



# **Summary of Royal Mail's supplementary submission for additional revenue to raise extra cash in 2011/12**

A supplementary response to Annex 4 of the Postal Services Commission's May 2010 consultation document, arising from cash position review

18 October 2010

# **ROYAL MAIL'S SUPPLEMENTARY SUBMISSION FOR ADDITIONAL REVENUE TO RAISE EXTRA CASH IN 2011/12**

## **EXECUTIVE SUMMARY**

The further downturn and uncertainty in the mails market means that – without appropriate mitigating action – Royal Mail faces the prospect of cash headroom reaching a level which could represent a risk to a business of our scale and with our cash outgoings.

As the financial health of Royal Mail and the Universal Service are intimately linked, action must be taken to safeguard the financial sustainability of Royal Mail and the Universal Service. The business is implementing a package of measures to safeguard the progress of continuing modernisation, the future of Royal Mail and the Universal Service. One of these measures is a request for up to an additional £100 million of earned revenue in 2011/12.

### **1. Modernisation must continue to advance at pace**

Royal Mail is implementing its major programme to modernise operations, introducing new machinery and changing working practices as it rolls out World Class Mail operations across its mails network.

Given declining mail volumes, the only sustainable strategy to protect the Universal Service is to modernise and improve efficiency. Slowing down modernisation is not a viable option for the medium to long term sustainability of Royal Mail. In fact the modernisation needs to be advanced at pace to secure the future of the Universal Service.

Whilst the changes needed to deliver the modernisation plans require significant investment, they will ultimately benefit our customers through further improvements to quality of service, our ability to maintain prices at amongst the lowest level in Europe and to sustain the Universal Service – and our ability to innovate in areas such as fully tracked letters and parcels.

### **2. Royal Mail cannot borrow from the capital markets to raise cash**

In a normal commercial environment the business response to a short-term reduction in cash headroom would be to seek additional funds either by extending borrowings from lenders or additional equity from shareholders. Royal Mail's current ownership and borrowing constraints mean that neither of these options is currently available.

### **3. Additional revenue is part of a package of measures to raise cash**

Royal Mail must secure a clear, timely and balanced solution to a cash constrained future. Royal Mail is implementing a package of measures to raise cash including reducing headcount, tightening spend with suppliers and raising proceeds from asset sales. Securing additional revenue is a further essential measure which Royal Mail needs to implement. Royal Mail firmly believes the business should not carry out actions which destroy longer term value - and therefore threaten the sustainability of Royal Mail and the Universal Service - to improve the cash position ahead of the measures described above. Therefore the measures being implemented will enable the business to manage the cash constrained future whilst continuing to deliver the modernisation programme at pace.

Royal Mail believes that additional earned revenue of up to £100m is necessary for 2011/12 as part of the measure to raise cash. Postcomm raised the subject of Royal Mail's cash position in its May 2010 consultation document, but without any further review of that cash position. Royal Mail confirmed the need for Postcomm to consider further its financial position in its consultation response (August 2010) and highlighted that it would be putting in a request for an additional price rise over and above the price control allowance. This was discussed with the Postcomm Commissioners in August and then through a formal presentation on 16 September. In addition to these Commissioner briefings Royal Mail has provided Postcomm with a substantial body of data and financial information to support the businesses requirement to generate up to £100m of additional earned revenue in 2011/12.

Royal Mail recognises the difficulty of raising extra revenues from prices in the current mails market. However, price rises are one of several measures that are needed to address the potential short-term cash position. Royal Mail does not intend to raise the additional earned revenue through the price of mail to single piece mail services. In other words Royal Mail will not increase 1<sup>st</sup> and 2<sup>nd</sup> class stamp prices beyond the level allowed in the current price control.<sup>1</sup>

The additional £100 million will be raised from business customers, through Wholesale's prices and Royal Mail Letter's prices of services currently in Basket B of Condition 21 of Royal Mail's Licence. In practice, this will mean an extra additional price increase allowance of up to 7 per cent for these business services (over and above that available from the current price control).

In addition, Royal Mail believes the sub-cap restriction for zonal access prices of 3 percent in paragraph 5A of Condition 21 of its licence should be amended to 10 percent for 2011/12. In the presence of significant changes to the prices of the national access contracts, this will enable Royal Mail to be more cost reflective in setting its zonal access prices for 2011/12.

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<sup>1</sup> Subject to the roll over to 2011/12 of the volume adjuster and proposed by Postcomm in its May consultation.

#### **4. Our proposal is consistent with Postcomm's duties**

Royal Mail believes that allowing the additional revenue, in this case, would be entirely consistent with Postcomm's duties:

- *Postcomm has a primary duty to ensure the provision of the Universal Service:* The proposal will contribute to ensuring the long term provision of the Universal Service during a period of significant change when the cash position of the business is low and the cash headroom has the potential to decline to, or below, 1 percent of revenue without the contribution from the additional price increase.
- *Postcomm has a secondary duty to promote effective competition:* There is significant development of competition in the mails market. The proposed extra price increases by Royal Mail will create opportunities for competitors.
- *Postcomm has a tertiary duty to encourage efficiency and economy while protecting the most vulnerable:* The additional revenues generated by Royal Mail's price increases will enable the modernisation programme to advance at pace and yield efficiency and economic benefits in the future. The extra allowed revenue will also be raised outside of the prices of Basket A services and thereby protects the most vulnerable social customers from further price increases.
- *Postcomm has a further duty to have regard to ensuring the finances of all licensees.* Royal Mail believes there is a need for Postcomm to take account of its cash position, and to amend the licence to assist in the recovery of additional earned revenue for 2011/12. Some of the additional revenue will be raised through Wholesale prices, and reflected in other operators' and Royal Mail Letters' prices, and consequently all existing licensees will be similarly affected.

#### **5. Implementation programme is achievable for April 2011 but tight**

Royal Mail believes that it should be possible to implement the price changes from April 2011. Royal Mail notes that any delay to the implementation date would reduce the cash available to it during 2011/12. Hence it is imperative that the implementation of the 2011 Tariff is progressed as soon as practically possible.