International Distributions Services

The Rt Hon. Liam Byrne MP
Chair
Business and Trade Committee
House of Commons
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Dear Mr Byrne

Thank you for your letter dated 18th December, I welcome the opportunity to respond on the points you have raised. I would also like to congratulate you on your election as Chair of the Business and Trade Committee Select Committee.

Prior to answering the details of your specific questions, I thought it may be helpful to you and your Committee for me to share several key reflections and actions we have taken to stabilise and improve Royal Mail's position since my appointment as Group CEO of International Distributions Services plc and as interim CEO of Royal Mail in August 2023.

The underlying position of Royal Mail's finances has been in decline since 2015, with the company most recently posting an adjusted operating loss of £319m for the first half of the current Financial Year. This is symptomatic of the long-term structural transformation that is required to modernise our business, the macroeconomic environment and also the period of instability that industrial action caused for our business, people and customers.

Royal Mail requires major change, and if executed correctly, I know the company has great potential.

Coming into the role, it was clear that we needed to take immediate short-term action. Firstly, we had to stabilise the business in the near term, which we have now achieved through rigorous cash management and reprioritising investment into high return projects. More action is required though for the long-term stability of the business.

Secondly, we had to grip quality of service to ensure we are delivering for our customers. I am fully aware that our current quality performance is not where we or our customers expect it to be. We need to improve further. This has been, and will continue to be, a top priority. In my long career in logistics, I have always experienced that a stable and engaged workforce, and an efficient network, are two important drivers for quality improvement. Therefore, in my first few months I have taken considerable short-term actions across both:

- **Launched a Quality Control Centre to strengthen our management information and insights.** On a day-to-day, hour-by-hour basis, this Control Centre triangulates performance data and customer complaints to identify areas with emerging service issues with the goal of intervening fast before problems materialise. This is a big step forward and has helped us to avoid network failures and intervene sooner on routes that could potentially fail.
- **Increased the recruitment of more permanent postmen and women whilst reducing our reliance on agency staff.** As customers and volumes return following the industrial dispute, and recognising

that permanent employees know their routes better and deliver better quality of service, we have taken the conscious decision to increase the ratio of permanent employees to agency staff.

- **Introduced new sickness and attendance policies in agreement with our trade unions, and rolled out an industry leading wellbeing programme to combat high rates of absence across the business**. These initiatives have played a significant part in sick absence falling around 25%, from 8% in December 2022 to ~6% by the end of December 2023.
- **Reinforced the entire operational management structure, bringing in experienced mail and parcel leaders, as well as increasing the number of frontline operational performance leaders (OPLs)**. OPLs are now responsible for overseeing an average of 15 delivery offices instead of 30, meaning that more targeted support and focus on quality can be given to the units that need it.
- **Maximised the use of our new Daventry and Warrington hubs, enabling processing six times faster than the next largest mail centre**. This improvement enables us to clear the parcel and letter pipeline up to delivery offices more efficiently than we ever have before.

Thirdly, and in conjunction with our efforts on quality, we needed to deliver Christmas for our customers to show them that they can rely on us. In addition to what I outline above, we implemented unprecedented Christmas support across our network this year:

- For the first time ever, we introduced a peak quality of service incentive for all 100,000+ frontline operational employees for hitting local and national service targets
- On top of our permanent recruitment efforts, we took on an additional 16,000 seasonal workers
- Opened five temporary sortation hubs, and
- Hired an additional 6,800 vehicles.

These actions and investments have enabled us to deliver our strongest Christmas quality of service performance in four years. Our teams worked tirelessly to ensure that all items posted before our last recommended posting dates were delivered in time for Christmas. Through more proactive intervention by the Quality Control Centre, the average number of full routes not covered in a day fell by more than two-thirds between October and December. Out of a total of circa 54,000 routes, by the end of December fewer than a hundred routes were not assigned a postie on any given day (or less than 0.2% of all walks). In addition, the introduction of automatic redelivery saved in excess of 1.5 million customer visits to our Customer Service Points to pick up parcels in December alone.

I would like to take this opportunity to put on record my personal thanks for the extraordinary effort that all employees at Royal Mail put in to delivering Christmas 2023. I am immensely proud of the way that colleagues pulled together at the end of a challenging year.

Although the extensive interventions we have made to grip quality and deliver Christmas over the short-term are starting to have a positive impact, I must be clear that our quality challenges will not be fixed overnight. We must now drive forward our modernisation agenda to sustainably improve our quality of service across both letters and parcels. To do so, we are getting on with implementing the changes set out in our CWU agreement, which provide a solid foundation for quality improvements and future growth. We are also actively looking ahead at our strategic development, including how we best serve our customers in the future, and the network required to enable this.

Whilst we are doing all we can to transform, and the actions taken by us to date provide some breathing space to continue our journey, we also need Ofcom and the Government to do their bit. Delivering the current Universal Service requirements – in a financially sustainable way - is increasingly difficult, if not impossible, to achieve as the mix and number of parcels and letters changes. The bar set by the regulations is unrealistic given the market realities. Ofcom's own guidance says that for the Universal Service to be financially sustainable, Royal Mail should be making an EBIT margin of 5-10%. Since privatisation in 2013, this has only been achieved twice.

It is simply not sustainable to maintain a delivery network that was built for 20 billion letters when we are now delivering only 7 billion.[1] At the current rate of decline, this will be closer to 4 billion letters in the next five years. As well as volumes declining, we are also having to deliver to four million more addresses. In practical terms, that means we are now only delivering around 4 letters to each address per week, compared to 14 letters per week in 2004/5. This means we have to walk more than three times as far to deliver the same number of letters as we were before – with a proportionate increase in the delivery cost per letter. There are a number of ways to tackle this problem, including significantly increasing prices, seeking a government subsidy, and/or reforming the Universal Service so that it is more reflective of the customer needs and market realities of today, not the needs of the past.

Under current regulations, Royal Mail is still required to deliver letters for one price nationwide, six days per week, against some of the highest quality standards across Europe (93% next day delivery for First Class). We are doing this in a country that is more than 90% rural by landmass[2] whilst our competitors can pick and choose where they deliver and surcharge for rural deliveries. Despite this, stamp prices in the UK remain below the European average, and the Universal Service is delivered without government subsidy.

Most other comparable countries have already taken action to significantly reform their Universal Service requirements. The UK has not. For example:

- Germany is moving to delivery on alternate days with a target of 95% of letters to be delivered within three days
- In France, letters are delivered within three days against a target of 95%. The French Government has granted a subsidy of €2.6 billion between 2021-2025 for La Poste
- Italy has introduced alternate day delivery with a target of 80% arriving within one, two or three days depending on the region. The Italian Government granted a €1.3 billion subsidy for 2020-2024 for Poste Italiane
- Denmark have removed the requirement for a universal service provider.

In contrast, we have seen no reform in the UK. We have been raising the need for Universal Service reform with Government Ministers and Ofcom since 2020. Whilst we welcome the forthcoming Ofcom review of the Universal Service, the inertia we have experienced means that we are now facing a far more serious situation than we would have been if action had been taken sooner.

Every day that Ofcom and the Government further delay reform just creates more risk for the long-term sustainability of the Universal Service, and indeed Royal Mail itself. We must maximise every pound spent to transform our business for the future and deliver more for our customers – not continue to sustain a service standard that was designed in a pre-internet era and no longer reflects customer needs.

I will now turn to your specific questions, though I hope from what I have said above that it is clear we have made quality of service a top priority across both letters and parcels over the short-term; have plans to further improve quality over the medium and long-term; and need urgent action on Universal Service reform

[1] Letter volumes have declined from 20 billion at their peak in 2004/5, to 7 billion in 2022/23. Addresses have risen by c.4 million (15% increase) in the same period.

[2] Rural areas make up 90 percent of England, while they make up 98% of Scotland. (Source - Fact file: Rural economy – House of Lords Library.)

to support us in transforming into a modern letters and parcels logistics company to meet the needs of our customers today and into the future.

<u>Question 1: Employee awareness of the Universal Service Obligation and initiatives to improve quality of service</u>

Your first question asked what we are doing to ensure that managers and postal workers are aware of our Universal Service obligations, and to explain why, if letters and parcels are treated with equal importance, people are experiencing delays to letters.

Upon joining Royal Mail, new recruits receive training explaining what the Universal Service is, the importance of it to Royal Mail, and our regulatory obligations, and all managers undergo refresher training every year. In addition, Royal Mail's workforce also receives regular communications reinforcing the need to deliver improved quality of service for both letters and parcels. Recently this has included running 'Quality Roadshow' Town Halls in every region of the UK which were attended by all operational managers.

I recognise that your letter was prompted a Sunday Times investigation which suggested that employees had been asked to prioritise parcels over letters to keep the network moving. Please be assured that we will always do our utmost to ensure that all mail – letters and parcels – are delivered on time. We have been clear that in exceptionally busy periods like Christmas, or when we are faced with short term resourcing issues, it may be logistically necessary to clear parcels first to keep the mail moving and ensure the safety of our colleagues, especially in small delivery offices.

It is important to say that this does not happen everywhere, and instead is a contingency where we have no other option. Ofcom is aware of this contingency, and in November 2023 Ofcom stated that it "*did not identify any suggestion that Royal Mail senior management had directed the prioritisation of parcels over letters outside of recognised contingency plans."*[3] I feel it is important to clarify that, contrary to media narrative, it is not 'illegal' for parcels to be cleared first before letters.

As I have outlined above, improving quality of service is and will continue to be a top priority. I would like to reassure the Committee that the vast majority of mail is delivered on time, and 96% of First Class mail arrives within three days of posting. However, I fully acknowledge that further improvement is needed. I have taken short-term action to improve quality, and invested in the necessary support across our network to deliver Christmas for our customers. These actions, as set out earlier, are starting to show results.

Medium and longer term, a number of changes we secured in the agreement with the Communication Workers Union (CWU) are also designed to underpin improvements in quality. This includes a joint initiative to improve quality of service, new sickness and attendance policies, seasonal hours to increase our resourcing in the busy peak period, later start times to increase the window of time we have to transport items overnight, and indoor method trials to improve the way we sort letters and parcels.

<u>Question 2: Sickness absence and staff retention</u>

Your second question asked how Royal Mail is dealing with the impact of sickness absence on quality of service, and about the Sunday Times' claims about issues with high staff turnover and recruitment challenges.

[3] Ofcom quality of service investigation, November 2023

At Royal Mail we are proud to have the best terms and conditions in our industry, and the average tenure for Royal Mail employees is 18 years. As a result, our turnover of staff is well below the industry average – 11% at Royal Mail compared to 26.9%[4] across the logistics sector. Nonetheless, we are focussed on increasing our retention rates amongst new recruits by ensuring that we are open about the physical nature of the role in our recruitment, and further supporting our managers to ensure that the onboarding process helps our new team members settle into their roles quickly.

Whilst we may have lower levels of turnover and better terms and conditions than most of the logistics sector, Royal Mail is not immune to the recruitment challenges that large parts of the economy are experiencing. The labour market is tight, with unemployment remaining near record lows. There remains intense competition for labour, particularly in areas of high employment and logistics competition.

Managing our sickness absence is exceptionally important. If we do not succeed in doing this, our quality across both letters and parcels is directly affected, our costs increase as we need to employ less productive agency workers and the risk of failing walks also increases.

As set out earlier, we have made significant progress tackling this problem in recent months, with frontline operational sick absence falling around 25%. We have achieved this by introducing new sickness and attendance policies, and an industry leading wellbeing offering. All employees can now access 24-hour online GP appointments, physiotherapy, mental health consultations and lifestyle and nutrition coaching to improve their health and wellbeing.

Question 3: Investing in our network to adapt to the growth in size and volume of parcels

Your third question asked about how Royal Mail plans to manage the space available in delivery offices and what plans we have to acquire new, larger facilities.

The parcels market has changed rapidly. In recent years, we have seen an increase in not only the volume of parcels, but also their size has grown significantly. In the last six years alone, the average size of a parcel handled by Royal Mail has grown by nearly 30% and the number of parcels classed as 'large parcels' (bigger than shoebox size) has more than doubled. These trends have had a direct impact on our business, which has seen us invest £4 billion since privatisation to modernise our business. We have:

- Invested heavily in two new automated parcel hubs in Warrington and Daventry. Over the Christmas period alone, these hubs processed over 28 million parcels, freeing up space and processing capacity at our 37 mail centres for letters and parcels
- Invested in upgrades and refurbishments of the mail centre and delivery office estate, modernising our mail centre letters and parcel sorting capabilities through further automation
- Reconfigured, where possible, the mail sorting frames to create more space in delivery offices
- Invested in larger vans and line haulage to transport the growing volumes and size of parcels
- Introduced around 3,000 dedicated parcel routes for the delivery of larger parcels, meaning our core walking routes can focus on letters and smaller parcels.

We are also constantly looking at ways to improve our ways of working. As part of the agreement with the CWU, we are undertaking a number of indoor method trials to further improve delivery office layouts for better processing of letters and parcels. This, in turn, is designed to improve quality of service and operational efficiency.

[4] Industry benchmarking analysis, K2B HR Analytics, November 2023

As we look to further modernise Royal Mail, we are reviewing and defining the setup of our future network. Achieving this future network will clearly take considerable investment over the coming years, and as a materially loss-making business we need to be mindful of where and when we can afford further investment.

<u>Question 4: Improving the financial performance of Royal Mail</u>

Lastly, you asked about my plans to improve the financial position of the company given the operating loss of £319 million in the six months to September 2023.

Making Royal Mail profitable again is no small task. As I have set out, we have already taken immediate short-term actions to stabilise the business, grip quality and deliver Christmas for our customers. As well as taking these actions, we are not losing sight of the importance of driving our modernisation agenda to achieve longer-term growth and efficiency in an exceptionally competitive market. As part of this, we are:

- Reviewing our channel-mix strategy to increase customer convenience in receiving and sending parcels
- Delivering the changes set out in the CWU agreement - this includes changes to adapt our ways of working to better reflect the needs of our customers, such as later start times to enable more next day delivery
- Defining our broader strategic plan during 2024.

The task ahead of us is vast. Royal Mail is materially loss-making. We are doing all we can to transform our business, deliver the services our customers want and ensure we are financially sustainable long term.

We will continue to transform our business, together with our people and our unions. But as I said earlier, we also need the Government and Ofcom to do their bit. If demand for any public service had fallen by two thirds, I am sure that HM Treasury would have insisted that the service be reformed to ensure a better return on investment for the public purse. I question why this has not happened when it comes to the Universal Service?

As the editorial of the Sunday Times said when the investigation was published, "*it is time for a realistic conversation on what Royal Mail can and can't do*" given the seismic and structural shift we have seen in our market. With the right regulatory framework in place, I am confident we can look ahead to a brighter future for our employees and our customers.

As your letter states, Royal Mail is a brand with a long and proud heritage, and an incredibly important part of the fabric of British life. The task ahead is to ensure it reaches its full potential.

Yours sincerely,

Martin Seidenberg
Group Chief Executive