CWU Response to Ofcom Review of the Regulation of Royal Mail

NON-CONFIDENTIAL VERSION

Introduction

1. The Communications Workers Union (CWU) is the largest union in the communications sector in the UK, representing approximately 192,000 members in the postal, telecoms, financial services and related industries. We are the recognised trade union for around 140,000 non-managerial staff in Royal Mail and we are therefore an important stakeholder in the postal sector, speaking on behalf of our members both as workers within the industry and as users of postal services.

2. The CWU responded to the first stage of Ofcom’s Review of the Regulation of Royal Mail last year, when we expressed serious concerns that the regulatory framework fails to adequately prioritise the universal postal service. We also made clear our opposition to the introduction of charge controls, so we welcome Ofcom’s view that such an intervention would not be appropriate. However, we continue to believe that regulatory pressure for ever-greater cost cutting, combined with the effects of intensive competition and privatisation are putting us on a path that threatens the future provision of the universal service.

3. We call on Ofcom to take action to ensure the sustainability of the universal postal service and to drive up standards across the postal sector rather than facilitating a race to the bottom. This should include a levelling up of minimum standards in the unregulated parcels sector which is notorious for poor service quality and worker exploitation. Regulation should also allow Royal Mail to focus on achieving long term growth rather than short term cost cutting, helping to support investment and innovation in new markets.

Overview of the CWU’s response

Charge controls and efficiency targets are inappropriate in a declining letters market

4. We agree with Ofcom’s proposal to avoid the introduction of charge controls and efficiency targets. As we said in our previous response, charge controls are inappropriate in a declining letters market and would put the financial sustainability of the universal postal service at serious risk.

Decent labour standards are essential for delivering a high quality service

5. We remain deeply concerned by Ofcom’s focus on employee costs and labour flexibility in the context of efficiency. Ofcom’s findings demonstrate that it views Royal Mail’s predominantly full time, permanent workforce on decent rates of pay as a barrier to the company making further

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efficacy gains.² We strongly reject this position, and as we have previously stated, we maintain that it is not in Ofcom’s remit to place pressure on the employment conditions of workers at Royal Mail.³

6. We consider that all postal operators should pay their workers a living wage or at least the statutory minimum wage. The ultra low cost business model adopted by unregulated parcel companies exploits workers who are falsely classified as self-employed and earning poverty pay below the legal minimum. This is the root cause of poor service standards in the unregulated parcels sector, and it also makes it impossible for Royal Mail to compete fairly and effectively in the parcels market. We argue that a properly rewarded workforce in directly employed jobs plays an essential role in improving productivity and delivering a high quality service to customers.

Unreasonable efficiency expectations will be damaging for postal services

7. Royal Mail has already made significant efficiency savings over recent years, in cooperation with the CWU and the workforce. We strongly disagree with Ofcom that Royal Mail could be expected to go further on efficiency than set out in its business plan. There is a limit to how hard staff can be expected to work in physically demanding jobs and how far Royal Mail can push efficiency improvements before quality of service is threatened. We firmly reject WIK Consult’s conclusions, including that Royal Mail should be more ambitious in cutting costs. We also question the objectivity of WIK’s analysis and the selective nature of some of its evidence which we believe does not provide a fair representation of the facts.

The Agenda for Growth agreement is delivering benefits for postal users

8. We believe that Ofcom has a duty to recognise that the Agenda for Growth agreement between the CWU and Royal Mail has enabled the company to deliver significant efficiency savings and grow new products and services for customers in an environment of industrial stability. Ofcom criticises the agreement for its perceived shortcomings,⁴ but offers no acknowledgement of the benefits it has brought for Royal Mail’s financial performance, its efficiency and the ongoing sustainability of the universal postal service. We believe this represents a serious omission in Ofcom’s analysis. Instead of seeking to discredit and undermine the agreement, we believe Ofcom should emphasise the considerable benefits it has brought for Royal Mail, the universal postal service and postal users.

Regulation must give Royal Mail sufficient scope to grow revenues to ensure the ongoing sustainability of the universal postal service

9. We believe the postal regulatory framework must be centred on allowing Royal Mail to maintain and increase its revenues and improve its efficiency through long-term growth rather than short-term cost cutting. This will support greater investment and innovation from Royal Mail in growing markets, which will help to maintain the financial sustainability of the universal service.

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² Review of the Regulation of Royal Mail, Ofcom, 25th May 2016, see in particular paragraphs 4.66 and 4.70 accessed at: http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-review/summary/Review-of-Royal-Mail-Regulation.pdf
⁴ Ofcom, ibid, 25th May 2016, see for example paras 4.66, 4.67, 4.73 and 4.74
Ofcom should introduce a ban on cherry-picking end-to-end delivery competition which threatens the future of the universal service

10. We are disappointed that Ofcom has taken no steps to ban cherry picking end-to-end delivery competition which, although not currently an immediate risk, could quickly resurface to threaten the future of the universal service.

Ofcom should help to improve the quality of services and secure the future of the universal service by making all parcel firms accountable to minimum standards

11. We believe that Ofcom’s proposal not to introduce minimum quality standards in the growing parcels market is regrettable and represents a missed opportunity to bring desperately needed service improvements for customers. This should include requiring all parcel operators to report on their performance and to comply with mail integrity regulations.

12. The act of levelling up quality of service standards in parcels through regulation would create better labour standards, and these two factors would be mutually reinforcing. It would also cultivate a more level playing field for competition in the parcels sector. Royal Mail will find it increasingly difficult to compete against low cost, poor quality operators without slashing its own costs and relying on more casual workers, which would have a seriously adverse affect on service quality and mail integrity.

13. The low cost business model used by many of Royal Mail’s parcel competitors means they can offer lower prices and this puts them in a stronger position to capture growth. This in turn reduces the revenues Royal Mail needs in growth areas to offset the decline in letters and to ensure the financial sustainability of the universal service.

Question 1: Do you agree that the evidence summarised in section 4 and set out in more detail in the annexes to this consultation does not support the imposition of (i) further price controls on parts of Royal Mail’s business or (ii) efficiency targets?

14. Yes, we agree that the evidence provided does not support the imposition of further price controls or efficiency targets.

15. Price controls would be inappropriate in a declining market and would pose a severe threat to the financial sustainability of the universal service. They would risk a return to the failures of Postcomm’s price control regime, which brought the universal service to the brink of collapse when Royal Mail lost £120m in 2010-11. Although Royal Mail’s financial position has improved since 2012, we do not believe it is sufficiently robust to justify the introduction of price controls. Royal Mail’s profit margin has only just reached the lower end of the 5%-10% EBIT margin range identified by Ofcom as consistent with securing a financially sustainable universal service.

16. Furthermore, price controls are unnecessary given the reasonably strong levels of consumer satisfaction with postal services; the progress Royal Mail has already made on efficiency; and the efficiency incentives it already faces as a result of privatisation, competition and e-substitution. Growth in parcels is not expected to be sufficient to offset the continued decline in Royal Mail’s letter volumes, and this combined with increasing parcels competition is already putting pressure on universal service revenues.

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5 Ofcom, Securing the Universal Postal Service: Decision on the new regulatory framework, 27 March 2012, para 2.5, p.11.
6 Earnings Before Interest and Tax (a measure of profit)
17. Efficiency targets are also unnecessary given Royal Mail’s rate of efficiency improvement both currently and over the last few years. Much of this has been achieved through cooperation with the CWU and the Agenda for Growth agreement, which has brought significant benefits to Royal Mail and the postal service as a result of industrial stability. Furthermore, Royal Mail is targeting considerable efficiency gains in the future, including the avoidance of around £500 million of annualised costs by 2017-18. We are concerned about the impact of this major cost cutting programme on jobs and quality of service. As we said in our previous response, efficiency targets may threaten service levels by attempting to accelerate efficiency beyond the current incentives.

18. We strongly disagree with Ofcom that Royal Mail could or should be expected to go further on efficiency than the forecasts set out in its business plan. Excessive cost cutting will be damaging for jobs, pay, conditions and therefore quality of service. We also reject the premise that secure, full time jobs or the payment of a decent wage are an obstacle to efficiency at Royal Mail. As we note in more detail later in this submission, we believe the opposite is the case and that good labour standards help to drive productivity improvements.

19. We note that Ofcom has published a statement countering concerns that it is pushing for low paid postal contracts. We do not believe Ofcom’s criticism of the Agenda for Growth agreement reflects this position, and we believe it constitutes unfair interference in the conduct of good industrial relations. Ofcom’s statement says that efficiency is not just about pay and contract terms, but that it can also mean “new working practices, automation and modernisation.” Royal Mail has improved its efficiency through all three of these methods by working with the CWU and will continue to do so under the Agenda for Growth agreement.

Question 2: Do you agree that the regulatory framework should remain in place until 2022 following the anticipated completion of Ofcom’s review by the end of 2016-17?

20. We agree that the current regulatory approach, established in 2012, should broadly continue. This means continuing to give Royal Mail freedom to set prices for the majority of products whilst also ensuring safeguards on affordability and monitoring. However, we also believe some regulatory changes are needed to secure the future sustainability of the universal postal service and to ensure good customer outcomes in a rapidly changing market.

Cherry picking end-to-end delivery competition
21. As we said in our response to Ofcom’s first consultation on the Review, we call on Ofcom to introduce a ban on cherry picking end-to-end delivery competition that threatens the future of the universal service. We recognise that there is currently very little end-to-end competition since Whistl exited the market in 2015, but there is every possibility that end-to-end competition could develop rapidly in future.

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8 Review of the Regulation of Royal Mail, Ofcom, 25th May 2016, p.47, para 4.71
9 Ofcom, ibid, 25th May 2016, see in particular paragraphs 4.66, 4.67 and 4.70
22. Whistl showed that it is possible to set up end-to-end delivery operations in profitable urban areas within a short space of time, after trialling services in 2012 and swiftly expanding across large areas of London as well as Manchester and Liverpool. Whistl gained a 20% share of total letter volumes in areas it was delivering and was expected to reduce Royal Mail revenues by £200 million on its published plans, putting the future of the universal service at serious risk. We believe that Ofcom should accept that end-to-end competition is not compatible with a financially sustainable universal postal service and introduce a ban on competitors cherry-picking in the end-to-end letters delivery market in order to put protecting the universal postal service front-and-centre of regulation.

Protection for consumers in the parcels market
23. We also call on Ofcom to introduce regulations that will ensure greater protection for consumers in the growing parcels market by making all parcel firms accountable to minimum standards. As we argued in our previous submission, there is evidence of significant consumer dissatisfaction in the parcels market. For example, 21 percent of respondents in Ofcom’s Communications Market Report 2015 stopped an online order because they had a previous poor experience with a retailer/deliverer. Poor service standards in the parcels sector have also been exposed by numerous recent surveys and reports, which we examine more closely in response to question 3.

24. The CWU believes that all delivery providers, including parcel firms, should be required to record and report on performance targets to both incentivise firms to improve quality of service and to ensure customers are properly informed. Rather than removing the Mail Integrity Code of Practice, we think it should be extended to apply to parcels as well as letters in order to ensure the same basic standards apply to the whole postal sector. Furthermore, we believe Ofcom should consider what additional amendments could be made to the postal regulatory framework to drive up standards in the parcels market.

Securing the future of the universal postal service
25. In fulfilling its primary statutory duty to secure the universal postal service, we believe Ofcom’s postal regulatory framework should pay more regard to the threat that intensive competition poses to the future sustainability of the universal service from downward pressure on price and revenues. It is because of this threat that we disagree with Ofcom’s fundamental starting position that consumers’ interests are best served by competition. We believe consumers’ interests are best served by ensuring the sustainability of a fully funded, reliable universal postal service delivering six days a week to all households at an affordable, geographically uniform price, alongside access to high quality non universal postal services. These objectives depend heavily on Royal Mail having sufficient pricing freedom to sustain and grow revenues, balanced against the requirements for affordability for consumers. They also rely on the introduction of quality of service standards for all postal operators.

Question 3: Do you agree that the analysis summarised in section 4 and set out in more detail in the annexes to this consultation accurately reflects the UK postal market?

26. We agree with some of Ofcom’s overall analysis of the postal market, including that Royal Mail’s financial position has improved since 2012, customers are reasonably satisfied with universal

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12 Ofcom, 25th May 2016, ibid, para 1.5, p.5
14 Ofcom, ibid, 25th May 2016, p.4
postal services, and letter volume decline is unlikely to be offset by the growth in parcels.\textsuperscript{15} However, we are concerned about the absence of analysis on quality of service and customer satisfaction in the expanding parcels market. We also disagree with many of Ofcom’s assumptions about efficiency, including that Royal Mail could become even more efficient than planned and that permanent, full time jobs on decent rates of pay are a barrier to efficiency. We will take each section of the analysis in turn.

**Quality of service and delivery of the universal postal service**

27. As Ofcom notes, Royal Mail’s requirement to provide universal services to a high standard is an essential component of the regulatory framework. The CWU believes these standards form an important part of Royal Mail’s universal service obligation and play a central role in maintaining a high quality universal postal service. We recognise that Royal Mail has consistently met the Second Class quality of service target since 2011-12, but that it has missed the First Class target in three of the last five years.\textsuperscript{16} We also note that Ofcom is now investigating whether Royal Mail has failed to comply with its quality of service obligations.\textsuperscript{17}

28. The CWU is concerned that Royal Mail’s capacity to meet its quality of service obligations is being undermined by the constant pursuit of cost efficiencies. The ongoing reductions in staff numbers and the targeting of around £500m in cost avoidance by 2017-18 is likely to severely limit Royal Mail’s ability to maintain and improve its service standards. We do not believe Ofcom can reasonably expect service standards to improve whilst simultaneously putting pressure on Royal Mail to make substantial cost reductions and introduce greater workforce flexibility.

29. Unlike other sectors such as telecoms or energy, mail delivery is a highly labour intensive business and a postal operator’s main asset is its labour force of postal workers. People costs account for 68% of all operating costs at Royal Mail, compared with 27% for BT and 38% for the National Grid.\textsuperscript{18} It stands to reason that if the workforce is weakened through continued job losses and job insecurity, it will struggle to maintain service levels.

30. In addition, as we have said in previous regulatory submissions, there is a connection between pay and conditions and quality of service. Numerous studies show that workers who are properly valued and earning decent rates of pay are more motivated and committed to their role.\textsuperscript{19} Studies also show that higher wages lead to improved productivity and enhance quality and customer service.\textsuperscript{20} Therefore, an essential part of being able to maintain and improve quality of service standards is having a regulatory framework that recognises the need for Royal Mail to invest properly in its workforce. This means allowing Royal Mail the scope to continue to employ predominantly permanent, full time staff earning a fair wage.

\textsuperscript{15} Ofcom, ibid, 25\textsuperscript{th} May 2016, (Annexes 5 to 11) para A5.56, p.11
\textsuperscript{16} Ofcom, ibid, 25 May 2016, para 4.8, p.28
\textsuperscript{17} Ofcom, Own-Initiative investigation into Royal Mail regarding quality of service performance, 13 May 2016, http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01183/
\textsuperscript{19} For instance, a June 2014 Living Wage Commission report ‘Work that pays’ showed that the Living Wage can open the door to productivity increases for businesses as a result of employees contributing higher levels of effort and an openness to changing job roles.
\textsuperscript{20} Wolfers, J. & Zilinsky J., Higher Wages for Low-Income Workers Lead to Higher Productivity, PIIE, 13\textsuperscript{th} January 2015, accessed at: https://piie.com/blogs/realtime-economic-issues-watch/higher-wages-low-income-workers-lead-higher-productivity
Consumer satisfaction

Poor standards in the unregulated parcels sector
31. Ofcom reports that general satisfaction with postal services is very high and improving among both residential consumers and SMEs. However, we are concerned that Ofcom’s analysis of customer satisfaction does not cover the unregulated parcels sector, which is notorious for quality of service failures. We believe this is a notable omission, and that Ofcom should be examining quality of service and customer satisfaction in parcels in order to make an informed decision on the best approach to regulation in this area.

32. A recent survey by Money Saving Expert reported that ‘parcel delivery horror stories abound ranging from no shows to “they threw the goods over the fence” or “they lied that we weren’t in”’. The survey results show that a number of parcel delivery companies, including Hermes, UK Mail and Yodel were rated as poor by a relatively high percentage of voters (36%, 37% and 57% respectively). Royal Mail Parcels, DPD and Parcelforce, on the other hand, were shown to provide a much more positive user experience (rated poor by 10%, 11% and 13% of voters respectively). A selection of the companies surveyed is reproduced in the table below.

Table 1: Parcel delivery firms: which are the best and worst? (MoneySaving Poll results, 2015)

<table>
<thead>
<tr>
<th>Company</th>
<th>Number of votes</th>
<th>User experience % of votes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Great</td>
<td>OK</td>
</tr>
<tr>
<td>Amazon Logistics</td>
<td>3,585</td>
<td>38%</td>
</tr>
<tr>
<td>DPD</td>
<td>5,298</td>
<td>71%</td>
</tr>
<tr>
<td>DX</td>
<td>694</td>
<td>17%</td>
</tr>
<tr>
<td>Hermes</td>
<td>6,419</td>
<td>34%</td>
</tr>
<tr>
<td>iPost Parcels</td>
<td>657</td>
<td>16%</td>
</tr>
<tr>
<td>Parcelforce</td>
<td>4,442</td>
<td>42%</td>
</tr>
<tr>
<td>Royal Mail Parcels</td>
<td>5,682</td>
<td>51%</td>
</tr>
<tr>
<td>UK Mail</td>
<td>2,086</td>
<td>21%</td>
</tr>
<tr>
<td>Yodel</td>
<td>6,203</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: MoneySavingExpert.com, 8th December 2015

33. Money Saving Expert ran the same survey a year earlier, and a comparison of the two indicates that quality of service amongst some of Royal Mail’s parcel delivery competitors has deteriorated over the last 12 months. For example, Hermes, UK Mail and Yodel were all rated ‘poor’ by a higher percentage of voters in 2015, up from 33%, 28% and 45% respectively in 2014. This supports a constant stream of other research, news articles and television programmes highlighting the problems and poor standards experienced by customers of unregulated parcel companies.

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23 Such as ‘Yodel Parcels Going Missing’, Don’t Get Done, Get Dom, BBC, 20 May 2015; programmes on BBCs’ The One Show; and a Channel 4 Dispatches documentary, January 2016.
Consumer body *Which?* has investigated the issue and reportedly found that six in ten shoppers had encountered a problem with an online delivery.

### The impact of poor employment standards in the parcels sector

34. As noted in our submission last year, we believe that the prevalence of low cost, high flexibility employment models amongst some of Royal Mail’s competitors is a major contributor to poor quality of service in the parcels sector. The unregulated parcels market largely relies on self-employed delivery drivers or “lifestyle couriers” who receive piece-rate payments for each successful delivery. A recent investigation by the Guardian exposed serious exploitation of workers in the sector. It found that all of Hermes’ 10,500 couriers are self-employed and that they are typically paid 48p per parcel. A Channel 4 Dispatches report earlier this year found that Yodel pays drivers as little as 60p per parcel, and a more recent Mail Online report said that Yodel drivers are forced to cut corners because of low pay. The Mail Online made a clear link between thousands of customer complaints about poor service and unacceptable employment standards, with couriers at Yodel reportedly described working for the company as ‘modern day slavery’. All three reports established that the low rate of pay means workers often do not earn payment equivalent to the statutory minimum wage.

35. Instead of seeking to undermine legally binding collective agreements between Royal Mail and the CWU, the Regulator should instead focus on seriously investigating and addressing the exploitative employment models operated by parcel companies like Hermes and Yodel, and tackle the use of shameful working practices more akin to the Victorian workplace than a modern 21st century economy.

36. The payment of ultra low piece-rates per delivery means workers are incentivised to offload their parcels quickly and at any cost. This leads to parcels being damaged because they are handled without due care, going missing or left visible on doorsteps when there is no one available to receive them. It is no surprise that Royal Mail and Parcelforce, who pay a decent basic wage and are far ahead of their competitors on employment standards, are also market leaders in customer service. Whilst we do not have a breakdown of employment standards across all of the companies covered in the MoneySavingExpert survey, it is clear that those we do know to have extremely low cost employment models from press investigations are among the lowest performers for customer service.

37. Furthermore, we are concerned that unlike Royal Mail and Parcelforce, unregulated parcel operators appear to rely on a predominantly self-employed workforce who are not entitled to basic rights like paid holiday, sick leave and parental leave. We do not believe this is a positive or healthy approach to employment in the postal sector, and we believe that in general better employment standards for workers translate into improved service standards for customers.

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24 Your rights when parcels go missing, Moneywise magazine, 11th December 2014, accessed at: http://www.moneywise.co.uk/scams-rip-offs/consumer-rights/your-rights-when-parcels-go-missing

25 Revealed: Delivery giant Hermes pays some couriers less than the living wage, Guardian (print edition), 19th July 2016

26 Yodel delivery bosses turn a blind eye to packages being thrown around, Metro, 31 Jan 2016, accessed at: http://metro.co.uk/2016/01/31/yodel-delivery-bosses-turn-a-blind-eye-to-packages-being-thrown-around-5653830/

38. It is also important to recognise that using self-employed drivers means that the parcel delivery firm engaging them is exempt from National Insurance Contributions, employer pension contributions and employer taxes. This reduces income for the Treasury and for spending on public services, shifts the burden of employment related costs on to the worker, and stores up major social and economic problems for the future, particularly with regards to pensions provision. There is no question that exploitative parcel delivery companies are in a position to treat their workers fairly and meet the cost of basic statutory employment obligations. Hermes, for example, has more than trebled its UK pre-tax profits over five years, making £36m in the year to February 2015.

39. We urge Ofcom to give this issue more serious consideration than it has hitherto with a view to lifting standards of quality in the parcels sector. Labour market exploitation is an area of growing concern amongst politicians and the British public, which has led to a recent call by the chairman of the House of Commons work and pensions select committee for the Prime Minister to launch an inquiry into the low pay of self employed couriers.

40. There is a danger that without appropriate action, the problem of poor service quality linked to low employment standards is set to worsen, particularly with speculation about online crowdsourcing platforms such as Uber entering the UK parcels delivery market in future. These platforms are notorious for their exploitation of workers in the so-called ‘sharing economy’, where people are denied access to basic employment rights.

41. Uber’s taxi service is currently facing a legal challenge in the UK by the GMB, accused of misclassifying its drivers as self-employed, denying them rights such as holiday pay and sick pay. It is shameful to find these potentially illegal working practices in 21st century Britain and we believe they have no place in any sector of the economy. We consider that such a legal challenge could equally apply to parcel operators like Hermes and Yodel, and that delivery drivers working regular hours for parcel companies have all the characteristics of permanent employees. As we have indicated we do not believe it is Ofcom’s role to unfairly interfere with labour standards in the postal sector. However, we consider that the act of levelling up quality of service standards in parcels through regulation would create better labour standards, and that these two factors would be mutually reinforcing.

Financial sustainability

Royal Mail’s EBIT margin

42. We recognise that there has been an improvement in the financial sustainability of the universal postal service since 2012, and that Royal Mail’s financeability EBIT margin has increased steadily following the introduction of the new regulatory framework. However, Royal Mail’s finances have improved from a very low base following a period of substantial losses prior to 2012, including a loss of £120m in 2010-11. Furthermore, we are concerned that the company’s performance is

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28 The Government’s automatic enrolment pension scheme does not extend to those who are self-employed
29 Guardian, ibid, 19th July 2016
31 Royal Mail’s reported EBIT margin adjusted to restate pension costs on a cash basis, which Ofcom considers takes account of the true cost of pensions
32 Ofcom, Securing the Universal Postal Service: Decision on the new regulatory framework, 27 March 2012, para 2.5, p.11.
at the lower end of the benchmark for financial sustainability, with no cushion to protect the universal service in the face of sudden shocks or otherwise difficult market conditions.

43. We also note that FTI Consulting stated that Moody’s methodology for the postal sector suggests that investment grade rating requires an EBIT margin between 8% and 12%. We would therefore question whether a profit margin of 5-10% is adequate to ensure consistency with the financial sustainability of the universal service.

44. As we said in our previous response, the CWU does not support Ofcom’s view that Royal Mail’s reported EBIT margin should be adjusted to restate pension costs on a cash basis. Using the pension cash cost (currently 17.1 percent of pensionable pay) has the effect of improving the reported EBIT margin because it is lower than the accounting cost (20.3 percent of pensionable pay). This does not provide an accurate reflection of the real ongoing costs of funding the Royal Mail Pension Plan (RMPP). Royal Mail only hit the lower end of this margin, at 5.6% in 2014/15, because Ofcom’s alternative ‘financeability EBIT’ measure uses the pension cash cost rather than the accounting cost.

**Ofcom’s focus on pay and pension costs in Royal Mail**

45. We are concerned about Ofcom’s emphasis on drawing out future pension costs and the new pay deal under negotiation as key downside risks to the future sustainability of the universal postal service. The provision of a decent occupational pension scheme and maintaining the real value of pay are central to ensuring a properly motivated, engaged workforce and delivering high quality services. We do not accept that these issues should be held up as barriers to financial sustainability and viewed as a potential problem to the provision of a universal postal service. On the contrary, decent pay and pensions are important to the workers who deliver the postal service, and this makes them integral to the performance of the service.

46. As we have previously argued, it is not Ofcom’s role to put pressure on the pay and conditions of postal workers, and Ofcom has said in its statement countering concerns that it is pushing for low paid postal contracts: “Questions of pay, contract terms and staff management are matters for postal companies themselves.” We assert that Ofcom’s emphasis on pay, pensions and terms of employment for Royal Mail workers is not warranted, and we call on Ofcom to avoid unfairly interfering on issues that affect workers. We also consider that it is inconsistent for Ofcom to call into question Royal Mail’s funding of the ongoing costs of its pension scheme, but not to raise any concern about the company’s commitment to growing shareholder dividends.

**The need for a clear regulatory strategy to intervene if financial sustainability is under threat**

47. We are also concerned that Ofcom has not developed a clear enough strategy, or the associated regulatory tools, to respond if Royal Mail’s EBIT margin falls below the 5-10% margin identified as consistent with financial sustainability. Ofcom states that it might intervene if there is a threat to

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33 Review of the Regulation of Royal Mail Annexes 5 to 11, Ofcom, 25th May 2016, para A6.82, p.58, accessed at: [http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-review/annexes/Annexes-5-11.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-review/annexes/Annexes-5-11.pdf)

34 Ofcom, ibid, 25th May 2016, para 4.28, p.37


36 Ofcom, ibid, 25th May 2016, para 4.39, p.40

financial sustainability, but offers no explanation of the regulatory remedies that will be relied upon to address the situation.

48. We believe there is a high risk that without such a strategy to protect the universal service, the first casualty of a weak financial performance at Royal Mail is likely to be the existing scope and quality of the universal service. The six day a week, next day universal postal service is highly valued by consumers and businesses, and based on its current activities Royal Mail delivers enormous economic and social benefit to the nation, adding £10.8 billion to the UK economy. A failure to secure the universal service in its current form would undermine these benefits and would be detrimental to postal users. Indications are that the growth of online commerce will continue to strengthen customer demand for a six day a week, next day service. In stating its commitment to the existing universal service, Royal Mail has said that the service brings economic benefits, underpins the development of e-commerce in the UK and that overnight six day a week services will be even more important in future.

Royal Mail must have scope to invest and innovate in the interests of financial sustainability

49. As part of the Agenda for Growth Agreement, Royal Mail and the CWU have been working together to deliver customer benefits and to identify new products and services to meet changing customer needs. For example, Royal Mail has developed the "Click and Drop" online tool for consumers and SMEs and has reduced prices for the fastest growing parts of the parcels market. It has also been focusing on offering predicted time of delivery and in flight options for consumers; rolling out parcels automation; introducing 2D barcodes on more parcels; and deploying finger scanning technology in its distribution centres and mail centres. The CWU would like to see greater investment and innovation from Royal Mail in growing markets, which will help to maintain the financial sustainability of the universal service. However, as we said in our previous submission, we believe Royal Mail’s ability to invest and innovate will be put at risk if Ofcom continues to pressure the business to achieve short-term cost savings.

Efficiency

Royal Mail’s efficiency improvements

50. We maintain that the efficiency improvements made by Royal Mail in recent years have been significant, rather than at the ‘lower end of a reasonable range for improvement’. We strongly disagree that Royal Mail could or should be expected to make greater efficiency gains than those forecast in its 2015 Business Plan. As we said in our previous response, there is a limit to how hard staff can be expected to work in physically demanding jobs and how far Royal Mail can push efficiency improvements before quality of service is threatened. FTI Consulting supports this

38 Ofcom, ibid, 25th May 2016, para 1.18, p.7
40 Guy Johnson, Director of Regulation and Competition Policy, Royal Mail, Westminster eForum, 26th Jan 2016
42 Ofcom, 25th May 2016, ibid, para 1.10, p.6
43 Review of the Regulation of Royal Mail, Ofcom, 25th May 2016, p.47, para 4.71
view, saying that management’s capacity to manage change is limited by the need to maintain its high quality of service targets.45

51. As the document says, average operational efficiency in terms of gross hours has improved by 5.8% since 2010-11 (approx 1.9% per annum) for delivery offices, and 8.8% since 2012-13 (approx 2.9% per annum for mail centres).46 Royal Mail has also delivered annual productivity improvements according to its own measure of 4.4%, 3.2%, 1.7%, 1.7%, 2.5% and 2.4% from 2010/11 through to 2015/16, owing to changes in mail processing, delivery and headcount reductions.

52. We note that Ofcom’s efficiency measure, PVEO (Price, Volume, Efficiency, Other) shows that Royal Mail reduced costs by 0.7% in 2013-14 and 2.6% in 2014/15 due to efficiency.47 As we said in our earlier submission, we are concerned that the PVEO calculation means that any pay rise that outweighs increases in the Consumer Price Index (CPI) will be classed as an inefficiency. We maintain that RPI is a better reflection of the actual rising cost of living for workers because it includes owner occupier mortgage costs and council tax, and it excludes households at the extremes of the income scale. That is why the CWU and other trade unions use RPI as the inflation measure against which to set pay claims and negotiate annual settlements. We do not consider it appropriate for Ofcom to use an efficiency measure that automatically assumes basic cost of living pay rises for workers are inefficient. This is a clear example of Ofcom unfairly interfering in employment related matters which are outside of its remit. We also believe the calculation would show an improvement above 2.6 percent at Royal Mail for 2014/15 if it were to use RPI inflation rather than CPI inflation.48

Cooperation with the CWU and the workforce on delivering efficiency improvements

53. We also wish to emphasise, as we have said in earlier submissions, that the improvements set out above have been achieved through cooperation with the CWU and the workforce. An important omission in Ofcom’s analysis is the lack of recognition of the contribution that workers have made to these improvements, or of the importance of constructive industrial relations in helping Royal Mail to modernise and remain efficient.

54. As the document states, Royal Mail began a modernisation programme in 2008 to adapt its processes to the changing market. This saw a significant reduction in mail centres, the introduction of automated walk sequencing, the deployment of new delivery methods including trolleys and vans, and extended delivery spans.49 Ofcom fails to note that these changes have been delivered in partnership with the CWU and the workforce in recognition that being efficient is important to the success of the business and, in turn, its ability to provide secure employment and good terms and conditions for staff in future.

55. Ofcom also fails to note the significant reductions in staff at Royal Mail in recent years, with UK based employee numbers falling by around 30% between 2003 and March 2016, amounting to nearly 60,000 jobs.50 Consequently, CWU members are working harder and longer whilst maintaining high quality of service standards for 29 million households in the UK – a number that increases by around 290,000 per year. The hard work and commitment of Royal Mail’s employees

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45 FTI Consulting, September 2015, ibid, p.13
46 Ofcom, 25th May 2016, ibid, para 4.56, p.43
47 Ofcom, 25th May 2016, ibid, para 4.54, p.43 and Annual Monitoring Update, Ofcom, November 2015, para 7.22, p.67
48 For more detail see the CWU submission to Ofcom, Royal Mail Access Pricing Review, 24 February 2015, p.7
49 Ofcom, 25th May 2016, ibid, para 4.49, p.41
50 Royal Mail reports and accounts, 2004 and 2015-16 (number of employees fell from 198,552 in 2003 to 139,000 in 2016)
has brought efficiency improvements each year for the last several years despite the fact that the annual increase in delivery points makes efficiency more difficult to achieve.\(^{51}\)

56. The Agenda for Growth agreement is only referenced by Ofcom in negative terms, describing it as something that is likely to have further limited Royal Mail’s ability to respond to volume decline. However, as we said in our earlier response, the agreement conferred commercial benefits to the company by virtue of improving industrial relations stability. It has already had a positive impact on Royal Mail’s productivity and efficiency by minimising the risk of industrial action. The agreement is supported by the Together for Growth training programme for managers and union representatives, and a joint mediation process, which facilitates a collaborative approach to improving efficiency at a local and national level.\(^{52}\) Through this and other initiatives, only 325 days were lost due to unballoted strikes in 2015-16, a reduction of 37 per cent compared with the previous year.\(^{53}\) Furthermore, the recent period of good industrial relations means there has been no national strike action in Royal Mail since 2009. The climate of industrial stability brought by the agreement is also likely to improve staff retention which in turn saves the company the costs of recruitment and training of new staff.

**Deloitte’s econometric benchmarking analysis of Royal Mail’s delivery offices and mail centres**

57. We do not agree that it is realistic or practical to expect all mail centres and delivery offices to become as efficient as the most efficient operating units, as suggested by the econometric analysis conducted by Deloitte.\(^{54}\) Operating units vary according to a range of factors including size, location, mail volumes, and the level of fluctuation in mail volumes, all of which will have an influence on efficiency levels. This makes it unfeasible for all units to become equally efficient. Such an expectation also risks bringing perverse incentives for Royal Mail to reduce the efficiency of the best performing units in order to ensure consistency across all units.

58. We recognise that Deloitte’s analysis controls for some factors that may lead to differences in operating costs, such as mail mix and geography. However, we believe there are other important factors that have not been considered, such as the level of front line work being carried out by managers and the amount of unrecorded time put in by front line staff (such as through early starts or working through breaks). If these factors have been omitted, the data is likely to overstate the level of efficiency at some operating units. Front-line mail centre and delivery work is frequently being undertaken by Royal Mail managers because of budget-pressure and a significant amount of labour and front-line costs are therefore hidden in the management budget. This establishes a level of “normal” performance that is misleading and will not provide an accurate picture of Royal Mail’s current efficiency.

**Ofcom’s overall approach to measuring efficiency**

59. We believe that Ofcom’s focus on ‘productive efficiency’ i.e. providing services as cheaply as possible is not helpful to quality of service. Royal Mail has been pushing hard on cost efficiencies in recent years due to e-substitution, parcel competition and shareholder pressure, and we believe this has been responsible for the failure to meet its First Class target in three of the last five years.


\(^{53}\) Royal Mail Annual Report and Financial Statements 2015-16, p.77

\(^{54}\) Ofcom, 25th May 2016, para A5.155
Furthermore, Royal Mail cannot cut its way to growth, and pressures on cost and price will constrain revenues which in turn will present serious risks for the sustainability of the universal service. Ofcom should adjust its fundamental approach to efficiency by placing more emphasis on allocative and dynamic efficiency, which are concerned with improving efficiency by ensuring customer needs are met and maximising the potential of investment.\(^{55}\)

**WIK Consult’s review of the projected costs within Royal Mail’s business plan**

60. We firmly reject the thrust of the conclusion drawn by the WIK Consult report commissioned by Ofcom, that Royal Mail is generally less efficient than its international peers and that therefore it should be more ambitious in cutting costs.\(^{56}\) We question the scope and objectivity of some of the data on which WIK bases its overall conclusions, and we strongly challenge the notion that more cooperative industrial relations are crucial for a successful transformation process.\(^{57}\) The CWU has worked constructively with Royal Mail over many years, negotiating successive agreements to help deliver business transformation and modernisation in a climate of industrial stability. Furthermore, the evidence in WIK’s own report shows that industrial relations in Royal Mail have been far more stable than in Germany, the Netherlands or France in recent years based on levels of strike action.

61. In our view, WIK has relied on a highly selective use of benchmarking data to fit a preconceived idea that poor quality employment models, characterised by part time contracts for full time workers, insecure jobs and low pay are beneficial for postal services because they keep costs low. We assert that this hypothesis is fundamentally flawed, and that it does not have the best interests of postal customers at heart. WIK’s analysis, we believe, is designed to support the case that postal competition and the pressure it brings on costs produces good consumer outcomes. However, this argument is not supported by the poor quality of service we are witnessing in the competitive parcels market. Neither is it held up by the experience ordinary postal users have felt following the liberalisation of postal services, which has been overwhelmingly negative.

62. The evidence tells us that the real winners from postal competition have been the large bulk mailers, or big businesses, who have enjoyed lower costs at the expense of small businesses and domestic customers who have experienced higher prices and poorer service from new entrants. Prices of single-piece mail have risen significantly faster than those for business mail products, showing that big business mailers are benefiting at the expense of ordinary postal users.\(^{58}\)

**WIK’s analysis of wage policy in Royal Mail’s competitors**

63. WIK draws the overall conclusion that ‘*Royal Mail’s poorer relative cost saving performance compared to its international peers is partly as a result of its decision to re-invest much of its efficiency driven savings in its workforce through higher pay awards*’.\(^{59}\) It goes on to say that ‘*All comparators agreed to pay increases during their last respective negotiations rounds. However, Deutsche Post, PostNL, and PostNord settled agreements well below 2\% per annum which means*’


\(^{57}\) WIK Consult, 31 March 2016, ibid, p.xix

\(^{58}\) The liberalisation of European Postal Markets and the Impact on Employment and Working Conditions, Forba, December 2013, p.11

\(^{59}\) WIK Consult, 31 March 2016, ibid, p.vii
that the increase was kept below or kept pace with inflation but did not mean an increase in real wages.’

64. We are not convinced by WIK’s overall conclusion on higher pay awards and the evidence used to support it. Firstly, WIK has not provided any data to validate its claim that the selected international peers settled agreements well below 2%. Secondly, if WIK is only considering pay settlements for 2015 then we do not believe this provides a sufficiently broad picture to support its case, and that it would be more informative to consider changes in pay over time. Finally, whilst we do not have data on pay at PostNL and PostNord, our sources indicate that WIK’s claim about pay settlements at Deutsche Post is not fully representative of the facts, and that pay awards at Deutsche Post have in fact been relatively strong over recent years.

65. As shown in the table below, pay awards for postal workers at Deutsche Post negotiated by German trade union Ver.di, have been above 2% in three of the last four years, and they have also exceeded inflation during those three years. Furthermore, WIK fails to note that last year’s pay settlement at Deutsche Post was a three year settlement, comprising of a one-off payment of €400 in 2015, a 2.0% rise in 2016, and a 1.7% rise in 2017. The 2016 pay settlement is higher than the 1.6% agreed at Royal Mail the same year, and pay rises at Deutsche Post have exceeded rises at Royal Mail in three of the last five years. We suggest this calls into question how representative WIK’s data is for Deutsche Post and the other companies listed. It also casts doubt over the rationale for WIK’s conclusion on pay awards at Royal Mail.

<table>
<thead>
<tr>
<th>Year</th>
<th>Deutsche Post Wage increase</th>
<th>Royal Mail wage increase</th>
<th>Inflation, Germany % (CPI)*62</th>
<th>Inflation, UK % (RPI)**63</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>4.5%</td>
<td>3.5%</td>
<td>2.0</td>
<td>3.6</td>
</tr>
<tr>
<td>2013</td>
<td>3.1%</td>
<td>3.0%</td>
<td>1.4</td>
<td>3.3</td>
</tr>
<tr>
<td>2014</td>
<td>2.6%</td>
<td>3.0%</td>
<td>0.2</td>
<td>2.5</td>
</tr>
<tr>
<td>2015</td>
<td>€400 one off payment</td>
<td>2.8%</td>
<td>0.3</td>
<td>0.9</td>
</tr>
<tr>
<td>2016</td>
<td>2.0%</td>
<td>1.6%</td>
<td>0.15 (average to date)</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Sources: Ver.di – United Services Union, 2016; Inflation.eu worldwide inflation data; CWU; UK Office for National Statistics

*Annual inflation (Dec vs Dec)  
**Annual inflation (March vs March)

66. WIK also notes that Deutsche Post, PostNL and USPS have implemented a two-tier wage schedule, despite union opposition. We do not believe this should be held up as a positive development for the postal sector. Paying people different rates to do the same role is wrong in principal and is likely to create a disengaged, discontented, de-motivated and less productive workforce.

60 WIK Consult, 31 March 2016, ibid, p.70  
62 The table shows the CPI measure of inflation because Germany uses its own bespoke CPI measure as its main indicator of inflation and this is used in wage negotiations, see: https://www.destatis.de/EN/Meta/abisz/VPI_e.html  
63 The table shows the RPI measure of inflation for the UK because RPI is the measure relied upon by the CWU to track the rise in the cost of living and to benchmark pay settlements.
67. Furthermore, we take issue with WIK’s representation of the two-tier wage schedule at Deutsche Post, which is used to make the case that Deutsche Post has been more effective at exerting downward pressure on remuneration costs than Royal Mail. Whilst it is the case that Deutsche Post changed conditions for postal workers in 2001, our sources show that pay rates for postal delivery workers in both salary ranges earn a higher hourly rate of pay at the maximum of the range than equivalent workers at Royal Mail. The maximum hourly pay rate for the main postal delivery grade at Royal Mail is £, compared with £ for the equivalent grade in Deutsche Post since 2001, and £ for workers who commenced employment before 2001. The annual pay settlements noted in Table 2 above apply to workers in both the pre and post 2001 salary bands at Deutsche Post.

WIK’s analysis of part time and flexible working in Royal Mail’s competitors

68. WIK states that ‘maintaining the existing full time/part time ratio and retaining permanent contracts leaves Royal Mail with few alternative ways of offsetting other restrictions in order to increase workforce flexibility’. However, it should be noted that Royal Mail is not unusual in the restrictions placed on the proportion of part-time contracts. Whilst PostNL has a dedicated part-time approach to its workforce, five of the seven international operators highlighted by WIK have limits to part-time contracts. In addition, all four of Royal Mail’s competitors that limit part-time contracts have an equivalent or lower proportion of part-time contracts than Royal Mail, as shown in the table below. La Poste, which is a highly successful operator providing a universal service six days a week for both letters and parcels, maintains a minimum of 90% full time contracts.

<table>
<thead>
<tr>
<th>Part time as a % of total in employment</th>
<th>Royal Mail</th>
<th>Deutsche Post</th>
<th>La Poste</th>
<th>PostNL DK</th>
<th>PostNord SE</th>
<th>PostNord DK</th>
<th>USPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>25%67</td>
<td>38%68</td>
<td>10%69</td>
<td>80%70</td>
<td>23%71</td>
<td>14%72</td>
<td>25%73</td>
<td></td>
</tr>
</tbody>
</table>

Source: Royal Mail and WIK, 2016

69. WIK concludes that ‘Royal Mail’s international peers have increased the flexibility of their workforce, and that Royal Mail has not yet achieved the same level of workforce flexibility’. This may be the case for some postal operators, but we reject the premise that flexible working models and outsourcing practices are beneficial for the delivery of postal services. There is no

64 Ver.di – United Services Union, 2016
65 Review of the projected costs within Royal Mail’s business plan, WIK Consult, 31 March 2016, p.xviii
66 Royal Mail, La Poste, PostNord Denmark, PostNord Sweden, USPS
67 Latest data from Royal Mail, 2016
69 WIK, 31 March 2016, ibid, p.63
71 WIK, 31 March 2016, ibid, p.63
72 WIK, 31 March 2016, ibid, p.63
73 WIK, 31 March 2016, ibid, p.63
consideration by Ofcom or WIK of the negative impacts of these models and practices either on postal services or on the economy and society more generally.

70. The WIK report points out that some operators including Deutsche Post and PostNL have introduced “flex-time” schedules which allows them to cut costs by reducing overtime payments. In Deustche Post workers are only compensated with time off for working overtime, and in PostNL, part time workers are asked to work more hours until a full week’s work (37 hours) is completed. This appears to be a model that exploits workers by keeping them on part time contracts to save on overtime, pensions and other employment related costs, whilst at the same time expecting them to work full time hours if necessary. This will do nothing to enhance employee motivation, engagement, productivity or service standards. We reject WIK’s recommendation that Royal Mail should look at using such practices. We believe such a move would create negative outcomes for workers and would be damaging for postal services.

71. The WIK report points out that Deutsche Post and PostNL have partially subcontracted out their parcel delivery services, suggesting that Royal Mail’s inability to do this is somehow an obstacle to efficiency. However, parcel subcontractors for former monopolists, such as Deutsche Post and PostNL, rely on self-employed “lifestyle” couriers on piece rate pay. As we outlined earlier in our submission this has led to widespread quality of service problems for customers with parcels routinely being lost or damaged.

72. Evidence suggests, therefore, that we are witnessing a deterioration in postal service quality as a result of the growth of competitors relying on a low cost business strategy using cheap, flexible labour. We strongly reject WIK’s recommendation that Royal Mail could consider franchising road transport, or in other words subcontracting its parcel delivery operations. While this approach may cut costs, the experience of other operators suggests it will also lead to a serious reduction in service quality.

73. There is also an important question to consider about what is an acceptable model of employment in today’s society and whether the types of labour standards WIK is advocating should in fact be illegal. There is evidence of a substantial and growing number of people who are falsely self-employed in the UK, and a recent report from Citizens Advice estimates that as many as 460,000 people could be in this situation. The Government pledged in 2013 that it would crackdown on “disguising employment as false self employment” and since then it has made some progress in

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75 WIK, 31 March 2016, ibid, p.70
76 WIK, 31 March 2016, ibid, p.113
78 WIK, 31 March 2016, ibid, p.113
tackling this issue in the construction industry\textsuperscript{82} where the problem is said to affect over 50\% of workers.\textsuperscript{83} The Prime Minister has recently said that the Government will legislate for people who “have a job but don’t always have job security”, and as mentioned she has been urged to open an inquiry into the growing use of self-employed couriers.\textsuperscript{84} Against this backdrop, we believe that in the interests of postal services, the economy and society, Ofcom must not pursue or set in place a race to the bottom on pay and conditions in its approach to efficiency.

\textbf{WIK’s analysis of industrial relations in Royal Mail’s competitors}

74. We strongly reject the suggestion that a more collaborative approach has somehow helped Deutsche Post and PostNL to introduce a more flexible employment model, or that opportunities for jobs with good standards are perhaps better in Germany or the Netherlands.\textsuperscript{85} In fact, there has been major opposition by the German and Dutch trade unions to these changes as would be expected and this has caused significant disruption for postal services. For example, as noted by FTI Consulting, the national strike action by Deutsche Post workers caused a significant negative impact on Deustchte Post’s volumes, resulting in the earnings guidance for the company being revised from at least €1.3bn to €1.2bn for the financial year 2015.\textsuperscript{86}

75. We also believe it is misrepresentative to say that “postal operators in countries with overall high strike days per 1,000 employees (such as France and the UK), face more frequent and significant conflicts”.\textsuperscript{87} This may be the case for La Poste, but as shown by the data in WIK’s own report, the last national strike in Royal Mail was seven years ago in the summer of 2009, amounting to a total of five days of strike action. This compares with four weeks strike action in Deustchte Post in 2015 and almost a week of strike action in PostNL in 2015.

76. Finally, WIK notes that Royal Mail and CWU have made remarkable efforts to ‘deliver cultural change’ through the agreement,\textsuperscript{88} but it fails to draw any clear connection between this and the company’s financial or efficiency improvements. This is despite recognising the importance of good industrial relations for postal services in general terms.\textsuperscript{89} We believe this amounts to a serious omission and presents a misleading and one-sided analysis.

77. We also take issue with the statement that ‘managing labour relations responsibly to achieve more flexibility for staff costs is pivotal to achieving further cost savings’.\textsuperscript{90} As we have already indicated, labour relations in Royal Mail have been managed responsibly by the union and the company over many years, and the Agenda for Growth agreement has delivered major benefits for the business

\textsuperscript{82} False self employment crackdown leads to increase in HMRC construction industry yield, business advice,13\textsuperscript{th} January 2016, accessed at: http://businessadvice.co.uk/tax-admin/false-self-employment-crackdown-leads-to-increase-in-hmrc-construction-industry-yield/

\textsuperscript{83} UCATT, False self-employment, accessed on 2\textsuperscript{nd} August 2016 at: http://www.ucatt.org.uk/false-self-employment

\textsuperscript{84} PM urged to launch inquiry into low pay of self-employed couriers, Guardian, 19\textsuperscript{th} July 2016, accessed at: https://www.theguardian.com/society/2016/jul/19/hermes-couriers-low-pay-national-living-wage-self-employed

\textsuperscript{85} For example, the WIK report states on p.67: “Deustche Post and to a lesser extent PostNL, have been following a close engagement policy for a number of years. For example, participation in pilot projects to test new working conditions (Deutsche Post) seems to have good results”. And on p.68: “In Germany and the Netherlands (low union membership but high collective bargaining coverage) might lead to a less controversial attitude towards negotiations as the chance to find a new job opportunity with comparable standards seems to be higher”.

\textsuperscript{86} Efficiency metrics for Royal Mail, FTI Consulting, ibid, p.15

\textsuperscript{87} WIK, 31 March 2016, ibid, p.68

\textsuperscript{88} Review of the projected costs within Royal Mail’s business plan, WIK Consult, 31 March 2016, p.65, accessed at: http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-review/annexes/projected-costs-review.pdf

\textsuperscript{89} WIK consult, 31 March 2016, ibid, see pages 67 and 68

\textsuperscript{90} WIK consult, 31 March 2016, ibid, p.xvii
and postal users in a climate of industrial stability. What would be irresponsible in our view, would be the introduction of regulatory pressure on Royal Mail to push too far and too fast for changes that lead to a breakdown in industrial relations. Any consequent industrial action could cause significant and permanent damage\textsuperscript{91}, which is clearly not in the interests of any party.

Postal Market Analysis
78. Whilst Ofcom generally takes the view that Royal Mail faces some pricing constraints, we would argue that the company faces significant constraints in profitably raising prices for letters and parcels, in particular from the threat of structural decline and e-substitution in letters and growing competition in parcels. We believe these constraints act as a strong incentive to drive cost efficiencies in the business, rather than raising prices excessively.

79. We recognise that Royal Mail retains a near monopoly in the provision of single piece letters and large letters, and that it provides the majority of bulk mail letter delivery. However, letters is a declining market, with total letter volumes falling by 18% since 2010-11. This presents a major challenge for Royal Mail in defending letter volumes and finding new areas of revenue growth to ensure the universal postal service remains financially sustainable.

80. Furthermore, Royal Mail faces the highest level of access competition in Europe, and the proportion of access mail in total letter volumes has increased from c.46% in 2011-12 to c.56% in 2015-16.\textsuperscript{92} Access mail now accounts for around 70% of bulk mail letter volumes, which is significantly higher than in any of Royal Mail’s international peers. Data from the European Regulators Group for Postal Services (ERGP) shows there are only two other EU countries with notable levels of access competition (above 5%) by volume – Germany at around 10% and Slovenia at around 7.5%.\textsuperscript{93}

81. Ofcom’s analysis shows that parcels competition is developing rapidly, with a 34% increase in volumes of single piece parcels carried by Royal Mail’s competitors between 2013-14 and 2014-15. Although Royal Mail’s UK parcel revenues grew by 1%, this was not sufficient to offset a 2% decline in UK letter revenues, and UK Parcels, International and Letters (UKPIL) saw a 1% overall decline in revenue in 2015-16.\textsuperscript{94} In addition, it is important to recognise that the UK has one of the most competitive parcels markets in Europe. Data from the ERGP shows that the three major UK postal providers including the universal service provider hold just a 50% market share of the parcels market. This is significantly lower than in some of the major European economies including Germany (70%), France (99%) and Italy (100%).\textsuperscript{95}

Assessment of the current regulatory framework against the 2012 tests
82. As we have mentioned, we support the proposal not to impose retail and/or wholesale price controls on Royal Mail. We agree with Ofcom’s conclusion that the current regulatory framework and market conditions incentivise Royal Mail to pursue efficiency improvements rather than excessively raising prices.

\textsuperscript{91} Efficiency metrics for Royal Mail, FTI Consulting, ibid, para 3.11 p.15
\textsuperscript{93} ERGP Report on end-to-end competition and access in European postal markets, June 2014, Figure 15, p.28
\textsuperscript{94} Royal Mail annual report and financial statements 2015-16, accessed at: \url{http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202015-16_0.pdf}
83. We disagree with Ofcom’s view that competitive pressures in the parcels sector are likely to provide the outcomes desired by consumers. The parcels market is already highly competitive but as we have discussed, it is currently failing to provide the service standards that consumers want or expect. Therefore, we do not agree with the conclusion that the maintenance of a competitive market for parcels should be the key objective for a regulatory framework for the parcels sector. In our view, Ofcom should introduce new regulations to ensure all parcel companies comply with a minimum set of standards.

84. We agree that the ongoing monitoring of the postal service remains an important component of the regulatory framework. Ofcom should continue to monitor a range of factors including Royal Mail’s performance on efficiency, quality of service, the financial performance of the universal service network, and competition in parcels and letters. This will support Ofcom in fulfilling its primary duty to secure the provision of the universal postal service, helping to identify problems at an early stage so that any necessary regulatory action can be taken in a timely fashion.

85. We also agree that Ofcom should continue to monitor consumers’ experiences in the postal sector for the purposes of understanding whether user needs are being met and how they may be changing. This will help to ensure that postal services remain highly valued, relevant and fit for the future.

Question 4: Do you agree with our proposal not to amend the Universal Service Order or the DUSP conditions to include tracking as standard on First and Second Class single piece parcels?

86. As part of a drive to promote standards for parcel services, we think tracking should be included as standard for first and second class single piece parcels. It is important to allow Royal Mail to compete on a level playing field with other parcel operators because this will help to secure the financial sustainability of the universal service and drive innovation in other parcel operators.

Question 5: Do you agree with our proposal to retain the safeguard cap in its current form?

87. We recognise that the safeguard cap on Second Class stamp parcels under 2kg was introduced to ensure that an affordable basic universal postal service is available to all. We believe that affordability is important in meeting the needs of ordinary postal users and ensuring the sustainability of the universal service. We also recognise that Royal Mail is currently pricing below the safeguard cap, and therefore the cap is not constraining the Royal Mail’s ability to set prices.

88. However, growing competition in single piece parcels could bring pricing constraints for Royal Mail in this market. Therefore, whilst we agree with the proposal to retain the cap for now, we believe Ofcom should closely monitor the development of competition in single piece parcels and review the position if necessary.

Question 6: Do you agree that we should amend the USPA Condition so that it is clear that access operators cannot be required to accept general terms and conditions that include shorter notification periods than those provided for under USPA 7?

89. We recognise the concerns raised by some stakeholders that Royal Mail’s use of contractual schedules means that it is able to make changes to products more quickly than the 10 week minimum notification requirements provided under Universal Service Provider Access Condition
(USPA Condition) 7. We therefore believe that Ofcom’s approach is reasonable, and that it should amend the USPA condition so that access operators are not required to accept shorter notification periods, as proposed.

90. However, we are concerned about the high level of access competition and the impact that this may have on the financial sustainability of the universal service in a declining letters market. As we have mentioned, access mail in total letter volumes has increased from c.46% in 2011-12 to c.56% in 2015-16. We consider that Ofcom must continue to monitor developments in this area to ensure that the level of access competition does not threaten the universal postal service. We also believe that any move towards expanding the products included in Royal Mail’s mandatory access requirements would impact its revenues further. Therefore, we welcome that Ofcom has not agreed to requests from stakeholders for access to be extended, and we believe that doing so would pose a risk to the sustainability of the universal service.

Questions 7-9

Question 7: Do you agree with our proposal to amend the scope of Essential Condition 1 to cover untracked letter and large letter mail, and single piece universal service parcels, and to remove the remaining universal service products from the scope of the Essential Condition 1?

Question 8: Do you agree with the proposed streamlining revisions to Essential Condition 1, including the removal of the Mail Integrity Code of Practice, as drafted in Annex 12?

Question 9: Do you agree that the proposed drafting of Essential Condition 1 including relevant definitions accurately capture our intended objectives and the intended operators and mail types?

91. We disagree with Ofcom’s proposals on Essential Condition 1 and the Mail Integrity Code. This includes the proposal to remove various universal service products from the scope of the Condition; remove the requirement to report on serious incidents; move to annual reports (rather than quarterly reports); and ensure that only those operators of scale (i.e. those delivering more than 250,000 relevant postal packets) are covered. We also disagree with Ofcom’s view that it is not necessary to extend mail integrity requirements to cover parcel operators.

92. As we have indicated in this submission, we wish to see a strengthening rather than a reduction in regulations that protect mail from damage, theft, loss and interference. We believe the experience of postal users in the parcels sector calls for a levelling up of standards across the postal industry as a whole. This should include:

- A requirement for all delivery providers, including parcel firms, to record and report on performance targets to both incentivise firms to improve quality of service and to ensure customers are properly informed.

- An extension to the Mail Integrity Code so that it applies to parcels as well as letters in order to ensure the same basic standards apply to the whole parcels industry and to protect all consumers.

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96 Essential Condition 1 requires ‘regulated postal operators’ to put in place processes that protect the integrity of mail, with regards to minimising its exposure to interference, damage, theft or loss.

97 A serious incident is an incident in which the percentage of packets affected exceeds 10% of the total volume of packets handled by a relevant employee that day (Mail Integrity Code of Practice, para 2.6)
Questions 10-11

Question 10: Do you agree with the proposed revisions to Consumer Protection Condition 2, including the removal of the PCOP code and agreement, as drafted in Annex 13?

Question 11: Do you agree that the proposed drafting of CP 2 including relevant definitions accurately capture our intended objectives and the intended operators and mail types?

93. We disagree with the proposed revisions to Consumer Protection Condition 2, including the proposal to remove the Postal Common Operational Procedures (PCOP) Code of Practice. We believe the proposed changes will weaken the obligations on postal operators to return mis-directed or mis-collected mail to the intended operator.

94. We believe the PCOP Code acts as an important safeguard for postal users, and that it should continue to cover all regulated postal operators. We consider that the proposed move to a more ‘principle based’ approach giving industry the freedom to put in place arrangements which are most suitable to them, risks undermining existing protections for postal users. This is because it will remove the regulatory requirement for operators to conform with minimum standards, which they are unlikely to replicate as thoroughly on a voluntary basis.

95. Whilst Ofcom considers it unlikely that the proposed measures would lead to ‘regulated postal operators’ refusing to enter into arrangements with Royal Mail for the repatriation of mis-directed or mis-collected mail, it nevertheless recognises this is a possibility.

96. As Ofcom notes, without regulation in place there is a risk that postal items which end up in the wrong network will be discarded or delayed to the detriment of consumers. Instead of deregulating in this area, we believe that Ofcom should be exploring ways to strengthen the obligations and incentives for all postal operators to minimise the risk of mis-posted, misdirected and mis-collected mail failing to reach the intended recipient.

97. We therefore disagree with the proposed drafting of CP 2 to exclude all regulated postal operators from the scope of the Condition except the universal service provider, and to exclude postal items except for untracked letters and large letters. We also disagree with the proposal to remove the annual reporting requirements, which help to provide an important record of the volume of mis-directed and mis-collected letters handled by operators.

Questions 12-13

Questions 12: Do you agree with our proposal to amend the scope of Consumer Protection Condition 3 so that it retains a minimum requirement for all postal operators, and that additional requirements in relation to redress and reporting apply to Royal Mail as the universal service provider only?

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98 Requires regulated postal operators to comply with rules (called Postal Common Operational Procedures, or PCOP) that aim to ensure there are processes in place to return mis-directed or mis-collected mail to the intended operator.
Question 13: Do you agree with our proposed drafting of Consumer Protection Condition 3 given our proposal to only apply the additional requirements set out in CP 3.3 in relation to redress and reporting to Royal Mail as the universal service provider?

98. We disagree with the proposal to amend the scope of Consumer Protection Condition 3\textsuperscript{99} (CP 3) so that it retains only a minimum requirement for all postal operators. We believe that all postal operators should be required to continue to comply with the full set of requirements under CP 3. This includes not only the requirement to establish a procedure for dealing with consumer complaints regarding postal services, but also for operators to be a member of a qualifying redress scheme.

99. Ofcom states that it appears disproportionate to apply the requirements of CP 3.3 (the additional requirements relating to redress and reporting) given that the delivery of almost all bulk mail letters is carried out by Royal Mail, and that other regulated postal operators are of a very small scale. However, again this appears to be weakening consumer protection when we believe there is a need to raise standards in the postal sector to improve customer satisfaction and confidence in postal services.

100. We also consider that the poor service standards we are witnessing in the parcels sector calls for an extension of CP 3 to unregulated parcel delivery companies. Evidence suggests that many parcel companies do not currently have satisfactory systems in place to deal with customer complaints and to provide redress when things go wrong.\textsuperscript{100} This is particularly the case for third party parcel brokers such as Parcel Monkey, which reportedly does not provide a customer telephone number. The process of locating a lost parcel can therefore be time consuming and frustrating for customers. Anecdotal evidence also suggests that when parcels go missing, customers can experience significant problems in securing redress from the retailer or the courier.\textsuperscript{101}

Question 14: Do you agree with our proposal to revoke Consumer Protection Condition 5?

101. We disagree with the proposal to revoke Consumer Protection Condition 5\textsuperscript{102} (CP 5). We believe this would remove protections for postal users which should remain in place and which should be extended to cover parcels.

102. Ofcom justifies this proposal on the basis that postal operators will have contractual arrangements in place with the sender under which they agree to deliver postal items, and that if they failed to do so ‘it is likely’ that their customers would have contractual remedies available. We are concerned that there is an element of uncertainty in this statement, and that it may be the case that not all operators have contractual remedies available for customers.

103. Ofcom also says it is not aware to date of any evidence to suggest that there have been any significant failures on the part of postal operators to deliver mail. However, as we have discussed

\textsuperscript{99} Requires all postal operators to have a complaints handling procedure in place, and imposes additional requirements on regulated postal operators, including the need to be a member of a redress scheme.

\textsuperscript{100} Your rights when parcels go missing, Moneywise magazine, 11\textsuperscript{th} December 2014, accessed at: http://www.moneywise.co.uk/scams-rip-offs/consumer-rights/your-rights-when-parcels-go-missing

\textsuperscript{101} Moneywise magazine, ibid, 11\textsuperscript{th} December 2014

\textsuperscript{102} Requires a regulated postal operator to deliver mail it receives in the course of operating its business as a postal operator
there are serious problems of delivery failures in the parcels market. Therefore we believe CP 5 should remain in place and that it should be extended to cover parcel operators.

**Question 15: Do you agree with our proposal to remove the one-month notification period for price decreases to Royal Mail’s universal service products and services?**

104. We agree that it is right to retain the one month notification obligation for changes to prices, except where a price decrease is proposed. We support the view that this may provide Royal Mail with the flexibility it needs to compete on price, while ensuring safeguards for consumers remain in place.

105. However, as we have indicated in this submission we are concerned about the impact of price and revenue reductions on the financial sustainability of the universal postal service. We are also concerned about the implications of a race to the bottom on price for postal jobs, pay and labour standards. We recognise that the regulatory change outlined here may help Royal Mail to grow its revenues if it can increase volumes through price reductions in some areas. However, we are opposed to a general push for lower prices through competition because we believe it will ultimately be damaging for postal services, jobs and labour standards.

**Question 16: Do you agree with our proposal to reduce the advance notice period for specified collection times to one month (reduced from three months)?**

106. We agree that advance notification of changes to the latest collection times remains important to meet the interests of businesses, SMEs and individual consumers. However, we also recognise that there should be a balance between consumer interests and the need to allow Royal Mail flexibility to change its collection times to meet its operational needs. Therefore, we recognise the rationale behind the proposal to reduce the notice period for specified collection times from three months to one month.

**Question 17: Do you agree with our proposal to remove the advance notice period for latest delivery times (currently at three months)?**

107. We disagree with the proposal to remove the advance notice period for latest delivery times. The most important reason for this is that CWU members have their home lives structured around delivery times, and changing these times at short notice would create serious difficulties for them and their families. For example, workers with children and other caring responsibilities cannot reasonably be expected to instantly adjust to new working hours. It takes time to make alternative arrangements for care and support at home, and we believe the needs of workers in this regard should be reflected in the regulations. We also believe that changing delivery times could have an adverse impact on SMEs if they rely on the postal service to make same day responses to customers, suppliers or other contacts. We therefore consider that there should be a minimum notice period of at least one month for latest delivery times.

**Question 18: Do you agree with our proposed restructuring and drafting of the Designated Universal Service Provider Conditions 1.10.1 and 1.10.2, and the removal of Designated Universal Service Provider Conditions 1.10.3?**

108. We disagree with the proposed changes to the Conditions based on our opposition to the proposal to remove the advance notice period for the latest delivery times.
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