited scale during the next price control period (proposed until 2010).

Significantly, the situation has not changed since Postcomm undertook its 2001 review. Royal Mail is the only operator able to offer guaranteed national coverage at present to business and residential addresses and this is vital to publishers who need to ensure that all their subscribers – both paid-for and controlled - can be accessed by a postal operator.

Publishers are coming under increasing pressure in terms of speed of delivery and a critical requirement for the majority of business-to-business magazines is next day delivery in order to meet both reader and advertiser expectations. Indeed, given the specific industry news and recruitment advertising that many of these magazines carry (e.g. *Caterer & Hotelkeeper*, *The Grocer*, *Campaign*), they are regarded as being as time-sensitive and 'perishable' as daily newspapers.

A small number of alternative mail providers are offering next day delivery in key city centres (see below under 'Current operators'). However, due to the limited level of coverage, the opening of the market for mailing on 1 January 2006 will not result in Royal Mail facing effective competition for next day delivery services in the foreseeable future. To do so would require a level of investment in infrastructure that operators are not prepared to make at this time. Royal Mail is therefore in the unique position of being able to set its own Presstream 1 market price with a complete lack of realistic competition or alternative providers for the market as a whole, and to set its Presstream 2 prices in only a limited and slow growing competitive marketplace.

PPA believes that the potential for the alternatives' share of the magazine delivery market to increase much beyond 5 per cent in the short to medium term is almost nil. This is backed up by research conducted among PPA members:

- On the basis that business-to-business publishers are the most likely to be using alternative mail providers, PPA gathered data from the 5 largest publisher members. Together they represent between 65 and 70 per cent of the business to business market.
- As an average figure, only 3 per cent of total magazine traffic for these publishers is being distributed through alternative carriers. There has been very little growth in the use of alternatives over the last 5 years: 5 years ago the figure was around 2 per cent.

### **Current operators**

AMP and DHL Global Mail are two companies currently providing an end-to-end next-day delivery service for magazines, but coverage is limited and restricted to city centres, and delivery is to business addresses only. According to AMP, it is able to cover, on average, around 30 per cent of business addresses for publisher clients. Given that business addresses represent 28 per cent of all UK addresses, AMP's coverage equates to only 8 per cent of UK addresses.

DHL has stated that it intends to have a coverage of 75 per cent of business addresses by the end of 2006, equating to only 20 per cent of all UK addresses.

There are other, smaller hand delivery companies operating a next-day service for business to business magazines, but again these are only operating in some major city centres and therefore coverage is limited.

Only one company (TNT Mail) is offering a 2-3 day delivery service to both business and residential addresses, but this is on a limited scale. Coverage currently stands at 20 per cent of UK addresses and at this time TNT Mail is unable to specify timescales for increasing the level of coverage or indeed the frequency of delivery.

## Delivery to residential addresses

Alternative mail providers have indicated to PPA that their intention in the short, and more importantly, in the medium term is to focus on establishing a delivery service to business addresses and not on delivery to residential addresses. One company has stated clearly that delivery to residential addresses will not form part of its future strategy. What is more, delivery to business addresses often takes place at times unsuitable for residential delivery.

With an increasing number of subscribers to business to business magazines choosing to receive their copy at home, the lack of delivery to residential addresses affects business as well as consumer magazine publishers, as highlighted by the case study below from a leading business to business publisher.

### Case study from Business Publisher A

- *Business to business Publisher A requires delivery to a total of 696k addresses nationally*
- *Of these, circa 548k are business addresses and 148k (21 per cent) are residential addresses*
- *Conversations with certain alternative providers indicate that they aim to achieve delivery to 75 per cent of business addresses, (with no plans for delivery to residential addresses)*
- *Even if this 75per cent coverage is achieved, for Publisher A's address base this means that circa 137k business addresses will not be serviced by these alternative providers.*
- *Added to the residential addresses that they are unable to deliver to, this will mean that there will be around 285k addresses (41 per cent) that only Royal Mail will deliver to.*

## Additional complexities of using more than one supplier

In addition to the limited geographical reach of alternative operators, any potential gains using these alternatives have to be balanced against the additional complexities of dealing with more than one supplier.

Many publishers are reluctant to do this since there are considerable additional costs for publishers and mailing houses to manage split distribution. This requires investment in new address management and sortation software, and operationally through segregation of mailings. Managing two or more suppliers is a duplication of activity across preparation, handover, customer service and account management. Tracking complaints requires cross-checking of suppliers, down to postcode sector level to identify the service provider. For many publishers this would require yet further investment to manage their subscription and controlled circulations effectively, particularly since the experiences of those publishers who have used alternative mail providers for some elements of their circulation show, in many cases, a disproportionately high level of complaints.

In most publishers' experiences, any price advantage which might be obtained by using such competitors is negated by the disadvantages of dual supply, hence the low take-up of services.

### **Downstream access**

Downstream access is not a viable option for the majority of business to business publishers for reasons of time sensitivity: alternative providers are only able to offer a 2-3 day delivery service.

PPA also believes that the access price which alternative providers are required to pay Royal Mail is set too high to drive further developments in this arena. Small lightweight items which have been in the van of downstream access have, according to service providers, been pitched at a market rather than cost-plus rate. This has allowed some incursion by alternative aggregators, but on a limited basis.

Nor is this base price reflective of the lower costs of repetitive traffic such as Presstream, or that it also adds value through driving additional postal revenue that lowers overall unit costs. The result is that alternative operators are unable to effectively compete for magazine traffic, as Royal Mail internal cost allocations (and associated unit savings) for Presstream pricing are not passed on through access pricing, rather aggregated and averaged across all services, and even then are market i.e. price-minus, rather than cost-plus based.

### **Mailsort is not an alternative**

PPA rejects the Postcomm assertion that Mailsort products offer a safe harbour for Presstream customers should Presstream prices rise excessively. This would inevitably lead to the removal of the existing Presstream and Mailsort price differentials and a *de facto* price rise for magazine customers. This despite the special nature of magazine traffic which has delivered long-standing and proven benefits previously accepted by Postcomm: namely that it is long-term, and on fixed days per week and month, giving substantial cost and service benefits to Royal Mail. Further, magazines deliver added value through the generation of further mailings by both customers, publishers and advertisers: figures from Royal Mail show that for an average title, 42 per cent of Royal Mail's revenue comes from Presstream, with the remaining 58 per cent coming from ancillary sources such as direct mail.

## **NON-POSTAL COMPETITION**

### **Newstrade distribution is not a viable alternative**

The competitive market for the Presstream service is set within the context of the postal delivery of magazines. Other non-postal channels of distribution, such as the newstrade supply chain, cannot be regarded as competitors.

In the case of **business to business magazines**, 90 per cent are distributed by post, either as paid-for subscriptions or controlled (free) circulation, the latter accounting for 70 per cent of postal circulation. Newstrade is not an option for the majority of business to business titles (controlled circulation) as the reader does not pay for them directly through a cover price and thus there is no margin share to allocate to retailers.

These two categories make up almost 80 percent of press distribution through Presstream.

Postal delivery remains a critical route to market, and particularly for a large number of specialist **consumer magazines** and new launches. This is due principally to the trend for other distribution channels (i.e. newsagents, supermarkets and high street shops) to limit the range of

consumer magazines sold: *"Due to the nature of the predators (the large supermarket chains), acquisition of convenience store chains usually means shifting the product range more heavily into fresh food. This is changing the nature of the convenience offer and is also putting pressure on the space devoted to other categories, including news and magazines". (Wessenden Marketing, Sept. 2004).*

Taking as an example, Tesco's acquisition of T&S Stores, in the largest store conversions the magazine range has been reduced by 52 per cent versus July 2003.

Therefore, postal subscriptions are increasingly the only route to market for many of these titles, yet they have no choice but to use Royal Mail due to the lack of coverage to residential addresses.

**Customer magazines** are heavily reliant on postal delivery since it is the most effective way of ensuring these titles meet their target customer base. Seventy per cent of customer magazines are distributed in this way, whilst the remainder are picked up in-store. It is neither appropriate nor feasible for these magazines to be distributed through the newstrade.

## QUALITY OF SERVICE

If Presstream is to be placed outside of the regulated area, the service provided to magazine publishers will not benefit from the current monitoring of performance against agreed quality of service targets nor will they be eligible for compensation as a result of poor performance. This is of concern to publishers, given that for the reasons outlined above, magazine traffic will continue to represent a 'captive' market for Royal Mail. There will be no incentive on Royal Mail to maintain good quality of service levels for Presstream, yet if faced with poor quality of service, the options for publishers to move their traffic to alternatives will be at best extremely limited, and at worst non-existent.

There is a very real danger that publishers will be faced with increased prices and declining quality of service levels.

## THE ROLE OF THE REGULATOR

Postcomm has consistently stated its aim to be a 'light touch' regulator whilst at the same time acknowledging that for as long as Royal Mail retains a dominant position in the postal market and customers have no effective choice of operator, it will be necessary to protect customers through controls on Royal Mail's prices and service quality: *"Competition does not develop in an ordered way. Instead, it develops in pockets and until there is consistent coverage, there remains a need for regulation".* (Sarah Chambers, Postcomm chief executive, June 2006).

PPA believes that within the overall postal market, 'light touch' regulation and a 'heavier' regulatory approach are not mutually exclusive: different aspects of the market will require the intervention of the regulator to a greater or lesser extent, depending on how effectively both that sector of the market is performing and also the relationship between Royal Mail and its customers within that sector.

## CONCLUSION

As indicated above, whilst PPA understands the wish of the Regulator to encourage competition PPA challenges the need to de-regulate sections of the mailing community in order to do so. Deregulating the magazine industry service in this way whilst continuing to offer protection to virtually all other regular mail services appears both arbitrary and discriminatory and goes in the face of the recommendations of Frontier Economics, its consultants.

- We do not believe the Regulator has taken sufficient account of the facts surrounding the different types of magazines and their distribution channels and, in particular, the completely different business models on which paid consumer and free-to-the-reader business magazines are based: Retail (newstrade) distribution is neither appropriate nor viable for free-to-the-reader business magazines which account for 70 per cent of all business magazines
- Even where alternative providers currently offer a 2-3 day delivery service, the coverage is still very limited, even to business addresses in city centres. The lack of delivery to residential addresses has an impact on business as well as consumer magazine publishers since an increasing number of subscribers to business to business magazines are choosing to receive their copy at home.
- We do not believe the Regulator has taken sufficient or reasonable cognisance of the changing nature of retail distribution of magazines and the dramatic effect “hard ranging” by supermarkets is having on the vast range of specialist consumer magazines. These magazines will become increasingly dependent on postal distribution for their future but with postal costs accounting for up to 50 per cent of total costs, the subscription model will not be economically viable if postal prices are too high.

As a result, PPA completely rejects the argument that there are other satisfactory or realistic alternatives for those magazines currently using the Presstream service.

Because of this misunderstanding we believe the Regulator is putting at risk the vital section of the business and professional press and withdrawing a vital lifeline for specialist consumer titles.

In view of this we ask the Regulator urgently to review the position being adopted and either to retain Presstream within the regulated service, at least until viable alternatives are established, in order that Postcomm does not inadvertently introduce an opportunity for price discrimination between bulk mail products that are, and those that are not, within price regulation.