

Market overview

Royal Mail operates in a marketplace which is undergoing profound change, driven by a structural decline in addressed letter volumes and continued growth in e-commerce. E-substitution in letters and disintermediation in the parcels market have changed our role in the value chain. In some areas, change has resulted in new opportunities. In others, our role has reduced.

UK letters market

The UK, like many other countries, is experiencing ongoing structural decline in addressed letter volumes. This decline is driven by e-substitution and growth in mobile and online advertising. Large businesses continue to adopt online communication methods and are strongly incentivising paperless billing. However, independent research shows that people understand information better, are more likely to take appropriate action and make better financial decisions as a result of receiving information by post rather than electronically¹.

We are seeing different types of letters experiencing different rates of decline due to this structural shift. As the leading letters delivery operator in the UK, the decline in addressed letter volumes means we need to deliver letters and parcels together and seek alternative revenue pools to underpin the Universal Service network.

Direct mail provides revenue that supports the Universal Service. Research shows that direct mail advertising spend grew by one per cent during 2015, while other forms of print advertising declined around 11 per cent. Direct mail is the fourth largest advertising medium in the UK, behind TV, internet and print². Forty-two per cent of people say they have taken direct action (e.g. purchased, spent, ordered, renewed) having received a targeted mailing³.

The UK postal access market has developed rapidly since its introduction in 2004 and is now by far the biggest and most developed mail access market in the EU⁴. Access operators handle about 70 per cent of all addressed letters posted by large businesses. Royal Mail continues to work with access operators to ensure sending and receiving customers enjoy a great service. Access Quality of Service was 95.7 per cent in 2015-16.

¹ London Economics behavioural economics study for Keep Me Posted

² WARC UK expenditure report, April 2016. Data from January to December 2015

³ Quadrangle, Valued Mail 2014

⁴ FTI consulting, September 2015

UK parcels market

The UK parcels market is one of the most competitive in Europe, with 16 major players. It is also one of the most evolved parcel markets in Europe; it has the highest per capita spend on e-retail and this is increasing. Approximately 14 per cent of all UK retail sales are estimated to be conducted online and e-commerce expenditure per head is over 50 per cent higher than in the US⁵.

E-retail continues to drive overall growth in UK parcels. The rapid pace of change in the parcels industry is expected to continue, due to low barriers to entry, greater disintermediation and disruptive business models. The actions of Amazon Logistics remain the most fundamental driver of change in the market. In a highly competitive retail landscape, the delivery experience has become a key differentiator for many online retailers. They are increasing shoppers' expectations regarding the convenience, speed and price of delivery. Several parcel carriers have invested significantly in expanding their capacity in recent years. This puts downward pressure on prices.

Growth areas

Clothing and footwear represents the majority of online non-food sales growth, due to frequency of purchase and a higher value per spend. Parcel returns continue to grow more quickly than deliveries, driven by the clothing and footwear sector in particular. Sales of physical books are showing some sign of resilience. This is partially offsetting the continued decline in music, film and video game sales⁶.

In the consumer/SME segment, there has been a very rapid expansion of click and collect, parcel shop networks and parcel locker stations, albeit from a low base. There are now more than 30,000 parcel drop off and pick up locations across the UK. Although there has been an increase in awareness and usage of click and collect and parcel shop deliveries,

⁵ Ofcom IMRC 2015

⁶ Verdict e-Retail 2015

home delivery remains the preferred option for the vast majority of consumers⁷.

Consumers are increasingly shopping at a time and place which suits them. UK industry experts have stated that, for the second year running, mobile platforms accounted for all growth in overall e-retail sales in 2015⁸. Many retailers are adopting a mobile-first channel strategy. Fashion retailer ASOS reported that almost half of its orders came through on a mobile device in February 2016.

International parcels

E-commerce is similarly driving European parcels market growth. E-commerce Europe research estimates that European B2C e-commerce grew 14 per cent in 2015 to €424 billion, with four billion parcels sent annually. This growth is uneven across Europe, due to varying economic performance and e-commerce adoption. The largest parcels markets outside the UK are Germany, France and Italy.

Consumers expect a seamless cross-border delivery and returns experience. Within Europe, cross-border online purchasing is growing faster than domestic online purchasing⁹.

The cross-border e-commerce trend¹⁰ is expected to continue in all major European countries in the future. A recent Royal Mail study into the international ambitions of small UK e-retailers found small businesses were confident in the current climate and were looking towards new markets, building on their existing international success. It found that Europe remains the main target for exports and almost 50 per cent of small e-retailers aim to sell their products in Europe in 2016, up from 30 per cent in 2015¹¹.

Outside the EU, Chinese e-commerce marketplaces Tmall and AliExpress significantly gained in popularity among online shoppers. Chinese customers spent over £9 billion through Alibaba in 24 hours on 'Singles Day' on 11 November 2015 and many analysts predict that a new record will be set again this year.

⁷ IMRG UK consumer home delivery review 2016

⁸ Capterra mRetail Sales Index, March 2016

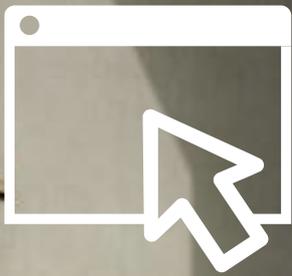
⁹ PostEurop December 2015

¹⁰ Forrester research. Online cross border retail forecast 2016-2021

¹¹ Royal Mail Group SME seasonal research, December 2015

Mail drives customers online

And mobile is making it easier than ever for people to access and use the internet¹².
Having received a mailing:



92%

driven to online or digital activity

86%

connected with business

43%

download something

87%

influenced to make online purchases

54%

engaged in social media

¹² Source: Royal Mail MarketReach, Mail and Digital Part 2, Quadrangle, 2014

Delivery matters

Home delivery is expected to remain our customers' preferred delivery option.



80%

of online shoppers would prefer to have items delivered to their home¹³.

¹³ Source: IMRG consumer home delivery review 2016

Leading in e-commerce

£1,591
per head

The UK has the highest spending per capita on e-commerce and this is increasing¹⁴.

¹⁴ Source: Ofcom ICMR 2015