

Review of the second class safeguard caps 2019

Citizens Advice's response to Ofcom's
consultation.



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Summary

As the statutory consumer advocate for postal consumers in England and Wales, Citizens Advice welcomes the opportunity to respond to Ofcom's consultation on the Second Class safeguard caps. Overall, we welcome Ofcom's approach. We consider the specific proposals on the safeguard caps to be proportionate and reasonable, and we have responded under to each question in the consultation under the headings in this document. Our key points are:

- Post remains an essential service. Despite structural decline in letters volumes, consumers (particularly vulnerable groups) rely on post.
- As an essential service, it is important that post remains affordable for all. This is particularly important for digitally excluded people who are unable to respond effectively to price increases by using digital alternatives.
- We would welcome further work by Ofcom to establish whether a discount scheme (limited by specific criteria) would mitigate the risk of certain vulnerable consumer groups being excluded from using post.
- As the near-monopolist in the letters market and the dominant player in the single piece parcels market, competitive constraints on Royal Mail are insufficient to protect vulnerable consumers from price increases.
- In our view, the safeguard caps therefore remain essential. They can also help address perceptions that stamp prices are increasing excessively. Ofcom data shows that people routinely overestimate the cost of stamps.
- We consider Ofcom's specific proposals on the safeguard caps to be proportionate and reasonable.
- However, we have concerns that under the proposed basket cap, Royal Mail could structure the pricing of its products to take advantage of segments of the small parcel market that may not be subject to significant competitive constraints due to factors outlined in Ofcom's analysis.
- We encourage Ofcom to monitor the prices of all products within the basket cap to assess whether consumers face unreasonable and unaffordable price increases for specific products for which there may be no reasonable competitive alternative.

As the regulator, Ofcom focuses on competition and consumer outcomes. Our recent research into Royal Mail's redirection service (a monopoly, USO service) found that the price of the cheapest package has risen by 74% in the last 6 years - and the cost puts many poorer consumers off using it.¹ We would welcome any further work by Ofcom to examine whether a similar price cap or further interventions could provide a solution for redirection and other USO products.

¹ [A new redirection?](#) Citizens Advice, 2018

Question 1. Do you agree with our market analysis?

Yes. We agree with Ofcom's market analysis and conclusion that the safeguard caps remain necessary. As Royal Mail is a near-monopolist in the letters market - and the only nationwide end-to-end operator for this product - competitive constraints alone are insufficient to protect consumers from Royal Mail increasing prices. As Ofcom notes, Royal Mail also has a significant share of the single piece parcels market, particularly for the products in scope for the safeguard caps (<2kg).

We also agree with the conclusion in Ofcom's consultation that price sensitivity is unlikely to provide a restraint on Royal Mail's pricing, as "particularly for residential consumers, few would respond to a significant price increase for a Second Class standard letter by choosing not to send the item." We note that some vulnerable consumer groups, such as digitally excluded people, are less able to respond to price increases by switching to a digital alternative. It is therefore particularly important that Ofcom ensures these vulnerable consumers are protected from significant price rises for an essential service.

We note that some consumer groups may be less able to switch to competitors in the parcel market due to their location. Our recent research into consumer access to parcel pick up and drop off points (PUDOs) in Great Britain shows that rural consumers are more dependent on the Post Office network to send and receive parcels through PUDOs.² The Access Criteria that requires Post Office Ltd to ensure that 95% of the rural population live within 3 miles of their nearest branch, and government financial support to rural post offices essentially mean that Post Offices prop up access to parcel services in rural areas.

Due to the exclusivity arrangement between Royal Mail and Post Office Ltd, in effect this means that rural consumers are less able to exercise choice between competitors for parcel sending products and could be more captive to price increases for specific products. While we recognise that Royal Mail is obliged to offer a geographically uniform price for universal service products, the dominant position Royal Mail has in the <2kg market (80-90% of both volume and revenue)³ and the market analysis that Ofcom sets out mean that competitive restraints are insufficient to protect consumers from price increases.

² [Mapping Parcel Shops](#), Citizens Advice, 2018

³ Ofcom's consultation document, paragraph 3.50, page 28

Question 2. Do you agree with our assessment of affordability of Second Class postal Services?

We recognise the challenge faced by Ofcom in identifying a single price point at the limit of affordability. We support Ofcom's approach of focusing on the adverse impacts on potentially vulnerable consumers. We consider Ofcom's analysis of affordability of is reasonable given relatively low household spend on post.⁴

However, we would expect Ofcom to monitor any price rises carefully to ensure that customers and consumers are getting value for money and that it ensures that Royal Mail is not unfairly treating (more captive) customers or engaging in any anti-competitive pricing.

As we noted in our response to the Review of the Regulation of Royal Mail in 2017, our research on consumer needs has indicated that affordability, along with reliability, safety and ease, continues to be a key consideration for consumers in their decisions about whether to send letters and parcels, with cost being of higher importance to lower income groups.

Our recent research into Royal Mail's redirection service demonstrates that those who find it hard to make ends meet are significantly more likely to be impacted by pricing structures than those who find it easy.⁵ While household spend on post is relatively low, letter post remain essential for vulnerable consumers less able to switch to digital alternatives, and it is vital that they remain affordable to all consumers.

We note that Ofcom's consultation states that for some consumers, "unfortunately postal services may be unaffordable... even if their prices were reduced significantly." As Ofcom's objective is to ensure that this basic universal service product is available to all, we would welcome further work by Ofcom to establish whether a discount scheme (limited by specific criteria) would mitigate the risk of certain vulnerable consumer groups being excluded from accessing essential postal services. Similar schemes in other countries such as Australia provide specific consumer groups with access to affordable postal services.

⁴ However, we would welcome any further work from Ofcom to consider how it assesses affordability in future. We particularly note the increase in private rental costs over the last few decades, with low income consumers most impacted <https://www.ifs.org.uk/publications/9986>. Including income "after housing costs" in any assessment of affordability may be valuable.

⁵ [A new redirection?](#), Citizens Advice, 2018. A softer measure of affordability like "find it hard to make ends meet" could provide further insight.

Question 3. Do you agree with our analysis of the commercial flexibility afforded to Royal Mail under the safeguard caps?

Yes. We agree with Ofcom's conclusion that the commercial flexibility afforded to Royal Mail under the proposed caps is sufficient, and does not present a risk to the sustainability of the universal service. We also welcome that Ofcom's consultation document recognises that it is essential that Royal Mail continues to make efficiency gains.

In relation to the headroom afforded to Royal Mail under the basket cap and scope for individual products to be subject to significant price increases, we ask Ofcom to note our response to Question 5.

Question 4. Do you agree with our proposals relating to the standard letter safeguard cap?

Yes. As an essential service, the price of a Second Class letter must remain affordable, particularly for vulnerable consumers. We agree with Ofcom that the safeguard price cap for standard letters remains necessary, and we believe that the proposed changes are proportionate and reasonable when considering the state of the letters market and Royal Mail's dominant position within it. As a monopoly provider to all intents and purposes, it is important that a safeguard cap remains to protect vulnerable consumers from ongoing price increases.

Given that consumers overestimate the cost of stamps,⁶ keeping the safeguard cap could also play an important role in reassuring consumers that Second Class stamps will not be subject to unexpected and severe price increases.

Question 5. Do you agree with our proposals relating to the basket safeguard cap?

We agree with Ofcom that the basket cap remains necessary for large letters and small and medium parcels up to 2kg. We also agree that it is proportionate and reasonable for this cap to remain in place at the existing level to continue to allow Royal Mail pricing flexibility. We note that the significant headroom that Royal Mail under the current basket cap does not prevent it from making a reasonable rate of return on the relevant products.

Ofcom recognises that given its dominant position in the <2kg parcels market, Royal Mail could structure the pricing of its products to take advantage of

⁶ [The UK Communications Market: Post](#), Ofcom, 2017

segments of the small parcel market that may not be subject to significant competitive constraints due the factors outlined in Ofcom's market analysis. We are therefore concerned that within the headroom available to Royal Mail under the current (and proposed) cap level, consumers could be vulnerable to significant price increases on specific postal products.

We note in particular that the structure of this cap enabled Royal Mail to increase products for certain products from 2011/12 to 2018/19.⁷ For example, the price of a 0-100g Medium Second Class parcel increased by 280% over this period. While we understand this was in part the result of structural price adjustments and Royal Mail's move to size-based pricing in 2013, it is our view that Ofcom should monitor future price increases for individual products within the basket cap to ensure that consumers are not penalised by significant price rises on specific products.

We would therefore welcome the publication - or dissemination to consumer advocacy bodies - of any analysis Ofcom has undertaken on the potential impacts on consumers of price increases on individual products within the basket cap on small and medium parcels <2kg to assess whether this presents a risk to consumers.

Moving forward, Ofcom should monitor the prices of all products within the basket cap to assess whether consumers face unreasonable and unaffordable price increases for specific products for which there may be no competitive alternative.

Question 6. Do you have any comments on our proposed modifications to the DUSP conditions specified in Annex 5?

No.

Question 7. Please provide any further comments or additional evidence that you believe we should consider in reaching our decision on the Second Class safeguard caps.

We have no further comments.

⁷ Table 2.1 in Ofcom's consultation, page 14