



National Audit Office

Re-opening the post: Postcomm and the quality of mail services

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National Audit Office

Re-opening the post: Postcomm and the quality of mail services

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EXECUTIVE SUMMARY



1 Even in an age of increasing use of digital and electronic communications the postal service remains of vital and growing importance to the UK economy. In 2005 domestic consumers and business spent approximately £9 billion on posting letters and parcels. The mail service delivers items ranging from utility bills and bank statements to promotional material and items purchased over the internet. A National Audit Office survey of UK consumers found that 69 per cent of those questioned believed that Royal Mail offers a value for money service.

2 Although the UK postal market has been fully liberalised Royal Mail still has a dominant position. To protect the interests of users Postcomm (the Postal Services Commission) regulates Royal Mail in the areas where there is little or no competition. It also ensures that Royal Mail provides the universal service.¹ Postcomm sets both the prices that Royal Mail is allowed to charge, and the quality standards it must meet in the regulated area. This mechanism is called a price control and is reviewed at regular intervals. In December 2005 Postcomm produced its final proposals for the next price control, which will run from April 2006 to March 2010. If Royal Mail does not accept the proposals Postcomm will then ask the Competition Commission to investigate the issues. The current price control will continue in the interim. This is a decision for Royal Mail's senior management, the substance and content of which is not covered in this report.²

1 Key facts about the UK Mail Market

The UK mail market was worth approximately **£9 billion** in 2004-05. **The regulated or licensed area** – mail that costs less than £1 to deliver and weighs less than 350 grams – **accounts for about 72 per cent of this market (some £6.5 billion)**. It is Postcomm's job to regulate that part of the mail market.

The total letters market (in the licensed area) continues to grow – with 20 billion items in 2004-05.

Businesses send 87 per cent of mail, in the UK licensed postal market – about 60 per cent of this mail goes from business to domestic consumers, and 27 per cent goes from businesses to businesses. **Domestic consumers post 13 per cent of mail.**

Fourteen licensed operators compete with Royal Mail. **New operators carried more than 106 million items "end-to-end"** (providing collection, sorting and delivery) in 2004-05 and their revenue rose by 121 per cent to £31 million.

Several companies have signed "access" agreements with Royal Mail, allowing mail they have collected and sorted to be fed into Royal Mail's network for final delivery. Total access volumes accounted for approximately 381 million items in the first half of 2005-06.

Royal Mail still dominates postal services, accounting for 97 per cent of mail volumes in the regulated area in 2004-05 when its revenue grew by 3.7 per cent. High market share and price increases led to increased profits.

¹ For the purposes of this report we use the term 'universal service'. The universal service is also referred to in the mail industry as the 'universal postal service' and the 'universal service obligation'.

² On 17 March, Royal Mail stated that it was minded to accept the price control - pending agreement on the formal amendment to its licence (Royal Mail press notice 17 March).

3 UK regulators have a long experience of the mechanics and processes used to set prices and introduce competition. In the postal sector Postcomm has created a clear framework for setting Royal Mail's prices even though the two parties may debate extensively about the exact level of prices. The mechanics for regulating quality of service in post are less clear and Postcomm does not have a tried and tested framework which it can readily adapt from another UK regulated sector. Quality of service regulation is also the least well developed aspect of Postcomm's role. It was identified as a risk in the National Audit Office's 2002 report on postal regulation³, which concluded:

on protecting the consumer:

- Postcomm needed to ensure that customer needs were clearly identified.

on implementing performance standards:

- Postcomm needed to ensure that Royal Mail met quality of service targets and that Postwatch had sufficient information to monitor their achievement.

4 This report examines developments in regulating quality of service since our 2002 report.⁴ We have focussed on this occasion on quality of service in preference to price setting. Royal Mail is introducing a new pricing structure in August 2006 based on the size of mail rather than its weight. Postcomm is also proposing to allow Royal Mail to increase the price of first and second class stamps by two pence from April 2006, and a further four and three pence respectively by 2010. The combined impact of these changes on consumers is as yet unknown and we will monitor developments. A National Audit Office survey found that only 11 per cent of people consider that the prices Royal Mail charges are poor or very poor value, and only 26 per cent know the price of a first class stamp. Furthermore, Royal Mail's prices are generally lower than most of its European equivalents. Most people also receive far more mail than they send. Both domestic and business consumers are, however, concerned with the quality of Royal Mail's services and last year made over 1 million complaints. This level of complaint suggests that quality of service is a crucial aspect of value for money.

5 The overall value for money of the quality of service regime put in place by Postcomm depends on the extent to which it protects consumers and does not over-burden Royal Mail. The regime currently in place (2001-2006) has shortcomings in protecting consumers and some elements of it over-burden Royal Mail. The proposed regime (for 2006-2010) improves the level of consumer protection. But there remains scope to improve implementation, which would further reduce regulatory burdens.

6 The report covers Postcomm's role (Part 1), the current regime (Part 2), and an evaluation of the proposed regime (Part 3). In all three parts we examine how Postcomm protects the consumer, and how it implements the performance regime.

Our findings

Protecting the consumer

7 Postcomm has put in place quality of service targets to protect the consumer. In 2001 Postcomm recognised that a performance measurement system was needed to protect the consumer from the risk of Royal Mail abusing its dominant position. It adopted Royal Mail's existing performance system which measured the transit times for mail, i.e. how long an item of mail takes from initial posting to final delivery. Adopting Royal Mail's system in 2001 was appropriate in the absence of other performance data and the time pressure Postcomm faced to establish a system. The system also met an EU requirement for transit time targets.

8 In the past Royal Mail missed most of its targets but performance is now improving (Figure 2). Royal Mail's performance against its targets has recently improved. In 2003-04 it missed all its targets, in 2004-05 it met four, and in the first half of 2005-06 performance was above target for all but four products. Royal Mail's underlying performance has also been improving since regulation was introduced. For example in 2001-02 it delivered 89.9 per cent of first class letters within one day against 91.4 per cent in 2004-05. Certain postcode areas, for example North West and South East London, although showing improvement over the years, have not yet achieved the licence target levels over a full reporting year. Consumers in these areas have not benefited from the overall improvement.

³ National Audit Office: *Opening the Post: Postcomm and Postal Services – the risks and opportunities*, HC 521 Session 2001-02, 24 January 2002.

⁴ The National Audit Office report *Improving the efficiency of postal services procurement in the public sector* is published on Friday 24th March.

2 Royal Mail's performance against Quality of Service targets

Product	Product description	2004-05	2003-04	2002-03	2001-02
1st Class Mail	1st and 2nd class mail covers stamped and metered mail only.	X	X	X	X
2nd Class Mail		✓	X	X	✓
Mailsort 1	Mailsort products are used by bulk mailers. The companies presort their outgoing mail before it is collected by Royal Mail. The three different products correspond to different transit times.	✓	X	✓	✓
Mailsort 2		X	X	X	✓
Mailsort 3		✓	X	✓	✓
Presstream 1	Presstream is used by newspaper and magazine companies to mail out their publications.	X	X	X	✓
Presstream 2		✓	X	X	✓
1st Class PPI	PPI (Printed Postage Impressions) – Envelopes are pre-printed in order to save time and/or money for large campaigns. Payment is settled through an account.	X	X	X	X
2nd Class PPI		X	X	X	✓
1st Class Response	Response services are prepaid business reply cards and envelopes.	X	X	X	X
2nd Class Response		X	X	X	X
Special Delivery	This product offers insurance in the case of loss or damage, and compensation in the case of late delivery.	X	X	X	✓
Standard Parcels	A basic untracked second class service available at Post Offices.	X	X	✓	X
Postcode area	These targets are minimum targets that must be achieved on all the first class products throughout the year on mail between and within postcode areas.	X	X	X	X
Intra postcode area		X	X	X	X
Total targets met out of 15		4	0	3	8

Source: National Audit Office

NOTES

The targets for 2001-02 and 2002-03 were for February and March only in line with Royal Mail's previous practice. Postcomm had annual targets put in place thereafter.

In 2001-02 and 2002-03 there were two other targets relating to mail delivered within 15 working days and post office queuing time. These have since been removed.

There are also tail of mail targets which cover all 13 separate products. These targets cover the amount of mail that arrives within a set period after the promised delivery period.

Figure 10 sets out the targets in more detail.

9 The existing quality of service targets do not cover all the aspects of quality that are important to consumers. The current system measures Royal Mail's performance against the transit time promised for each of its products (for example, 93 per cent of stamped and metered first class mail should be delivered the next day). The current system does not, however, measure all the aspects of quality that are important to consumers. For example the highest number of complaints to Royal Mail concern loss of mail. Yet this is not measured. Performance over Christmas, Royal Mail's busiest period, although measured and published, is also excluded from the targets as this is an abnormally busy period.⁵ Royal Mail's performance on collecting and delivering by its stated collection and delivery times is also not measured.

10 The proposed performance management system has a greater focus on what consumers view as quality. Postcomm has proposed a measurement system to run from 2006 to 2010. The proposed system retains at its core the concept of transit times as the principal definition of quality. But the existing 15 transit time targets have been grouped into 8 targets and 4 new targets have been added, thereby reducing the overall number from 15 to 12. The new targets cover mail delivered to both the wrong address and addressee, the percentage of delivery routes and collections completed, and a transit time target for outgoing international mail. These changes reflect the consumer's perspective of service quality as identified through consumer research.

11 Postcomm has proposed a system to report on whether Royal Mail meets its advertised collection and delivery times. Postcomm has not proposed targets for specific collection and delivery times as this would restrict the flexibility Royal Mail needs to run the business efficiently, both in terms of its financial viability and in terms of introducing new technology. Postcomm has therefore proposed that Royal Mail publishes the percentage of deliveries completed by the latest published delivery time each day and the percentage of final collections made at or after their stated time. Should this data identify any shortcomings in performance Postcomm

can then consider a hierarchy of options for remedial arrangements ranging from voluntary to prescriptive measures. Such measures may have to involve a change to the licence which would require the agreement of Royal Mail.

Implementing the performance regime

12 Postcomm has proposed increasing Royal Mail's financial incentives by increasing the level of revenue adjustments. If Royal Mail misses its targets Postcomm can reduce Royal Mail's revenue and launch an investigation to determine whether to levy a penalty. Royal Mail also has to pay automatic compensation to bulk mailers for poor performance, and there is a retail scheme for domestic consumers.

- **Revenue adjustment:** The revenue adjustment has a maximum value of 0.9 per cent of revenue earned on any non bulk mail product. The maximum value can only be levied if performance is 5 per cent below target. Postcomm and Postwatch believe that the maximum value of 0.9 per cent is too low to incentivise Royal Mail fully. Revenue adjustments in 2004-05 were some £10 million. Postcomm has proposed an increase in the revenue adjustment to a maximum of 5 per cent of revenue. Royal Mail calculates that if it missed all its targets by 5 per cent it would result in a revenue adjustment of some £140 million, representing a very significant proportion of its annual profit.⁶
- **Compensation:** If Royal Mail misses its targets on bulk mail products by at least one per cent it has to compensate the bulk mailers up to 5 per cent of product revenue. Compensation of £24 million was paid out in 2004-05.⁷ Postcomm has not proposed any changes to the level of compensation. Royal Mail calculates that if it missed all its targets by 5 per cent it would result in compensation of some £190 million. Retail compensation is also payable on non bulk mail products on a case by case basis. Retail compensation of £1.1 million was paid out 2004-05.

5 Postcomm requires Royal Mail to publish its performance over the Christmas period but does not expect it to meet the annual targets during this period. To do so would require a high level of investment in extra capacity by Royal Mail. The Christmas period is defined as running from the first Monday in December until the first working day in January.

6 In Royal Mail's response to Postcomm's proposals, Royal Mail calculates that the maximum value of revenue adjustments and compensation will be some £330 million, about twice its allowable profit after including funding for its pension deficit.

7 The bulk mail compensation scheme was subject to a judicial review in December 2005. The review found that Postcomm had not interpreted the rules of the scheme correctly. Royal Mail has appealed against the decision which is in respect of around £38 million compensation. The final figure for bulk mail compensation in 2004-05 could increase pending the outcome of the appeal.

- **Financial penalties:** Postcomm also incentivises Royal Mail by investigating whether it has used ‘all reasonable endeavours’ to meet its targets. If Postcomm finds that Royal Mail fails this test it can levy a financial penalty. One penalty of £7.5 million has been levied to date in respect of missed targets. Most recently, in February 2006, Postcomm announced its intention to fine Royal Mail £13.8 million for three breaches of its licence. Of this, £271,000 was for poor quality of service at Postcode area level, with the remainder being for lost mail and breaches in agreements that allow competitors access to its network.

13 Implementation of the financial penalty regime has placed a burden on all parties. The investigations into whether Royal Mail has used ‘all reasonable endeavours’ place a burden on all parties and take a long time to carry out. For example, Postcomm’s investigation into Royal Mail’s 2003-04 performance took longer than the permitted duration of 12 months. As a result, if Postcomm had decided to levy a financial penalty Royal Mail could have appealed against the decision on the basis that it was ‘timed out’. Postcomm’s proposal to increase the automatic revenue adjustments to 5 per cent of revenue may reduce the number of investigations. Postcomm has proposed shifting the burden of proof onto Royal Mail, but should Postcomm then decide to investigate its process for investigations will remain broadly unchanged.

14 Postcomm does not have all the information it needs to make decisions on quality of service levels. In setting quality of service levels, Postcomm must balance the value consumers place on quality with the cost to Royal Mail of achieving a given quality level. There are gaps in the information that Royal Mail produces that prevent Postcomm from resolving this balance. For example although Royal Mail has produced information on consumers’ willingness to pay for increased reliability of transit times⁸ there is no information on the cost to Royal Mail of achieving this. Similarly, there is no information on the savings to Royal Mail should Postcomm choose to reduce one of Royal Mail’s target levels.

8 *Royal Mail, Pricing Quality of Service, Final Report*, September 2005. Prepared by Accent and RAND Europe.



RECOMMENDATIONS

15 The UK's quality of service regime for post is already one of the most sophisticated internationally. In developing it further Postcomm needs to:

a In co-operation with Royal Mail, **develop the information** needed to improve implementation of the performance regime and inform the next price control:

- Universal service failures – develop a validation system for the universal service failure reporting system via an independent reporter.
- Cost of quality – identify the cost of increasing Royal Mail's performance, for example by one per cent, and the cost that could be saved by setting lower targets.
- Collection and delivery times – monitor Royal Mail's performance in meeting its stated collection and delivery times.

b **Improve implementation** of the regime to **reduce burdens** on Royal Mail, where appropriate:

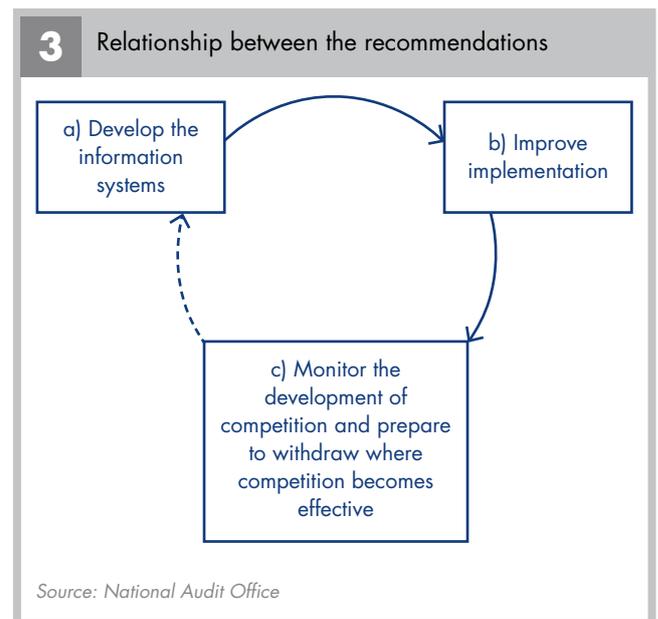
- Investigations – Postcomm should develop a framework for investigations that details the likely circumstances in which Postcomm would investigate shortfalls in performance, the range of information it would require, and standard responses to common issues. This should be set against the need to retain discretion over responding to exceptional circumstances.
- Collection and delivery times – where monitoring information indicates that remedial action is required, Postcomm should start by considering the least intrusive response.



c Monitor the development of competition in the postal sector and prepare to **withdraw from detailed regulation** when competition becomes effective, by:

- Establishing criteria for adding and removing products from the universal service. This might involve balancing the cost of quality against the consumers' willingness to pay. The decision should follow the principles of Better Regulation and be transparent, accountable, and justifiable.
- In time for the next price control, carrying out further joint research with Postwatch and Royal Mail to establish the needs of consumers, how they are changing and how the universal service may be best adapted to accommodate them.

16 The links between the recommendations are set out in **Figure 3**.



PART ONE

Introduction



This section describes Postcomm’s statutory background and its main role of protecting the consumer by ensuring the provision of a universal postal service. The section also covers the scope and methodology of the report, including our criteria for assessing performance measurement and implementation.

1.1 Every day 84 million items of mail are posted by businesses and domestic consumers, and delivered to 27 million addresses.⁹ **Figure 4** shows the typical journey of a letter.



9 Royal Mail, Annual Review 2004-05.

1.2 The postal market has both sending and receiving consumers.¹⁰ It is generally the sender who pays. Businesses send about 87 per cent of all mail in the UK licensed postal market of which 60 per cent goes to the domestic consumer. **Figure 5** shows the mail flows.

Royal Mail

1.3 Royal Mail Group is the dominant postal services operator in the UK. Its sales revenue in 2004-05 was nearly £9 billion and it employs 196,000 people. It operates under a postal licence from Postcomm. In addition to its mail business, its other operating units are: Post Office Limited, which provides government, financial and retail services through its network of some 14,600 post office branches; Parcelforce Worldwide, its domestic and international express parcels business; and General Logistics Systems, a European parcels business operating in 34 countries.

1.4 Royal Mail dominates postal services, accounting for more than 97 per cent of mail volumes in the regulated area in 2004-05. Its revenue in that area grew by 5.4 per cent in the year ending 31 March 2004, as a result of price increases in May 2003 and a 1.6 per cent increase in volumes.

The European Framework

1.5 In December 1997 the EU adopted the first Postal Services Directive 97/67/EC (the first Directive). The EU's aim is to implement the Single Market for postal services, by opening up the sector to competition in a gradual and controlled way, within a regulatory framework which assures a universal service. The universal service is a definition of the minimum level of service that must be provided and is effectively a protection for consumers in member States.

1.6 The EU directive provided, among other things, common rules on:

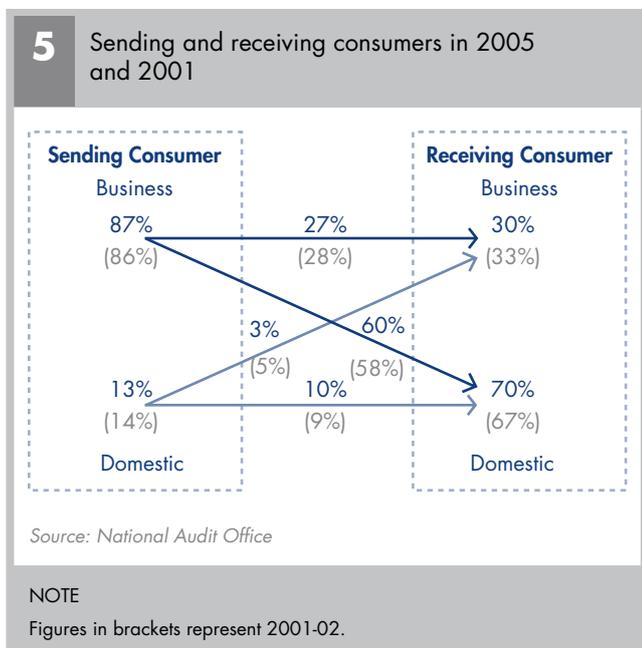
- the provision of a universal service for post within the European Community;
- the services which may be reserved for universal service providers; and
- setting quality standards for universal service provision.

The universal service in the Postal Services Act

1.7 The EU's definition of the universal service was broad and the process of defining the detail was devolved to member States.¹¹ For example, member States could choose whether they wanted a cheap and basic service or a more expensive and timelier postal service. The Postal Services Act 2000 (the Act) transposed the first EU Postal Directive into UK law. The Act defined the universal service as:

at least one collection and one delivery per working day across the country of postal packets up to 20 kilograms (44.1 pounds) – at an affordable price which does not vary with distance.

1.8 In return for supplying the universal service, Royal Mail was granted a statutory monopoly over part of the postal market, termed the reserved area. This was defined in terms of price and weight and would be gradually reduced as part of market liberalisation.¹² Only Royal Mail is required to provide the universal service although other operators can also apply for a licence to provide it.



10 Telecomms is the only other regulated market with sending and receiving consumers.

11 In line with the EU's principle of subsidiarity. The first Postal Services Directive stated that *in accordance with the principle of subsidiarity, a set of general principles should be adopted at Community level, whilst the choice of the exact procedures should be a matter for the Member States, which should be free to choose the system best adapted to their own circumstances*. The first Postal Services Directive 97/67/EC.

12 In addition to reductions in price and weight over time, the first Postal Directive excludes new services from the reserved area.

Postcomm

1.9 There is a risk that, in the absence of effective competition, Royal Mail could abuse its dominant position to the detriment of the consumer. To prevent this, the Postal Services Act established the Postal Services Commission, known as Postcomm (Figure 6).¹³

1.10 Postcomm's duties under the Postal Services Act are:

- a primary duty to ensure the provision of the universal postal service.
- a secondary duty to protect the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators. It does this by making recommendations to the Government about the size and scope of the regulated area, and by licensing postal operators to compete with Royal Mail Group plc within the regulated area.
- to have regard to the need to ensure that licence holders can finance their activities.

6 Postcomm	
Formal title	The Postal Services Commission.
Type of body	Non-Ministerial Government Department.
Date established	1 January 2001 by the Postal Services Act 2000.
Postcomm's mission statement	Postcomm's vision is "a range of reliable, innovative and efficient postal services, including a universal postal service, valued by customers and delivered through a competitive postal market".
Management structure	The Postal Services Commission, appointed by the Secretary of State, currently comprises the Chairman, Nigel Stapleton, the Chief Executive, Sarah Chambers and six other commissioners.
Annual Budget	£10.2m per annum.
<i>Source: Postcomm</i>	

1.11 Postcomm has powers under the Act to enforce the terms of Royal Mail's licence, to issue enforcement orders to Royal Mail and, where appropriate, to fine Royal Mail if Postcomm deems it has not made "all reasonable endeavours" to comply with the terms of its licence.

Postwatch

1.12 The Act also created a new consumer body, the Consumer Council for Postal Services (Postwatch). Postwatch offers independent advice, information and help to the users of postal services¹⁴ (Figure 7). Its main roles are to:

- provide strategic advice to the regulator (Postcomm) on consumer interests.
- provide independent advice and information to users of Royal Mail or other postal services.
- represent consumers who have made a complaint to Royal Mail or another licensed operator and are dissatisfied with the outcome.

7 Postwatch	
Formal title	Consumer Council for Postal Services (a non departmental public body).
Date established	1 January 2001 by the Postal Services Act 2000.
Postwatch's mission statement	"To protect, promote and develop the interests of postal users in the United Kingdom".
Management structure	Governed by a National Council. There are nine regional offices: six in England, plus Scotland, Wales and Northern Ireland. Each region has a Committee and their Chairs are members of the Council Headquarters. Additionally there are four independent members and a national chair.
Complaints received in 2004-05	34,200 complaints received (27,500 in 2003-04).
Annual expenditure	£10.3m expenditure in 2004-05.
<i>Source: Postwatch</i>	

¹³ Also in line with the EU Directive. *The national regulatory authorities shall have as a particular task ensuring compliance with the obligations arising from this Directive. Article 22, The first Postal Services Directive (97/67/EC)*

¹⁴ We have examined the work of Postwatch previously. National Audit Office: *Energywatch and Postwatch: Helping and Protecting Consumers* (HC 1076 2003-04), 15 October 2004.

Royal Mail's shareholder

1.13 The Shareholder Executive (sponsored by the DTI) manages the Government's shareholding in Royal Mail.¹⁵ The Executive has committed to following similar high level shareholding principles to those of institutional shareholders who invest in private sector companies. The Shareholder Executive wants to see Royal Mail provide good quality services as this will enable it to maintain market share and enhance shareholder value. The Executive scrutinises the Royal Mail Remuneration Committee's proposals for performance targets and remuneration packages for Royal Mail's Executive Directors. It is therefore a key stakeholder in influencing Royal Mail's performance.

1.14 The Shareholder Executive's role as shareholder is deliberately separate from Royal Mail's regulatory framework to avoid confusing the roles and functions of the regulator with that of the shareholder. This report is an evaluation of the regulatory framework put in place by Postcomm. The Shareholder Executive is therefore outside the scope of our evaluation.

Audit scope, criteria and methodology

Audit scope

1.15 We reported in 2002 on the introduction of regulation to the postal sector.¹⁶ This identified two categories of risks to the regulation of postal services. One category related to the introduction of effective competition, the other related to regulation where competition had not yet become effective.

1.16 Since our report in June 2002 Postcomm has put in place a regime for regulating the cost and quality of postal services. It has set price controls in 2001 and 2003 and has licensed new operators (currently fifteen). It has also set a framework for liberalising the postal market (**Figure 8**), driven by reductions in the reserved area stipulated by EU Directives. Postcomm decided to bring forward the timetable for full liberalisation from that envisaged by the EU so that, by January 2006, there was no part of the market reserved exclusively to Royal Mail.

1.17 Competition has not yet had much time to develop in those areas of the market that were previously reserved to Royal Mail. In the absence of effective competition Postcomm is still regulating Royal Mail in its previously reserved areas. We have therefore examined in this report the regulatory regime that Postcomm has put in place for Royal Mail rather than the introduction of competition.

1.18 The two attributes of value for money that Postcomm regulates in the postal sector are prices and quality of service. We have examined quality of service in preference to price setting. Royal Mail is introducing a new pricing structure in August 2006 based on the size of mail rather than its weight. Postcomm has also proposed allowing Royal Mail to increase the price of first and second class stamps by two pence from April 2006, and a further four and three pence respectively by 2010. The impact of these combined changes on consumers is as yet unknown and we will monitor developments. A National Audit Office survey found that only 11 per cent of people consider that the prices Royal Mail charges are poor or very poor value, and only 26 per cent know the price of a first class stamp. Most people also receive far more mail than they send. Business and domestic consumers are, however, concerned with the quality of Royal Mail's services and last year made over 1 million complaints. This level of complaint suggests that quality of service is a crucial aspect of value for money.

1.19 An assessment of the value for money of the quality of service regime depends on the extent to which it protects consumers and does not over burden Royal Mail. These two issues were identified in the National Audit Office's 2002 report on postal regulation which concluded:

on protecting the consumer:

- Postcomm needed to ensure that customer needs were clearly identified.

on implementing performance standards:

- Postcomm needed to ensure that Royal Mail met quality of service targets and that Postwatch had sufficient information to monitor their achievement.

¹⁵ The Secretary of State for Trade & Industry holds 49,999 ordinary shares and one Special Share. The latter is used to give consent for matters such as major transactions, board appointments and remuneration. The Treasury Solicitor also holds one share.

¹⁶ National Audit Office: *Opening the Post: Postcomm and Postal Services – the risks and opportunities*, HC521 Session 2001-02, 24 January 2002.

8 The opening of the UK postal market to competition

Date	Reserved area (Royal Mail monopoly)	Regulated area (by Postcomm and Postwatch)
March 2001 (1st Postal Directive)	350 grams or less, and costing £1 or less	350 grams or less, and costing £1 or less. Postcomm defines which products are covered within the universal service.
1 January 2003 (2nd Postal Directive)	100 grams or less, and costing 80p or less	
1 January 2006 (2nd Postal Directive)	50 grams or less, and costing 65p or less	
1 January 2006 revised (Postcomm decision)	Ended	

Source: National Audit Office

1.20 This report covers consumer protections and implementation of the performance regime by examining the effectiveness of the current performance regime (part 2); and how it can be improved in future (part 3). We use the term performance regime to refer to all the processes which Postcomm and Postwatch can use to regulate or influence Royal Mail's performance:

- **Royal Mail's licence conditions.**
- **Performance measurement system:** the set of targets which are linked to automatic revenue incentives and compensation payments.
- **Postcomm and Postwatch investigations:** Ad-hoc investigations into Royal Mail's performance that may result in a financial penalty.
- **Compliance checks:** Postcomm and Postwatch investigations into failures by Royal Mail to provide the universal postal service.

Audit criteria and methodology

1.21 Our value for money assessment of the quality of service regime is based on the extent to which it protects consumers and does not over burden Royal Mail. Our assessment of consumer protections is underpinned by the best practice identified in a recent joint National Audit Office report on performance measurement.¹⁷ Our evaluation of the implementation of regulation is similarly underpinned by the Better Regulation Commission's five principles (see Appendix 1). Appendix 1 explains our methodology in detail, including a survey of domestic consumers and a statistical analysis of Royal Mail's performance against quality of service targets.

¹⁷ HM Treasury, Cabinet Office, National Audit Office, Audit Commission, Office for National Statistics, *Choosing the Right Fabric. A Framework for Performance Information.*

PART TWO

The current performance regime



This section evaluates the performance regime for Royal Mail put in place by Postcomm and Postwatch. It shows that:

- a performance regime was needed;
- Postcomm established an initial regime using the best available information in 2001;
- there are flaws with the design and implementation of this regime; and
- Royal Mail has not been able to meet the targets set, although its underlying performance shows improvement.

The need for a performance regime

2.1 In a competitive market consumers have a choice of service providers. They can choose the service that best meets their needs at the price they are prepared to pay. Competition therefore encourages companies to offer consumer-focussed services in the most cost effective way.

2.2 Where one provider has a dominant position, as does Royal Mail, a performance regime can serve as a proxy for competition. A performance measurement system, linking quality of service targets and financial incentives, is needed because Royal Mail could otherwise improve its financial position by reducing its quality of service. The EU Directive also obliges Postcomm to set and publish transit time quality of service standards for the universal service.

The design of the current performance regime

The timescale for setting the initial performance regime

2.3 Postcomm needed to establish a performance regime as part of the 2001 Price Control. It only had 12 months to put one in place after it came into existence (**Figure 9**). Failure to issue a licence by then would have meant that Royal Mail could not have legally provided a postal service.

9 Key Dates	
The Postal Services Regulations 1999, which transposed the first EU Directive	1 September 1999
Postcomm began in shadow form	April 2000
Postal Services Act 2000	28 July 2000
Postcomm and Postwatch formally established by the Act	1 January 2001
Deadline for issuing Price Control, including Quality of Service targets and licence to Royal Mail	26 March 2001

Source: National Audit Office

The definition of the universal service

2.4 The Postal Services Act defined the universal service broadly and left Postcomm to develop a more detailed working definition. In 2001, the universal service definition was not yet sufficiently developed to use in isolation as a basis for Postcomm's performance measurement system. For example the definition specified one collection and delivery every working day at a geographically uniform price, but did not specify which mail products would be covered by the service.

Royal Mail's pre-regulation measurement system

2.5 When Postcomm introduced a performance regime in 2001 Royal Mail had never faced competition in the reserved area of the postal market. Royal Mail therefore had never had an incentive to develop sophisticated costing and management information systems. There was also limited information from competitors. Postcomm could not therefore make quality comparisons, unlike other regulated industries such as water.

2.6 Royal Mail had, however, pioneered an independently run transit time measurement system for postal services. This system measured the percentage of mail that reached its destination in the time promised and had targets for each mail product. The system was audited by Royal Mail's external auditors. Royal Mail had used the system since 1988.

The targets established by Postcomm in 2001

2.7 Postcomm decided to use Royal Mail's transit time targets as the basis of its performance measurement system. There were no other viable data and the definition of the universal postal service was not specific enough to develop a robust performance measurement system. The EU Directive also required transit times to be measured. The targets agreed in 2001 are still in force, with minor amendments (**Figure 10**).

Measurement and validation

2.8 A good performance regime should have a system for verifying performance information. This is also a requirement of the first Postal Services Directive. The system currently in place for Royal Mail meets this criteria and is also subject to independent audit. Postcomm also now require other operators to measure and report their performance, although there is scope for variation between operators in how they do this.

2.9 Royal Mail employs two independent research companies to measure transit time performance at a cost of over £6 million per year. The system uses some 6,000 panellists anonymous to Royal Mail, who represent a cross section of Royal Mail's customers. They post nearly 1.2 million items of test mail through the system per year and record when it arrives at its destination.

2.10 In 2001 Postwatch appointed an independent auditor to audit the performance information annually. The auditor forms opinions on whether the survey processes keep to the survey specifications, the extent to which the control systems over each survey are likely to produce representative and accurate survey results, and whether the reported survey results are free from material misstatement. Prior to 2001 the performance information had been audited by Royal Mail's external auditors.

Shortcomings of the current performance regime

Transit times

2.11 All of the current targets relate to transit times for postal products. The targets measure whether a mail item posted by the last collection time on a particular day is delivered by the *day* specified for that class of service. The targets do not measure the actual *time* of collection or delivery¹⁸. Any changes in delivery and collection times therefore reduce the comparability of one year's figures with another.

18 The definition of transit times in the EU Directive precludes this.

10 Targets set for Royal Mail in 2005-06

Product	Target (next day)	Target (if not next day)	Comment
1st class mail	93%		1st and 2nd class mail covers stamped and metered mail only.
2nd class mail		98.5% (3 working days)	
Mailsort 1	91.5%		Mailsort products are used by bulk mailers. The companies presort their outgoing mail before it is collected by Royal Mail. The three different products correspond to the different transit times offered.
Mailsort 2		97.5% (3 working days)	
Mailsort 3		97.5% (7 working days)	
Presstream 1	91%		Presstream is used by newspaper and magazine companies to mail out their publications.
Presstream 2		97.5% (3 working days)	
1st class PPI	91.1%		PPI (Printed Postage Impression) – Envelopes are pre-printed in order to save time and/or money for large campaigns. Payment is settled through an account.
2nd class PPI		97.4% (3 working days)	
1st class response services	90.8%		Response services are prepaid business reply cards and envelopes.
2nd class response services		97.5% (3 working days)	
Special Delivery	99%		This product offers insurance in the case of loss or damage, and compensation in the case of late delivery.
Standard Parcels		90% (3 day service)	A basic untracked second class service available at Post Offices
Postcode area targets: stamped and metered		91.5% in all areas	These targets are minimum targets that must be achieved on all first class products throughout the year on mail between and within postcode areas.
Postcode area targets: intra area mail		92.5% in all areas	

Source: Postcomm

NOTE

There are also tail of mail targets which cover all 13 separate products. These targets cover the amount of mail that arrives within a set period after the promised delivery period. Currently 99.9 per cent of all mail must arrive within three working days of the delivery date.

2.12 Royal Mail is delivering post later in the day than when regulation was introduced. This is largely as a result of the change to a single daily delivery, a move supported by both Postcomm and Postwatch as part of Royal Mail's plan for returning to financial stability. The change is reflected in a comparison of the National Audit Office's 2005 and 2001¹⁹ surveys of domestic consumers. Nearly four out of ten respondents said that their first postal delivery arrived at their home after 10 am and one in 25 said it normally arrived after noon. In 2001 about one in ten respondents said that their first postal delivery arrived after 10 am.

Correlation between the indicators

2.13 A good performance measurement system should have a small number of targets and these should be focussed on the aspects of performance that are important for providing quality to the consumer.²⁰ At present Royal Mail has 15 separate performance targets, including one for each of its main products and two for performance at postcode area level.

2.14 As Royal Mail's products flow through the same process (set out in figure 4) it is likely that the targets are essentially measuring the performance of a single system.²¹ The National Audit Office analysed the strength of correlation between Royal Mail's performance on its different products to determine whether this is the case. A high correlation (anything between 0.7 and 1) would suggest that the targets are measuring the same process, whereas a low correlation (between 0 and 0.7) would suggest they are not.

2.15 We found that performance against the targets in each class of mail (for example all 1st class products) is very highly correlated (all except three above 0.7 with some around 0.9) (Appendix 3 gives full details). **Figure 11** gives the results for all 1st class products.

Aspects of quality outside the system

2.16 The handling of complaints, provision of information and the security of the mail system are all important elements of quality in a postal service. **Figure 12** profiles the complaints made to Royal Mail between 2002 and 2005 indicating the areas of quality that consumers are concerned about. Many of these areas, for example loss and misdelivery, fall outside the existing performance measurement system. Furthermore, performance over the Christmas period, although measured and reported, is currently excluded from the targets.²²

2.17 A comparison between our 2005 and 2001²³ surveys of domestic consumers found that an increasing minority of the public receive mis-directed mail – one in four say this happens often or very often as against one in five in 2001. While this may also reflect a level of incorrectly addressed as opposed to mis-delivered mail, mis-delivery is the fifth most common customer complaint to Royal Mail. It is also the main contributor to lost mail – the biggest type of complaint.

19 See Appendix 2 for full details. The 2001 survey was reported in National Audit Office: *Opening the Post: Postcomm and Postal Services – the risks and opportunities*, HC521 Session 2001-02, 24 January 2002.

20 HM Treasury, Cabinet Office, National Audit Office, Audit Commission, Office for National Statistics, *Choosing the Right Fabric. A Framework for Performance Information*.

21 Pre-sorted mail enters Royal Mail's system at a later stage to non sorted mail.

22 The Christmas period is defined as running from the first Monday in December until the first working day in January.

23 See Appendix 2 for full details. The 2001 survey was reported in National Audit Office: *Opening the Post: Postcomm and Postal Services – the risks and opportunities*, HC521 Session 2001-02, 24 January 2002.

11 Statistical correlations

Target	First class mail	Mailsort 1	Presstream 1	PPI First class	Response services First class
First class mail	1.00	0.91	0.93	0.79	0.70
Mailsort 1	0.91	1.00	0.90	0.76	0.56
Presstream 1	0.93	0.90	1.00	0.68	0.71
PPI First class	0.79	0.76	0.68	1.00	0.54
Response services First class	0.70	0.56	0.71	0.54	1.00

Source: National Audit Office

NOTE

This figure shows the extent to which the performance of Royal Mail's products are correlated with each other. For example the first row shows that performance against target of 1st class mail is closely correlated to the performance of Mailsort 1, with a figure of 0.91.

12 Average number of complaints made to Royal Mail per annum on all products between 2002-03 and 2004-05

Top ten complaint types	Average number of complaints received pa
Loss	767,000
Other (General before 2004-05) ¹	178,000
Delay	159,000
Redirection Failure	135,000
Misdelivery	132,000
Delivery Procedure Errors	65,000
Damage	58,000
Delivery Frequency	25,000
Redirection Centre Failure	23,000
Part Loss	20,000

Source: Royal Mail

NOTE

¹ The category for 'other' may also include complaints relating to non quality of service issues.

Additional measures of quality of service

2.18 Postcomm recognised the initial performance measurement system could not measure all aspects of compliance with the universal service. In particular, Postcomm had no effective test of whether Royal Mail had made a collection from each post box each day. Nor could it ascertain whether a delivery service had been made available to each address each day.

2.19 It has therefore sought to develop additional reporting systems to do this. For example, concerns about delivery failure in the South and South West of England, especially from Postwatch, led to Royal Mail introducing detailed reporting arrangements for walk failures (failure to complete delivery rounds in whole or in part).²⁴ This reports any failure, either in whole or in part, to carry out a postman's/postwoman's delivery round. And Royal Mail has now developed systems for measuring daily collection failures, which are currently based on manual reporting. Royal Mail is in the process of introducing bar code readings which will automate the reporting of performance.

²⁴ National Audit Office: *Opening the Post: Postcomm and Postal Services – the risks and opportunities*, HC521 Session 2001-02, 24 January 2002 paragraph 3.23 and Figure 23.

2.20 The new reporting systems can involve both Postcomm and Postwatch in very detailed monitoring of Royal Mail's performance at local level. **Figure 13** shows a recent example of the workings of the system.

Incentives on Royal Mail

2.21 A performance system is strengthened if it incorporates some form of financial incentive.²⁵ The performance regime put in place by Postcomm has automatic revenue adjustments and compensation payments if Royal Mail misses its targets. Postcomm can also investigate and impose a financial penalty on Royal Mail in addition to the revenue adjustments if it believes this is appropriate.

Revenue adjustments and compensation

2.22 If Royal Mail falls below its target on any non bulk mail product Postcomm can reduce Royal Mail's revenue in the following year. This mechanism is called a 'C' factor. The maximum revenue adjustment is 0.9 per cent and this maximum is due only if performance is 5 per cent below target. Bulk mail is excluded as it is covered by a separate scheme which compensates consumers up to a maximum of 5 per cent of revenue for targets missed by at least one per cent.²⁶

13 Delivery Failures at Haslemere

In May 2005 Postcomm and Postwatch were notified by Royal Mail's reporting systems of persistent failures to carry out whole or part walks (delivery rounds) in Haslemere. Royal Mail stated that the failings were largely due to an inability to attract and keep staff in an area of the country with high living costs. At Postcomm's request, Royal Mail produced a report in August on progress on recruitment issues across the Twickenham/Kingston/Guildford area. Since the office was reviewed by Postcomm there have been 16 minor incidents, the last of which occurred in December 2005. These incidents were failures to complete part of a delivery and were below the trigger levels for reporting to Postcomm.

Source: National Audit Office

2.23 We evaluated the 'C' factor against the Better Regulation Commission's principles of good regulation²⁷ (see paragraph 1.21). We found that the concept of a 'C' factor meets these principles.

- **Targeted:** revenue adjustments are targeted on underperformance.
- **Proportionate:** the adjustments increase as the shortfall in performance increases.
- **Accountable:** the system has been subject to scrutiny through the consultation process.
- **Consistency:** adjustments are calculated automatically and therefore consistent over time.
- **Transparent:** the predictability of the system makes it transparent.

2.24 There is, however, room for dispute over the *level* of the 'C' factor. Postcomm and Postwatch consider that the 'C' factor is not currently high enough. In 2003-04 Royal Mail missed all its targets, resulting in a revenue adjustment of £17 million, Bulk Mail compensation of £43 million and retail compensation of £0.5 million. Research by MORI also showed that all types of user place greater monetary value on Royal Mail's performance than a 0.9 per cent 'C' factor. Royal Mail has told us, however, that increasing the level of the 'C' factor would create very significant commercial risks, since a larger proportion of its annual profit would be at risk.

Financial penalties

2.25 If Royal Mail fails to meet a service quality target Postcomm can carry out an investigation to establish whether Royal Mail has used "all reasonable endeavours". Postcomm then decides whether to impose a financial penalty and gives Royal Mail not less than 21 days to make representations. Any penalties are paid to the Treasury. Royal Mail may also make a case to Postcomm for "force majeure" and request that the affected performance is excluded from Royal Mail's performance figures if it believes incidents outside of its control have harmed its performance. For example, Royal Mail recently made a 'force majeure' request following a serious fire that closed the East London Mail Centre.

25 National Audit Office: *Opening the Post: Postcomm and Postal Services – the risks and opportunities*, HC521 Session 2001-02, 24 January 2002 paragraph 3.26.

26 The bulk mail compensation scheme was subject to a judicial review in December 2005. The review found that Postcomm had not interpreted the rules of the scheme correctly. Royal Mail have appealed against the decision, which relates to £38 million of compensation payments.

27 Better Regulation Task Force, *Principles of Good Regulation*, 2003.

2.26 “All reasonable endeavours” is a difficult test. There is a lack of clarity as to what the term²⁸ means and whether it has been satisfied: for example, it is unclear how much Royal Mail should spend on remedial action before it meets the test. This, combined with a lack of agreement over the meaning of “force majeure”, means that Postcomm’s investigations have been administratively burdensome to Royal Mail, Postwatch and Postcomm itself.

2.27 In 2003-04, Royal Mail missed all its targets (**Figure 14**). Although Postcomm eventually decided not to fine Royal Mail, the decision making process took longer than the permitted time of 12 months from the service failure. Royal Mail could have therefore claimed that Postcomm had been ‘timed out’ and any decision may have then been unenforceable. A flow diagram showing the process for financial penalties is at **Figure 15 overleaf**. Most recently, in February 2006, Postcomm announced its intention to fine Royal Mail £13.8 million for three breaches of its licence. Of this, £271,000 was for poor quality of service at Postcode area level, with the remainder being for lost mail (£11.38 million) and breaches in allowing competitors access to its network (£2.16 million). Royal Mail is appealing against these penalties.

Royal Mail’s performance

2.28 Postcomm has to balance incentives to Royal Mail to ensure quality of service with the need for Royal Mail to finance its functions. When the first licence was granted Royal Mail was heavily loss making, with a gross loss of £318 million in 2001-02.

14 Postcomm’s decision not to fine Royal Mail for 2003-04 performance

Royal Mail missed all its 2003-04 quality of service targets. On 27 May 2004 Postcomm launched an investigation and in March 2005 Postcomm announced its decision not to impose a fine.

Royal Mail claimed it missed its targets due to bedding down of its new nationwide transport arrangements, and unofficial industrial action. Postcomm reviewed Royal Mail’s argument and decided not to fine as it believed the circumstances were a one-off occurrence. The decision also reflected Royal Mail’s efforts to restore service quality, the £43 million compensation paid to customers, revenue adjustments of £17 million and Royal Mail’s undertakings to Postcomm to prioritise and protect quality of service in future. Improved compensation arrangements would also be available. Postcomm did not believe that in these circumstances imposing a fine would further its duty to customers.

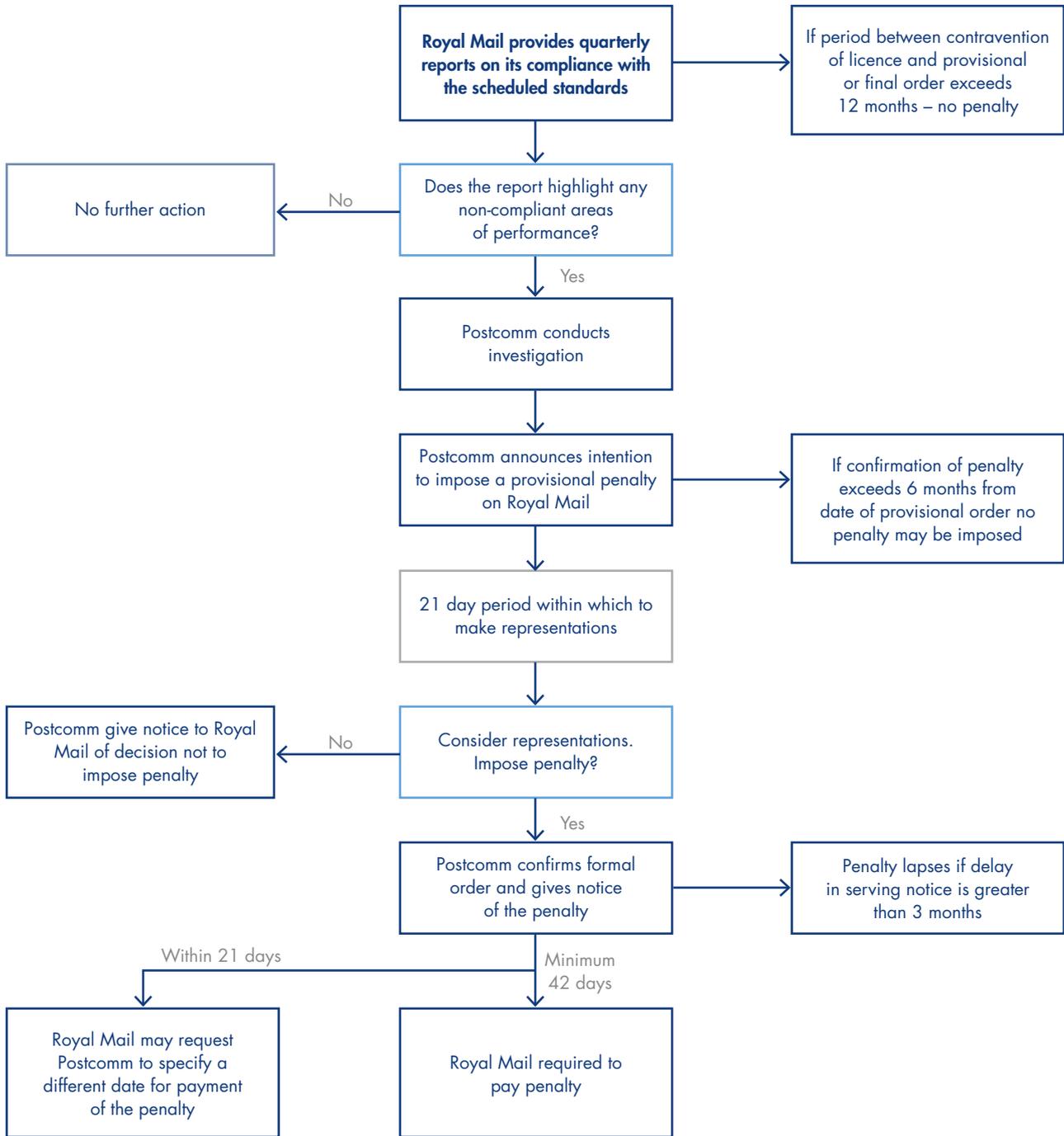
Source: Postcomm: Royal Mail’s Quality of Service Performance. Report on Investigations by Postcomm

2.29 During the 2001 and 2003 price control periods Royal Mail in consultation with Postcomm made a series of major changes to its operations to improve its financial position. These included abolishing the second daily delivery, delivering later in the day, a voluntary redundancy programme, reorganising its transport arrangements, and introducing an incentive scheme for all staff. As a result, Royal Mail’s financial position improved and it achieved a profit of £537 million in 2004-05 (**Figure 16 on page 23**).

28 Traditionally the use of the legal term “all reasonable endeavours” has been viewed as a mid-point between “best endeavours” and “reasonable endeavours” and probably requires more than just minimal or no effort at all.

15 Postcomm’s process for financial penalties

Imposition of Financial Penalties



Source: National Audit Office

Performance against quality of service targets

2.30 Royal Mail's performance against its targets has recently started improving. In 2003-04 it missed all its targets, in 2004-05 it met four, and in the first half of 2005-06 performance was above target for all but four products. Royal Mail's underlying performance in meeting its transit time obligations has also been improving since regulation was introduced. Performance is higher in 2004-05 than in 2001-02 for all its products except for 2nd class response, and special delivery.

16 Gross Profit/(Loss) of Royal Mail Group plc

2004-05	2003-04	2002-03	2001-02
£537m	£220m	(£197m)	(£318m)

Source: Royal Mail Annual Reports

2.31 Royal Mail's underlying performance is given in **Figure 17** (with missed targets shown in bold). In 2001-02 and 2002-03 Royal Mail's targets covered performance in only the last two months of the year. Comparative figures for the full year are therefore given in brackets in Figure 17 for those periods.

2.32 There are a number of consistently poorly performing postcode areas, with London North West, London West Central and London South East appearing in the bottom 20 postcode areas for four consecutive years (**Figures 18 and 19 overleaf**). As a result, consumers in these areas have experienced poor performance and not benefited from improvements at the national level.

17 Royal Mail's performance against its Quality of Service targets since 2001-02

Product	2005-06 (half year)		2004-05		2003-04		2002-03		2001-02	
	Target	Performance	Target	Performance	Target	Performance	Target	Performance	Target	Performance
1st Class Mail	93.0	93.9	92.5	91.4	92.5	90.1	92.5	91.7 (91.8)	92.1	91.6 (89.9)
2nd Class Mail	98.5	98.7	98.5	98.5	98.5	97.8	98.5	98.2 (98.6)	98.5	98.9 (98.3)
Mailsort 1	91.5	94.1	91.0	91.1	91.0	89.2	93.0	94.5 (90.8)	92.1	94.4 (90.0)
Mailsort 2	97.5	98.6	97.5	97.3	97.5	95.7	98.5	97.8 (96.5)	97.6	97.7 (95.5)
Mailsort 3	97.5	99.5	97.5	98.5	97.5	97.4	98.5	99.1 (98.0)	98.5	99.6 (97.9)
Presstream 1	91.0	94.0	90.5	90.4	90.5	88.1	92.5	91.2 (90.8)	91.0	93.0 (89.2)
Presstream 2	97.5	98.2	97.5	97.5	97.5	95.1	98.5	97.8 (96.8)	97.6	99.1 (96.2)
1st Class PPI	91.1	92.1	90.6	87.5	90.6	83.5	92.5	86.3 (83.9)	90.0	81.7 (81.4)
2nd Class PPI	97.4	97.3	97.4	96.0	97.4	94.6	98.5	97.5 (96.9)	97.0	97.1 (94.4)
1st Class Response	90.8	89.3	90.3	80.5	90.3	81.7	92.5	86.8 (80.3)	90.5	81.6 (78.1)
2nd Class Response	97.5	94.6	97.5	93.4	97.5	92.2	98.5	95.6 (93.7)	97.0	95.2 (93.7)
Special Delivery	99.0	98.9	99.0	98.0	99.0	97.9	99.0	98.8 (98.6)	99.0	99.1 (98.5)
Standard Parcels	90.0	92.0	90.0	89.7	90.0	88.9	90.0	91.6 (88.5)	88.0	81.0 (81.6)

Source: National Audit Office

NOTES

Missed targets are in bold text.

The targets for 2001-02 and 2002-03 were for February and March only in line with Royal Mail's previous practice. Postcomm had annual targets put in place thereafter. Figures for performance over the full 12 months are given in brackets for 2001-02 and 2002-03.

Standard Parcels was transferred from Parcelforce to the mails business in 2002-03.

18 Royal Mail postcode area performance

Bottom 20 Mail Centres from financial year 2001-02 onwards

	2004-05	2003-04	2002-03	2001-02		2004-05	2003-04	2002-03	2001-02
Appears in all 4 years					Appears in 1 year only				
London North West	90.2	85.6	89.7	85.7	Bath	90.2	–	–	–
London South East	90.2	84.4	89.4	86.3	Blackburn & Burnley	–	–	90.3	–
London West Central	89.0	85.6	88.2	85.5	Chester & Deeside	–	–	–	87.1
Appears in 3 out of 4 years					Dudley	–	–	89.5	–
Chelmsford	–	85.8	89.3	87.3	Enfield	–	–	–	86.5
London East	86.5	87.5	–	83.2	Exeter	90.1	–	–	–
London North	90.2	86.4	–	86.0	Falkirk	89.7	–	–	–
London South West	–	82.1	87.7	86.4	Glasgow	88.8	–	–	–
London West	–	84.6	90.4	84.8	Ipswich	–	–	90.0	–
Norwich	88.8	87.1	90.1	–	Liverpool	89.8	–	–	–
Oxford	85.7	87.5	–	87.2	Luton	–	–	–	87.6
Southend-on-Sea	–	87.9	88.1	86.4	Milton Keynes	–	–	90.2	–
Uxbridge	89.4	87.3	–	86.2	Newport	89.7	–	–	–
Appears in 2 out of 4 years					Northern Ireland	–	–	90.3	–
Colchester	–	87.8	89.0	–	Peterborough	89.2	–	–	–
Dartford	89.7	85.3	–	–	Plymouth	–	–	90.3	–
Harrow	–	84.8	–	86.4	Portsmouth	–	–	89.8	–
Ilford	–	86.4	–	85.9	Salisbury	–	–	90.0	–
Northampton	90.0	74.3	–	–	Slough	–	–	–	86.8
Romford	–	87.1	–	87.1	Teesside	90.1	–	–	–
Stoke-on-Trent	90.1	87.5	–	–	Telford	–	–	90.1	–
Torquay	89.7	88.0	–	–	Walsall	–	–	89.7	–
City of London	–	–	90.4	87.6	Watford	–	–	–	87.8

Source: Royal Mail

NOTE

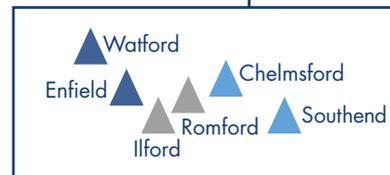
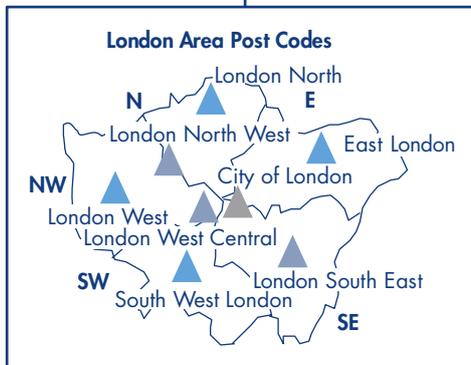
Performance figures are given for only those years where the postcode was in the bottom 20.

19 Royal Mail postcode area performance by geography



Key

- ▲ Appears in 1 out of 4 years
- ▲ Appears in 2 out of 4 years
- ▲ Appears in 3 out of 4 years
- ▲ Appears in all 4 years



Source: National Audit Office

PART THREE

The proposed performance regime



This section of the report evaluates the performance regime proposed by Postcomm in December 2005 for the 2006 price control in terms of consumer needs and protection. It shows that:

- Postcomm proposed new targets based on consumer research;
- Postcomm proposed stronger financial incentive arrangements;
- there are still areas of implementing the regime where improvements are required; and
- the long term success of the regime will depend on its ability to cope with a rapidly changing postal market.

A more consumer focussed performance measurement system

3.1 Postcomm proposed a revised regime which establishes a stronger link between quality of service, the universal service and consumer expectations. This reflects the findings of research jointly commissioned by Postcomm, Postwatch and Royal Mail in 2004, described in more detail in Appendix 5.

The proposed targets

3.2 Postcomm proposed a new set of targets which broaden the scope of the performance measurement system and take account of the consumer research. The proposal reduced the overall number of targets from 15 to 12. **Figure 20 overleaf** details the proposed targets.

Changes and reduction in number of the existing targets

3.3 The proposals group most of the existing targets into 'baskets'. So for example all bulk first class mail is now covered by one target where previously there were four (Mailsort 1, Presstream 1, 1st class PPI, and 1st class response services). Postcomm has proposed to remove the target for the area of special delivery (next day) that relates to large business users.²⁹ This is because Postcomm is satisfied that competition is developing and protects customers' interests in this area.

3.4 The reduction in the number of targets removes problems associated with having multiple targets relying on the same process (paragraphs 2.13 – 2.15). Postcomm has sensibly chosen to group those targets that are most closely correlated into the same basket. For example all the first class products that move through similar parts of the Royal Mail system have been grouped together.

3.5 Although the products within the separate baskets are correlated, there is a risk that exceptional circumstances may affect only one of the products within a basket. This could result in poor performance of that product not triggering any of the financial incentive arrangements. For this reason Postwatch does not support the move to grouping targets into baskets. Postcomm has proposed retaining its right to investigate should any individual product fall more than 5 per cent below the target level regardless of the performance of the basket.

²⁹ Special Delivery products posted at post offices will remain in the price control.

20 Postcomm’s proposed targets

Target	Status	Associated financial incentives	Performance band	Stakeholders view	Evaluation
Stamped and metered 1st class	All 1st class mail products (except bulk mail)	Revenue adjustment and retail compensation	If Royal Mail’s performance is more than 1% below the target users receive compensation ¹ . If performance is more than 5% below the target Royal Mail becomes liable for fines unless it can prove it has used all reasonable endeavours to perform to the highest possible level in the circumstances. Between 1% and 5% Postcom may investigate.	Royal Mail and Postwatch both support a move away from the existing pass/fail criteria towards a structure based on performance bands. Postwatch do not support the move to baskets.	Grouping the targets into baskets is desirable. Revenue adjustment penalises the service provider but does not compensate the consumer.
Stamped and metered 2nd class	All 2nd class mail products (except bulk mail)	Revenue adjustment and retail compensation			
Standard parcels	Standard parcels only	Bulk mail compensation scheme			
1st class bulk mail	All 1st class bulk mail	Bulk mail compensation scheme			Compensation to the customer provides a direct link to performance shortfalls.
2nd class bulk mail	All 2nd class bulk mail	Bulk mail compensation scheme			
3rd class bulk mail	All 3rd class bulk mail	Bulk mail compensation scheme			
Special delivery (next day)	Product target	Compensation direct to customer			
Postcode area targets	Product target	Revenue adjustment			Revenue adjustment penalises the service provider but does not compensate the consumer
Outgoing international mail	New target	Revenue adjustment	Postwatch has expressed concern over this target.	Royal Mail only has control up until the point of departure. Revenue adjustment penalises the service provider but does not compensate the consumer	
Correct delivery	New target	Revenue adjustment	Revenue adjustment if performance is more than 0.1% below target. If performance is more than 0.5% below the target Postcomm may investigate.	Consumer research highlighted that these areas are important to consumers.	New targets focus on aspects of quality that are important to the consumer.
Daily collections completed	New target	Revenue adjustment			
Daily deliveries completed	New target	Revenue adjustment			

Source: National Audit Office

NOTE

1 Except for special delivery (next day) where compensation is done on a case by case basis.

New targets

3.6 Postcomm has proposed four new targets:

- **Correct delivery:** Postcomm has proposed a correct delivery target for the 2006 Price Control. The target covers mail that has been delivered to both the wrong address and the wrong person. Postcomm has not proposed a target for mail that has been lost completely. Lost mail is very difficult to measure with any statistical accuracy. Postcomm has instead proposed that this issue will be addressed through Royal Mail's compensation schemes.
- **Collection and delivery (two targets):** Postcomm has proposed targets for the percentage of delivery routes completed and the percentage of collections made each day. Targets are not proposed for collection and delivery times. But Postcomm has proposed that Royal Mail publishes the percentage of deliveries completed by their target delivery time each day, and the percentage of collections made at or after the final stated collection time.
- **Outgoing international mail:** Postcomm proposes that outgoing European international mail is covered by a standard in line with Royal Mail's obligations under the first EU Postal Services directive.

3.7 In the case of collections and deliveries, Royal Mail has stated that it needs flexibility in collection and delivery times in order to run the business efficiently. The timing of collections and deliveries has a high impact on Royal Mail's costs, and the optimum collection and delivery profiles may alter with future technological investment. These issues were central to Royal Mail's case in moving to a later single daily delivery (paragraph 2.29).

3.8 In these circumstances a level of consumer protection is needed, but any regulatory response needs to be proportionate to the risk of service failure, the burden placed on Royal Mail, and Postcomm's duty to balance consumer needs with Royal Mail's financial viability. An appropriate response would involve putting in place data collection, monitoring and reporting systems. Postcomm has proposed that Royal Mail publishes the percentage of deliveries completed by their stated delivery time each day and the percentage of collections made at or after the final stated collection time. Should the system identify any shortcomings

in performance Postcomm can then consider a hierarchy of options for remedial arrangements. These would depend on the severity of the problem and range from:

- discussing the nature of the problem with Royal Mail and agreeing a voluntary undertaking to remedy the problem; to
- putting in place prescriptive incentives which would require Royal Mail's agreement and a change in the licence, for example targets and financial penalties.

In deciding what arrangements are necessary Postcomm should apply the principles of Better Regulation. In this context this means starting with a presumption in favour of the least intrusive method of regulation.

Expected performance levels

3.9 As well as setting the framework for targets, Postcomm also needs to set the *level* – that is the percentage targets that Royal Mail must meet. Postcomm's proposals retain the performance percentages from 2005-06 for the period 2006-07. So, for example, the targets for 1st and 2nd class stamped and metered mail have been held at 93.0 per cent and 98.5 per cent respectively. Postcomm believes that Royal Mail has not yet demonstrated that it can consistently meet the levels set.

3.10 Setting target levels is not straightforward. Royal Mail has recently produced research on consumer willingness to pay for a higher (or lower) quality of service, but Postcomm lacks information on the cost to Royal Mail of providing that higher quality.

- **Willingness to pay:** Consumers' willingness to pay for a higher quality of service is a crucial element in evaluating changes to a performance regime. In September 2005 Royal Mail published research covering how much consumers would be prepared to pay for increases in quality of service levels for Royal Mail's main products.
- **Costs to Royal Mail of changes in service level:** Royal Mail does not currently have sufficient costing information to be able to say how much a percentage increase or decrease in its delivery targets will cost. This means that in turn Postcomm cannot be sure of the impact that changing the level of targets will have on Royal Mail's finances.

Defining the universal service further

3.11 Postcomm has also been working towards a more comprehensive and consumer orientated definition of the universal service. In April 2003, Postcomm began a two year review to find out what kinds of postal services consumers think should be provided as part of the universal service in a fully open postal market, and which of Royal Mail's products this should cover. The results are due to be implemented alongside Royal Mail's price control in April 2006. The review of the universal service did not cover detailed quality of service issues as Postcomm believes that these should be set out in the licence and reconsidered at each price control rather than stated in the universal service definition.

Greater clarity in implementation

3.12 Postcomm is proposing a clearer relationship between Royal Mail's performance and the remedial actions it will take; stronger financial incentives on Royal Mail to meet its quality of service targets; and the retention of its own ability to investigate serious shortfalls in Royal Mail's performance.

Performance Bands

3.13 Postcomm, Postwatch and Royal Mail have all agreed to move away from the existing specific percentage targets to a structure based on "performance bands". These bands would represent different degrees of failure to meet targets, with for example missing a target by 3 per cent being treated differently to missing it by a marginal degree (0.1 per cent). Postcomm believes this approach to reporting quality of service will better indicate how well Royal Mail's performance has met consumers' needs.

3.14 If banding is to be successful the boundaries between bands will need to reflect trigger points in the performance regime. These will clarify the level of performance shortfalls which trigger the payment of compensation to customers, adjustments to Royal Mail's revenue, and Postcomm's consideration of possible enforcement action including financial penalties. In our view such an approach will comply with the principles of Better Regulation.

Increased C factor

3.15 If Royal Mail misses its service targets for non-bulk mail, the 'C' factor currently reduces Royal Mail's allowed revenue by up to 0.9 per cent in the following year³⁰, a figure that Postcomm and Postwatch believe is too low (see paragraphs 2.22 to 2.24). Postcomm proposed increasing the 'C' factor from 0.9 per cent to 5 per cent. The current bulk mail compensation scheme will continue: Royal Mail can forego up to 5 per cent of revenue for quality of service failures for the relevant products. Royal Mail estimates that the maximum revenue adjustment if it missed all its targets by 5 per cent would be some £330 million, about the same amount as its allowable profit and compensation payment.³¹ It therefore considers that the 'C' factor of 5 per cent is excessively punitive. **Figure 21** gives more details on the proposed revenue adjustments.

3.16 The purpose of increasing the 'C' factor is to bring a greater degree of regulatory certainty and clarity both to Royal Mail and to its current and future competitors. The success of this is dependent on Postcomm and Postwatch committing not to investigate in the areas where the 'C' factor applies. Its success also depends on the 'C' factor being proportionate. In these circumstances this means that it should not be so severe as to endanger the viability of Royal Mail.

3.17 Postcomm intends to use the 'C' factor to make revenue incentives more automatic and reduce complexity. In particular, it can limit the extent to which Postcomm and Postwatch get involved in carrying out detailed investigations into underperformance. Both parties have told us that it will be unlikely to take enforcement action unless Royal Mail's performance is more than 5 per cent below the target (i.e. the maximum 'C' factor adjustment), in the absence of exceptional circumstances.³² Postcomm has also proposed retaining its discretion to consider a specific application for suspension of the 'C' factor.

³⁰ The "C" factor is an automatic increase in revenue allowed under the price control to reflect good quality of service performance on non-bulk mail products.

³¹ In Royal Mail's response to Postcomm's proposals, Royal Mail calculates that the maximum value of revenue adjustments and compensation will be about twice its allowable profit after including funding for its pension deficit.

³² Postcomm 2006 *Royal Mail Price and Service Quality Review – Initial Proposals*, 1 June 2005, p159.

21 Proposed Revenue adjustments under the 2006 Price Control

Type	Applies to	Description	Stakeholder views	Evaluation	Comment
Increased 'C' factor	Non bulk mail	If Royal Mail misses its service targets, the 'C' factor reduces Royal Mail's allowed revenue in the following year. The proposal is to increase the 'C' factor from 0.9 per cent of revenue products to 5 per cent.	Postwatch supports the increase. Royal Mail is concerned about the size of the potential financial effect.	The change aligns the 'C' factor with the bulk mail compensation scheme in terms of revenue adjustments for service failure. This is in line with the Better Regulation Commission's principles of good regulation i.e. consistency, transparency and accountability (justifying actions and decisions).	Royal Mail could lose some £330m per year from these financial incentives if it misses all its quality of service targets by 5 per cent. ¹
The bulk mail compensation scheme	Bulk mail	The current bulk mail compensation scheme will continue: Royal Mail can forego up to 5 per cent of revenue for quality of service failures for the relevant products.		Success is dependent on Postwatch and Postcomm withdrawing from detailed investigations in the area covered by the 'C' factor, and the level not having a detrimental effect on Royal Mail's viability.	

Source: National Audit Office

NOTE

¹ Postcomm 2006 Royal Mail Price and Service Quality Review – Initial Proposals, 1 June 2005, p159. The current requirement is for Royal Mail to use all reasonable endeavours to meet its targets..

The framework for investigations

3.18 The proposed price control retains Postcomm's ability to investigate if Royal Mail falls short of its targets. However, as noted in Part 2, when Postcomm does investigate it places a burden on all parties and there is still scope to reduce the regulatory burden. Postcomm could achieve this by developing a more detailed investigative framework. This would describe the likely circumstances in which Postcomm would investigate, the range of information it would wish to review, and a tariff of responses that may be applied to the more frequently occurring shortfalls. This should be set against the need to retain some discretion over the need to respond to exceptional circumstances.

3.19 Producing such guidance and developing a framework would have the following benefits:

- Decisions could be made at an appropriate level: For example, the framework would tell Postcomm whether the services failures are significant or not, thereby giving an indication of the degree of effort merited by the case. Royal Mail could find it easier to understand the strength of the case against them.
- Decisions could be made more quickly: Postcomm could decide whether to continue with the investigation or end it. Royal Mail could conclude whether it was worthwhile to continue fighting the case. This could have an impact on the costs of the investigations.

Changing the “all reasonable endeavours” duty

3.20 Under Postcomm’s proposals Royal Mail would have to demonstrate to Postcomm that it had used “all reasonable endeavours” to provide its services “to the highest level possible in the circumstances”.³³ If Royal Mail fails the targets by more than 5 per cent (0.5 per cent for correct delivery and daily collections and deliveries completed) there is a presumption that this requirement has been breached. There is a risk, however, that the new arrangements will be just as costly and time consuming to investigate.

The future of the proposed regime

3.21 The postal market is currently going through some of the biggest changes in its 350 year history. Royal Mail now has fourteen competitors, including subsidiaries of the dominant German and Dutch postal operators. These companies have introduced new mail services to the market. Deutsche Post, through its purchase of Exel, has acquired a parcels business with a national distribution network. It could potentially mount a substantial challenge to Royal Mail in the business mail market. Royal Mail is responding to competitive pressures by introducing new pricing systems and products.

3.22 The regime’s long term success will depend on its adaptability to changes in the market and the possibility of increased competition. As described in parts 1 and 2, the performance regime is a proxy for the effects of competition, intended to incentivise Royal Mail to deliver customer focussed quality services. Despite its statutory monopoly disappearing on 1 January 2006, Royal Mail is still in a dominant position in its former reserved area. Although the UK postal market will be fully liberalised, it may take time for effective competition to appear. As competition does develop Postcomm will be able to withdraw from detailed regulation.

³³ Postcomm 2006 *Royal Mail Price and Service Quality Review – Initial Proposals*, 1 June 2005, p159. The current requirement is for Royal Mail to use all reasonable endeavours to meet its targets.

GLOSSARY

Access pricing	The price another mail operator pays to Royal Mail to deliver postal packets from the Inward Mail Centre to the customers' address.
Bulk mail	Mail sent by large consumers (e.g. businesses) which may be pre-sorted to obtain a cheaper rate from Royal Mail.
Bulk mail compensation	A scheme to compensate consumers for poor performance on bulk mail.
Direct mail	A communication consisting solely of advertising, marketing or publicity material and comprising an identical message except for the addressee's name and address, and which is sent to a significant number of addresses.
Licensed area	The area within which postal operators require a licence from Postcomm to provide postal services. The current licensed area is below 350 grams and £1.
Mailsort 1, 2 and 3	Three Royal Mail products used by bulk mailers. The bulk mailers presort their outgoing mail before it is collected by Royal Mail. The three different products correspond to the timeframe for delivery.
Postal Services Act 2000	The legislation that transposed the first EU Postal Services Directive into UK law. It created the postal regulator Postcomm, and the postal consumer body Postwatch.
Postal Services Directive 97/67/EC	The first EU Directive which aimed to implement the Single Market for postal services, by opening up the sector to competition in a gradual and controlled way, within a regulatory framework which assures a universal service.
Postcomm	The Postal Services Commission (the industry regulator).
Postwatch	The Consumer Council for Postal Services.
Presstream	A Royal Mail delivery service for customers who regularly post magazines, newspapers or journals in bulk within the UK. The charge reflects periodicity, volume and destination.
Pricing in Proportion	Royal Mail's decision to move away from prices based only on weight to a system that also takes into account the size of items being posted.
Printed Postage Impression or PPI	A Royal Mail product for standard tariff mail sent on account. It uses pre-printed envelopes in order to save time and/or money for large campaigns.
Receiving consumer	The addressee or, in the case of misdelivered mail, the person or organisation at the address to which the item of mail has been delivered.

Recorded delivery	A Royal Mail service for customers wanting their items of mail to be signed for on delivery. The sender gets a receipt, which proves the item has been posted. There is no guarantee of next working day delivery. For items up to 1kilogram, the service costs 66 pence on top of the normal 1st Class or 2nd Class postage. Maximum compensation is £30, for loss or damage.
Reserved area	A statutory monopoly over part of the postal market granted to Royal Mail in return for providing the universal service. It was defined in terms of price and weight. It was reduced in size and eventually abolished in January 2006.
Sending consumer	The originator of a communication. Normally the one who pays for the postal service.
The Shareholder Executive	The Executive manages the Government's shareholding in Royal Mail. It is sponsored by the Department of Trade and Industry.
Special delivery	A Royal Mail service intended for customers sending urgent and/or valuable items. The service guarantees next working day delivery to most destinations in the UK either by 9am or 1pm with a money back guarantee. A signature is obtained on delivery. Compensation is offered where loss and/or damage occurs.
Standard Parcel	Royal Mail's second class (3 working day delivery) parcel which is delivered by the Mail's business. Royal Mail's Parcelforce business offers other parcel products.
Universal Service/Universal postal service	A level of service that must be provided to all consumers as specified by the Postal Services Act 2000. The universal service is the term used in the EU Postal Directive. The Act refers to the universal postal service. It is also described as the Universal Service Obligation within the mail industry.
Walk	A postman or postwoman's delivery round.

APPENDIX 1

Audit criteria and methodology

Audit criteria

1 Our value for money assessment of the quality of service regime is based on the extent to which it protects consumers and does not over burden Royal Mail. Our assessment of consumer protections is underpinned by the best practice identified in a recent joint National Audit Office report on performance measurement³⁴ (see paragraphs 2-5). Our evaluation of the implementation of regulation is similarly underpinned by the Better Regulation Commission's five principles of good regulation (see paragraphs 6-8).

The principles of a performance regime

2 The purpose of a performance regime is to "evaluate how well organisations are managed and the value they deliver for customers and other stakeholders".³⁵ The National Audit Office jointly produced a best practice guide for departments when establishing performance measurement systems for their agencies. The same principles of good practice also apply to a performance regime for a regulated entity.

- 3 The guide established two principles:
- An *overarching* strategic objective is vital. The performance measurement system sits underneath and supports this objective. The measures should align with strategic objectives and quantify the required level of performance to be achieved. In addition a robust method of data collection should capture timely and accurate results. Evaluation of the information provided by the system may then be used to re-evaluate the overarching strategy.
 - A performance regime should reflect the *user's service requirements* and be supported by financial incentives on the service provider. These incentives should be as automatic as possible to introduce clarity and certainty.
- 4 The overarching objective of a performance measurement system for post should be to demonstrate compliance with the universal postal service. A set of measures based on this objective would allow targets to be negotiated and agreed for each of its attributes. This would then reflect the service requirements of consumers.
- 5 The principles set out in the National Audit Office's best practice guide underpin our evaluation of the performance regime for Postcomm. In particular, the paragraphs at 2.4 to 2.20 and 3.1 to 3.10 describe the results of the analysis.

34 HM Treasury, Cabinet Office, National Audit Office, Audit Commission, Office for National Statistics, *Choosing the Right Fabric, A Framework for Performance Information*.

35 Moullin, M. *Defining Performance Measurement*, Performance Measurement Association Volume 2 Issue 2 2003 p4.

The principles for implementation

6 In the context of regulation the implementation of any performance regime should also meet generally accepted principles of good regulation.³⁶ These are summarised by the Better Regulation Commission's five principles.

- **Proportionate:** Regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised.
- **Accountable:** Regulators must be able to justify decisions, and be subject to public scrutiny.
- **Consistent:** Government rules and standards must be joined up and implemented fairly.
- **Transparent:** Regulators should be open, and keep regulations simple and user-friendly.
- **Targeted:** Regulation should be focussed on the problem, and minimise side effects.

7 In the context of implementing its performance regime for post, Postcomm should therefore seek to minimise the regulatory burden and intrusiveness of the regime on Royal Mail, and bring regulatory certainty to its decision making where possible.

8 These principles underpin our evaluation of Postcomm's implementation of the quality of service regime. Paragraphs 2.21 to 2.27 and 3.12 to 3.20 describe the results of the evaluation with regard to better regulation.

Methodology

9 The key elements of our study methodology designed to gather and analyse the evidence are set out below.

Survey of consumer experiences of post (Appendix 2)

10 Consumer protection is a fundamental element of value for money in postal service regulation. We therefore analysed domestic consumers' experiences of postal services through an omnibus survey of 2000 adults. The survey was similar to one that we carried out jointly with Postcomm and Postwatch in 2001.³⁷ It was carried out using the same sampling criteria as the first survey, a similar set of questions, and over the same week in the year. We were therefore able to analyse changes in domestic consumer experiences since 2001. More detail on methodology and results is at Appendix 2.

Correlations (Appendix 3)

11 We correlated Royal Mail's quarterly performance against its quality of service targets for the period 1995-2005. This analysis was designed to examine the strength of relationship between the performances of the products in the current regime; and help us to comment on the proposed new regime (Appendix 3).

³⁶ Better Regulation Task Force, *Principles of Good Regulation*, 2003.

³⁷ In 2002 the NAO report *Opening the Post* gave findings of our 2001 survey of consumers' knowledge and perceptions of postal services.

Benchmarking (Appendix 4)

12 We benchmarked the UK postal service against postal regimes abroad. In particular:

- Types of Quality of Service targets
- Alternatives to targets
- Performance against targets

13 The international benchmarking exercise was of limited value. As European member States are free to decide their own level of quality and corresponding price for postal services there is little comparability between the performance regimes. Some international benchmarking data on targets, performance and price is given at Appendix 4.

14 We looked at UK comparators (other regulators and Government bodies). In particular:

- Types of Quality of Service targets
- Alternatives to targets

Analysis of existing research and key documents (Appendix 5)

15 In addition to commissioning our own research, we examined key documents as well as research commissioned by Postcomm, Postwatch and other stakeholders. The most important research documents examined are set out in Appendix 5.

Work shadowing

16 We carried out work shadowing with a selection of Royal Mail's operational staff at Kingston and Bow Delivery Offices, the East London Mail Centre and the Contact Centre at Dearne. The work shadowing was designed around a) Royal Mail's delivery process from posting to delivery, and b) the principal point of contact between Royal Mail and customers who have complaints. The study team spent half a day at the East London Mail centre following Royal Mail's system from post box through to outward processing and dispatch. We spent one day at both Kingston and Bow delivery offices following the mail through the delivery process, from arrival at the delivery office to posting through domestic and commercial letterboxes. We also spent a day at Dearne following a series of complaints through the centre. The work shadowing gave us detailed insights into Royal Mail's operating environment and the way in which quality of service issues are dealt with at an operational level.

Stakeholder consultation

17 We met the management and staff of Postcomm, Postwatch, Royal Mail and the DTI Shareholder Executive. We also attended Postcomm and Postwatch consultation meetings and conferences and reviewed the consultation documents produced as part of the price control. We also held semi structured interviews with the following mail operators: TNT, DHL, UK Mail and SMS. These operators were chosen as they represent a cross section of Royal Mail's main competitors in the UK. We also obtained the views on quality of service of business customers who were using the services of other mail operators (Lloyds TSB and TSO) and liaised with the Office of Government Commerce's Postal Services Evaluation Team.

APPENDIX 2

Results of the National Audit Office survey of domestic users of postal services

1 In 2001 we conducted a joint survey with Postcomm and Postwatch to obtain the views and experiences of the general public on postal services in the United Kingdom. We commissioned Capibus (Ipsos-RSL Ltd) to undertake the survey using their weekly omnibus survey of Great Britain and a representative sample of citizens in Northern Ireland. The results were then merged to provide a representative sample across the UK of 2,065 adults aged 15 years and over. The survey was conducted by interview between 27 July and 2 August 2001. Because Royal Mail is a significant employer, we identified and then excluded those adults who had ever worked in a post office, for the Royal Mail or for Parcelforce Worldwide. This reduced the number of adults taking part in the main part of the survey to 1,931.

2 In 2005 the NAO repeated the survey; commissioning the same survey company (and the same survey managers) to carry out the survey in the same way and in the same week as 2001³⁸. The results were then merged to provide a representative sample across the UK of 2,054 adults aged 15 years and over. The survey was conducted by interview between 29 July and 4 August 2005. Similarly we identified and then excluded those adults who had ever worked in a post office, for the Royal Mail or for Parcelforce Worldwide. This reduced the number of adults taking part in the main part of the survey to 1,877. This Appendix sets out the main findings from the 2005 survey and compares them with the 2001 survey. Figures for 2001 are given in brackets in the tables below.³⁹

The public are less aware of the prices of standard 1st Class and 2nd Class postage stamps – only a quarter and fifth got the prices right in each case

3 In 2001 about four out of ten respondents knew the precise prices of standard 1st and 2nd Class stamps. In 2005 this had fallen to a quarter and a fifth respectively. People who are older or in higher social grades had a greater awareness of the stamp prices. People with higher incomes had a greater awareness of the price of a 2nd Class stamp but lower awareness of the price of a 1st Class stamp.

What is the price of a 1st class stamp and a 2nd class stamp?

(1st, 27p and 2nd, 19p in 2001, and 30p and 21p respectively in 2005)

By type of area		
	% 1st class	% 2nd class
All	26 (44)	20 (38)

The public think the 1st and 2nd Class postal services provide value for money

4 In 2001 73 per cent of respondents said that the 1st and 2nd Class post provides good or very good value for money. In 2005 69 per cent said that the 1st and 2nd Class post provides good or very good value for money.

³⁸ Capibus took a random location sample, representative of the UK's adult population in terms of region, area, gender, age and working status. It used the Postal Address File, a frequently updated record of addresses recognised by Royal Mail. All interviews for Capibus were carried out in-home using Computer Assisted Personal Interviewing to collect the data. The results were weighted using a rim weighting system that allows for profiles of age, social grade, region and working status within gender.

³⁹ Figures do not always total 100 due to roundings and the exclusions of 'don't knows'.

A 1st Class stamp costs 30 pence and a 2nd Class stamp 21 pence. To what extent do you think each is value or money?

The responses for 1st Class were as follows

	Percentage				
	Very Good VFM	Good VFM	Neither good nor poor VFM	Poor VFM	Very poor VFM
All	18 (21)	51 (52)	18 (15)	8 (9)	3 (2)
By type of area					
Urban	18 (22)	53 (45)	17 (21)	7 (9)	2 (2)
Suburban	17 (18)	41 (57)	19 (14)	7 (9)	3 (1)
Rural	19 (30)	42 (48)	21 (8)	9 (9)	4 (4)
By age					
15-34	18 (22)	48 (56)	22 (13)	7 (7)	2 (1)
35-54	22 (22)	53 (54)	16 (14)	5 (7)	2 (2)
55+	15 (18)	51 (47)	16 (18)	11 (13)	5 (3)
By social grade					
AB	19 (17)	50 (51)	19 (19)	7 (10)	3 (2)
C1	19 (19)	51 (57)	18 (14)	7 (8)	3 (0)
C2	19 (24)	51 (50)	16 (14)	8 (9)	2 (2)
DE	15 (22)	50 (53)	19 (13)	9 (9)	4 (2)
By region					
South	16 (15)	50 (55)	23 (16)	6 (11)	2 (2)
Midland & Wales	18 (23)	49 (47)	18 (16)	10 (10)	2 (3)
North	21 (28)	52 (52)	18 (11)	6 (7)	2 (2)
Scotland	12 (13)	54 (63)	18 (16)	6 (6)	6 (1)
By income					
Low income	13 (22)	51 (49)	22 (16)	7 (10)	5 (3)
Mid income	20 (21)	55 (49)	17 (20)	7 (9)	1 (1)
High income	20 (23)	57 (51)	15 (15)	5 (9)	1 (2)

NOTES

1 In 2001 and 2005 the responses for 2nd Class were very similar to those for 1st class in most cases.

2 Figures do not include 'don't knows'.

More items of mail are received by the public than they send – half send only one item a week, while nearly half receive up to four items

5 In 2001 about half of respondents said that they receive up to four items of mail each week, while a quarter received nine or more items. More mail was received by rural than urban and suburban respondents, while those in the south of England received more than those in the north. Those on higher incomes also received more mail. In 2005 the proportion of respondents that said they received up to four items of mail each week rose to just over half, while those receiving nine or more items fell to a fifth. The proportion of suburban respondents receiving nine or more items increased slightly whereas there was a fall in this category among rural respondents and a fall among urban respondents as well. The decrease in the South had resulted in Midland and Wales receiving the most mail. Those on high incomes continued to receive the most mail although the proportion had declined.

6 In 2001 half of respondents said that they sent only one item a week, while a quarter sent three or more items. The pattern of usage was similar to that for receiving mail, with rural and higher income respondents and those residing in the South of England being the greatest users. By 2005 the proportion of respondents that said they send only one item a week had risen to nearly six out of ten, while those sending three or more items fell to a fifth.

How many items of mail do you personally receive on average each week? Please exclude items of junk mail, newspapers, items of adverts hand-delivered.

	Percentage		
	1-4 items	5-8 items	9 or more items
All	51 (45)	29 (29)	19 (26)
By type of area			
Urban	53 (42)	29 (34)	18 (24)
Suburban	51 (45)	29 (28)	20 (26)
Rural	45 (36)	33 (28)	22 (37)
By region			
South	47 (38)	30 (31)	23 (31)
Midland & Wales	47 (43)	28 (31)	25 (26)
North	49 (51)	31 (25)	20 (24)
Scotland	62 (46)	31 (29)	8 (25)
By income			
Low income	62 (56)	26 (24)	11 (20)
Mid income	48 (47)	32 (32)	20 (21)
High income	32 (23)	39 (35)	29 (42)

NOTE

Norther Ireland is not shown because the sub-analysis samples were too small to be statistically accurate.

How many items of mail do you post on average each week, including any business mail if you are self-employed? This includes letters and parcels.

	Percentage		
	1 item	2 items	3 or more items
All	58 (52)	22 (21)	20 (27)
By type of area			
Urban	65 (50)	20 (23)	15 (27)
Suburban	58 (53)	21 (20)	21 (26)
Rural	46 (43)	29 (26)	25 (32)
By region			
South	50 (45)	24 (23)	26 (32)
Midland & Wales	58 (52)	22 (23)	20 (25)
North	60 (60)	18 (16)	22 (25)
Scotland	56 (54)	30 (24)	14 (22)
By income			
Low income	64 (60)	22 (20)	14 (20)
Mid income	59 (52)	19 (25)	22 (22)
High income	43 (36)	27 (22)	30 (42)

NOTE

Northern Ireland is not shown because the sub-analysis samples were too small to be statistically accurate. However, the responses to this question, and to No 4, indicated levels of activity below the lowest region in Great Britain.

Post is arriving later: nearly four out of ten respondents said that their first postal delivery arrived at their home after 10 am and one in 25 said it normally arrived after noon

7 In 2001 about one in 10 respondents said that their first postal delivery arrived after 10 am and one in 25 did not know when the post arrived. Royal Mail has since abolished the second daily delivery for residential customers and rolled out Single Daily Delivery over the UK. Royal Mail now has internal targets of delivery by lunchtime in urban areas and mid afternoon in rural ones. In 2005 nearly four out of ten respondents said that their first postal delivery arrived after 10 am. One in 25 respondents said that postal deliveries normally arrived at their home after noon and nearly one in ten did not know when the mail arrived. Nearly three out of ten respondents

said that someone from their household was not normally home when the post was delivered. People in social grade DE or over 55, or with low incomes or in rural and suburban areas were more likely to be at home.

8 We carried out further analysis to establish whether someone from the respondent's household had been home at the time of delivery. Respondents were less likely to be at home for deliveries after 9am but there was little difference in response rate thereafter.

Is someone from your household normally in when the post is delivered?

	Percentage					
	Before 8am ¹	8am to 9am	9am to 10am	10am to 11am	11am to Noon	After Noon
Yes	90	82	66	63	66	61
No	10	17	30	34	30	34

NOTES

1 Before 8am – low base

2 9 per cent of respondents did not know

Satisfaction with the provision of post boxes is high but satisfaction with the provision of post offices has declined⁴⁰

9 In 2001 only one out of ten respondents found the provision of post boxes and post offices unsatisfactory. Within this overall picture of high satisfaction, urban respondents were less content with the provision of post boxes than suburban and rural respondents, while those in urban and rural areas were notably less content with the provision of post offices than suburban respondents.

10 In 2005 people's views about the provision of post boxes and post offices were no longer so similar:

- just under nine out of ten respondents found the provision of post boxes satisfactory. Within this overall picture of high satisfaction, urban respondents were less content with the provision

of post boxes than suburban and rural respondents, suburban satisfaction having increased but rural satisfaction being subject to a decrease. Respondents from Scotland and Northern Ireland experienced a drop in satisfaction but those from the other three regions had an increase. Satisfaction is income related: respondents with the lowest income were least satisfied. Two per cent of respondents do not know where their post box is.

- The proportion of respondents who consider there is a post office within easy reach of their home has declined by five per cent since 2001. The overall trend is not surprising given the post office closures.⁴¹ Within this overall picture, urban and rural respondents are less content with the provision of post offices than suburban and rural respondents. Satisfaction is income related: respondents with the lowest income were least satisfied. One per cent of respondents do not know where their post office is.

Is there a post box within a convenient distance from your home?

	Percentage	
	Yes	No
All	89 (90)	9 (10)
By type of area		
Urban	83 (84)	13 (16)
Suburban	93 (91)	6 (9)
Rural	87 (94)	9 (6)
By region		
South	92 (91)	7 (9)
Midland & Wales	91 (88)	8 (12)
North	94 (90)	5 (10)
Scotland	77 (86)	17 (14)
Northern Ireland	88 (96)	12 (4)
By income		
Low income	84 (86)	14 (17)
Mid income	90 (87)	8 (13)
High income	91 (91)	8 (9)

40 Post Office provision is not part of the regulated letters service.

41 National Audit Office: *Department of Trade and Industry: Financial Support for Post Offices*, HC 287 of 2004-2005, 24 February 2005.

Is there a post office within easy reach of your home, including those in newsagents, sweet shops etc?

	Percentage	
	Yes	No
All	83 (88)	16 (12)
By type of area		
Urban	79 (84)	18 (16)
Suburban	86 (90)	13 (10)
Rural	79 (85)	17 (15)
By region		
South	86 (90)	14 (10)
Midland & Wales	84 (89)	15 (11)
North	84 (87)	15 (13)
Scotland	78 (86)	16 (14)
Northern Ireland	78 (85)	21 (15)
By income ¹		
Low income	78 (87)	19 (13)
Mid income	84 (85)	15 (15)
High income	84 (91)	16 (9)

NOTE

¹ Income Base smaller: 980 in 2005, 1058 in 2001

An increasing minority of the public receive misdirected mail – one in four say this happens often or very often as against one in five in 2001⁴²

11 In 2001 about half of respondents said that they do not often receive misdirected mail, and a quarter said that this never occurs. But there are significant regional variations, with the performance in Scotland being much better than the north of England, while urban areas receive misdirected mail more often than suburban areas. In 2005 the proportion of the public that did not often receive mis-directed mail increased slightly, but less than a fifth said that it never occurs. There are significant regional variations with improved performance in the North and a marked decline in the South and the Midlands and Wales. Rural areas have seen a smaller decline in performance than suburban and urban areas.

⁴² Misdirected mail includes misaddressed mail which is beyond Royal Mail's control.

How often do you receive mail at home that should have been delivered to another address?

	Percentage		
	Very often/ Often	Not often	Never
All	25 (20)	55 (53)	18 (26)
By type of area			
Urban	29 (26)	51 (55)	17 (18)
Suburban	24 (19)	57 (52)	17 (28)
Rural	21 (20)	55 (52)	22 (26)
By region			
South	26 (18)	58 (52)	13 (29)
Midland & Wales	26 (21)	54 (53)	17 (26)
North	21 (27)	58 (48)	19 (24)
Scotland	15 (16)	57 (65)	25 (18)

NOTES

¹ Northern Ireland is not shown because the sub-analysis samples were too small to be statistically accurate.

² For 'All', 7 per cent said Very Often and 13 per cent said Often in 2001 and 8 per cent and 17 per cent in 2005. The sub-analysis samples were too small to show Very often and Often separately.

³ The sub-analysis does not total 100 per cent in all cases due to roundings and 'Don't Know'.

Slightly more people are willing to consider an alternative courier company

12 One in five respondents, slightly more than in 2001, were prepared to use a reputable alternative courier company for a slower service than Royal Mail's 2nd Class service but costing less than 21p.

13 Three in ten respondents, slightly more than in 2001, were prepared to use a reputable alternative courier company for a more consistent service than Royal Mail's 1st Class, but costing more than 30p.

14 Three in ten respondents were prepared to use a reputable alternative courier company for a two day delivery service, faster than Royal Mail's 2nd Class, but costing 25p.

APPENDIX 3

Correlations

1 Royal Mail's products pass through similar processes but are subject to separate targets agreed with Postcomm and Postwatch. The National Audit Office's analysis was designed to examine how strong the statistical correlation is between the performances of the products in the current regime.

2 Correlation is a statistical technique which can show whether and how strongly pairs of variables are related. The main result of a correlation is called the correlation coefficient (or "r"). If r is close to 0, it means there is no relationship between the variables. The closer r is to 1 the stronger the relationship between the variables.

3 Our statisticians statistically correlated quarterly data from 1995-96 to 2004-05 for the following:

- Performance against all 1st class services⁴³ targets: i.e. targets 1, 3, 6, 8 and 10 to establish the extent to which performance on 1st class post (target 1) correlated with performance on other 1st class targets.
- Performance against all 2nd class services targets: i.e. targets 2, 4, 7, 9 and 11 to establish the extent to which performance on 2nd class post (target 2) correlated with performance on other 2nd class targets.
- The extent to which performance against Target 5 (Mailsort 3), a 7 day service, is correlated with performance on 2nd class service targets (2, 4, 7, 9 and 11)
- The extent to which performance against 1st class targets (1, 3, 6, 8 and 10) is correlated with performance against 2nd class service targets (2, 4, 7, 9 and 11) and Target 5 (Mailsort 3)

Performance against standard parcels was not included in the correlation due to lack of comparable data. Standard parcels were originally delivered by Royal Mail's Parcelforce business and have switched over to delivery by the mail's business.

43 Excluding targets 14 & 15 postcode area targets (all and intra).

4 Partial correlations between the 11 products presented show that all products are highly correlated with each other (all except three above 0.7 with some around 0.9). Specific results are:

■ Performance against all 1st class services targets

Correlations		1	3	6	8	10
No.	Target	First class mail	Mailsort 1	Presstream 1	PPI First class	Response services First class
1	First class mail	1.00	0.91	0.93	0.79	0.70
3	Mailsort 1	0.91	1.00	0.90	0.76	0.56
6	Presstream 1	0.93	0.90	1.00	0.68	0.71
8	PPI First class	0.79	0.76	0.68	1.00	0.54
10	Response services First class	0.70	0.56	0.71	0.54	1.00

■ Performance against all 2nd class services targets

Correlations		2	4	7	9	11
No.	Target	Second class mail	Mailsort 2	Presstream 2	PPI Second class	Response services Second class
2	Second class mail	1.00	0.83	0.80	0.92	0.83
4	Mailsort 2	0.83	1.00	0.93	0.74	0.85
7	Presstream 2	0.80	0.93	1.00	0.66	0.86
9	PPI Second class	0.92	0.74	0.66	1.00	0.67
11	Response services Second class	0.83	0.85	0.86	0.67	1.00

■ Target 5 (Mailsort 3) v 2nd class service targets (2, 4, 7, 9 and 11)

Correlations		Mailsort 3
2	Second class mail	0.69
4	Mailsort 2	0.81
7	Presstream 2	0.78
9	PPI Second class	0.58
11	Response services Second class	0.71

5 As not all targets satisfy the normality assumption (which is important when using the Pearson correlation coefficient above), correlations were also obtained using the non parametric equivalent coefficient of Spearman which provided only just slightly lower correlations.

6 Factor analysis was used to identify homogenous subgroups for the 11 products and to investigate better alternatives to the new targets. However, because of the high correlations between all products previously identified, factor analysis was not able to differentiate products and create sub-groups.

7 A similar technique to factor analysis – Cluster analysis – was also used as a means to validate the results of factor analysis and was unable to create individual clusters of products within the original list.

8 On the extent to which performance against 1st class targets (1, 3, 6, 8 and 10) is correlated with 2nd class service targets (2, 4, 7, 9 and 11) and Target 5 (Mailsort 3): an individual ‘first class’ measurement was obtained from scores on targets 1, 3, 6, 8 and 10 and correlated against an individual ‘second class’ measurement (obtained in the same way from scores on targets 2, 4, 7, 9 and 11). As expected correlations were high or very high between the three targets:

Correlations	First class’ set	Second class’ set	Mailsort 3
First class’ set	1.00	0.85	0.60
Second class’ set	0.85	1.00	0.78
Mailsort 3	0.60	0.78	1.00

APPENDIX 4

International benchmarking

Comparison of first class quality of service targets and performance in Europe

This table shows that the targets and performance of first class post in western Europe vary greatly. The figures presented are annual reported figures, some are measured by financial year and some by calendar year (i.e. 2003).

	Percentage	
	Target 2003-04	Performance 2003-04
Germany	80.0	96.0
France	80.0	65.7
Greece	82.0	62.9
Sweden	85.0	95.7
Italy	87.0	87.0
UK	92.5	90.1
Ireland	94.0	71.0
Netherlands	95.0	96.1
Finland	95.0	95.0
Denmark	97.0	95.1

Comparison of basic weight postage prices in Europe

This table shows that Royal Mail's prices are generally lower than a selection of comparable European countries.

Weight	UK	Netherlands	Sweden	Germany	France	Spain
20g	£0.30	£0.27	£0.42	£0.38	£0.34	£0.20
50g	£0.30	£0.55	£0.81	£0.69	£0.51	£0.28
100g	£0.46	£0.81	£0.81	£1.00	£0.76	£0.38
150g	£0.64	£1.08	£1.64	£1.00	£1.31	£0.63
200g	£0.79	£1.08	£1.64	£1.00	£1.31	£0.63
350g	£1.21	£1.56	£2.46	£1.00	£1.83	£1.12

APPENDIX 5

Research examined during the audit

Postcomm: Monitoring developments in the postal market – market survey by Roland Berger April 2004.

The object of the survey was to monitor developments in the UK postal market, from a customer perspective, especially the perception of postal services been provided, combined with customer demands and their relative impact on market liberalisation.

Royal Mail Quality of Service, Research Study conducted for Royal Mail, Postwatch and Postcomm June – July 2004 (the MORI report).

The main aims of the study were to:

- Establish customer requirements of a Universal Postal Service in terms of speed of delivery, reliability and security
- Assess customer expectations of quality over the period of the next price control

In particular, the survey was intended to make a first step in understanding the current perceptions and day-to-day service requirements of Royal Mail's customers across all sectors. It was also important to gain an insight into how much customers are willing to pay for the services provided by Royal Mail.

Royal Mail, Pricing Quality of Service, Final Report, September 2005. Prepared by Accent and RAND Europe.

The research's main aim was to understand the relationship between service standards for transit time of First and Second Class, Mailsort letter mail, parcels and customer expectations of the whole customer experience and Royal Mail's prices. It sought to establish the price customers would pay for enhanced services and whether they would be prepared to trade off lower service levels against price decreases.

1 Of these, the most significant item of research was the joint research. When the performance regime was introduced in 2001 there was very little information on what consumers viewed as quality. All parties recognised that more research was needed. Furthermore the National Audit Office report of October 2004 on the postal and energy consumer bodies recommended that Postwatch should seek to develop a better understanding of the nature and extent of the problems faced by consumers. In early 2004 all three parties jointly commissioned MORI to survey the consumer base and they have all also carried out other individual research.

2 The MORI research indicated that consumers considered three factors as critical: Reliability; Delivery on promises; and Trustworthiness. The reliability of mail arriving on the specified day was essential to all respondents and was considered more important than actual delivery time and of equal importance with price. Most were unwilling to accept slippage of more than two working days. This underlines the importance customers attach to 'Reliability' and 'Delivery on promises'. Furthermore loss was unacceptable to all customers and confidence in Royal Mail was significantly undermined where it had occurred. The heaviest users were particularly reluctant to accept a price increase for additional security against low levels of loss. Less frequent users were willing to pay a further premium to have access to a more secure service.

APPENDIX 6

Timescale for 2006 Price Control

The timetable was set out in March 2004 and confirmed in September 2004.⁴⁴

Date	Milestones
April/ May 2004	Postcomm appoints consultants to carry out efficiency review, costing and cost attribution work and review of Royal Mail's volume forecasts Royal Mail and Postwatch jointly commission independent research on service quality issues
June 2004	Postcomm's consultation about the timetable and main issues to be considered during the price control review ends
July 2004	Date by which Royal Mail is asked to provide all of the information requested by Postcomm in its initial information request
August 2004	Postcomm publishes the responses to the timetable and main issues consultation, and confirms its timetable Date by which service quality research is to be completed
September 2004	Postcomm publishes initial issues consultation Postcomm publishes competitive market review, including proposals for further market opening from April 2005
November/ December 2004	Postcomm holds customer/ industry meeting to discuss the initial issues consultation
January 2005	Initial issues consultation ends. Postcomm places non-confidential responses on its website Postwatch brings forward proposed changes to service quality standards
June 2005	Postcomm publishes initial proposals for consultation. This includes publication of consultants' reports for the efficiency review, costing and volume forecasts work. Proposals for changes to quality of service standards are also included
May/June 2005	Postcomm holds customer/ industry meeting to discuss the initial proposals consultation
September 2005	Initial proposals consultation ends. Postcomm places non-confidential responses on its website
September 2005	Postcomm publishes competitive market review
December 2005	Postcomm publishes final proposals for consultation. This includes publication of final consultants' reports for the efficiency review, costing and volume forecasts work. It also includes final proposals for service quality standards
March 2006	Final proposals consultation ends. Postcomm places non-confidential responses on its website Postcomm makes a decision about whether to implement a price control if Royal Mail accepts the final proposals, or to make a Competition Commission reference if Royal Mail rejects the final proposals. Postcomm issues decision document to explain its decision
April 2006	New price control, and service quality standards would take effect provided there is no Competition Commission reference

⁴⁴ Postcomm: 2006 Royal Mail Price and Service Quality Review Consultation about Process, Timetable and Main Issues for the Review, March 2004. Postcomm: A Revised Market Opening Timetable, Proposals for Consultation, 20 September 2004.