

RESTRICTED – POLICY AND COMMERCIAL

To Jo Swinson
From Post Office Team
Date 17th September 2012

**Meeting with the Chair and CEO of Post Office Ltd
(Tuesday 18th September 2012, 10:30-11:00)**

Purpose

This is your first meeting with Alice Perkins and Paula Vennells (Chair and CEO of Post Office Ltd respectively).

Attendees

Alice Perkins and Paula Vennells (Chair and CEO, Post Office Ltd)
Roger Lowe and Jane Hoy (ShEx Post Office team)

Your objectives

- To communicate that this is a priority area within your portfolio.
- To understand Alice and Paula's priorities for the business.
- To stress that it is vital for Post Office Ltd to deliver against all elements its strategic plan, and seek Alice and Paula's views on how POL is positioned to deliver on each of these.
- To set out your commitment to making progress towards mutualisation.

Alice and Paula's objectives

- To set out her vision for the business, progress POL is making against plan, and any key areas of concern.
- To underline the importance of new revenue and government work in securing a viable future for the network. Alice and Paula are likely to seek your support in this area.

Annexes

Annex A: POL background

Annex B: Further information on Network Transformation

Annex C: Short biography of Alice Perkins and Paula Vennells.

CC: Cable MPST; Perm Sec MPST; SpAd MPST; ShEx Post Office Team

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Speaking Notes / Questions to ask:

	Points to draw from:
Opening remarks	<ul style="list-style-type: none"> • I am delighted to have the opportunity to build on the good work of my predecessor. • This is an exciting time for the Post Office; recent separation and Government investment presents an opportunity for positive and lasting change. • Post Office Ltd must deliver its commercial strategy – so successfully rolling out new network models and growing new revenues is crucial. • I stand ready to support you where I am able to deliver these priorities.
Network Transformation	<ul style="list-style-type: none"> • I understand that the Network Transformation programme is due to formally rollout on 1 Oct, with a plan to convert 1,200 branches by 31 March 2013 and a further 4,800 in the following 2 years. • <u>Are you confident that you will achieve this target?</u> • I understand that existing subpostmasters who are considering leaving will be incentivised to do so through the programme. What provision to continue service is being made for cases where the existing subpostmaster retires outside of the programme and there is no alternative subpostmaster available? • What is the plan for the remainder (c.4,000 branches) of the network who do not convert under Network Transformation?
Government Services	<ul style="list-style-type: none"> • I am pleased that POL has made some early progress but there is some way to go to reach forecast revenues from new services. • Clearly the current DVLA contract will be crucial – how confident are you of winning this? • More broadly, how do you feel the Company is set up to deliver its GS ambitions in the life of the plan – what are the barriers within the Company to delivery, if any? <p><i>If pushed to 'give' work to POL:</i></p> <ul style="list-style-type: none"> • I understand that all legal advice suggests that Post Office Ltd must compete for work – so it will be important that POL develops a clear, compelling GS offer. • All Departments are facing spending pressure – so will be looking to save costs. • I want to engage, coordinating with your efforts, to ensure that people are clear of our policy for the network, the positive changes underway, and the options the post office can offer to support delivery.

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Financial Services	<ul style="list-style-type: none"> • First, can I say how delighted I am to see agreement between HSBC and POL to allow access to current accounts at the post office – this is great news. • Also pleased to note conclusion of the Bank of Ireland renegotiation – believe this is key for expansion of personal FS, which will be an important part of POL's response to the introduction of Universal Credit. • I am keen to keep abreast of Post Office Ltd's work towards developing transactional accounts. • What are your thoughts on POL's future direction for financial services? How are you thinking about replacing POCA revenue in the longer term as it continues to decline?
Mutualisation	<ul style="list-style-type: none"> • I am pleased that the POL stakeholder forum is being established and is scheduled to meet for the first time in October – this is an important milestone in POL's mutualisation process. • How do you envisage the mutualisation process developing following this first meeting, both in terms of the structure of the process and its timing? • In what ways could other areas of POL impact on mutualisation, such as Network Transformation and your revenue growth plans? • What other challenges have you identified that pose risks to mutualisation, and how do you expect to be able to navigate these? • I am committed to supporting POL in making progress towards mutualisation. I am also conscious that no process will be possible without a commercially and financially stable business - it is therefore important to me that POL continues to work to deliver its plan. <p><u>If dispute between POL and NSFP on number of seats the NSFP have on the stakeholder forum is raised:</u></p> <ul style="list-style-type: none"> • It is important that the structure (including the Governance structure) of a mutual is developed collaboratively between POL and its stakeholders. • This is the same message I would give to George if he raises this question with me when we meet later today.
<u>IF raised</u> Remuneration	<ul style="list-style-type: none"> • I thank your team's engagement on this with my officials to date – would encourage this to continue. • I hear what you are saying, and it will of course be important to consider this within the wider context of an intense focus on pay in Government and Government-owned institutions. • Would encourage you to continue to work with officials on this issue.

RESTRICTED – POLICY AND COMMERCIAL**Annex A: POL Background****Network Transformation (NT)**

POL will shortly move to full implementation of their modernisation programme, which will see the conversion of 6,000 branches to new models (4,000 'Mains' and 2,000 'Locals' by end March 2015). It is crucial that POL delivers on these NT targets. **Annex B** gives more detail on Network Transformation.

Crown branches

Under the terms of the £1.34bn funding package agreed in 2010, POL is required to eliminate the losses of the directly managed Crown post office network (373 branches) by March 2015. The Crown network has been making heavy losses for many years (peaking at c £70m) primarily as a function of high staff (CWU negotiated pay rates now well above market levels) and property (city/town centre) costs. Previous attempts to address these losses have had limited success. Crown network losses for 2011-12 were £46m.

In recent months POL has been revising and refining its strategy to reach Crown network breakeven progressively over the three financial years to 2014-15 and now has Board approval for its programme to achieve this.

Government services (GS)

POL has forecast significant growth in GS income, accelerating throughout its commercial plan, which will be a challenge as it is against a backdrop of declining revenues from 'traditional' GS. POL wishes to develop a 'new generation' of GS which will support Government's plans to move more services online. This would be through services such as identity assurance, applications where POL captures digital data as part of the application process, and by providing 'assisted digital' services, supporting people who are not able to access online services independently.

POL has yet to fully define its offer in some areas, and needs to continue to focus on this. Some potential future services – such as the current DVLA contract – are well defined, but others are less clear. POL needs to focus on better defining its offer, working with Government to grow its pipeline of business. We should and do support POL as far as possible, but it is important that POL is clear that they are responsible for winning work in line with EU procurement regulations.

Post office has strengthened its GS team and they're approach seems to be improving but there is a long way to go to win new business to meet revenue forecasts. POL will also need to develop its plans to react to anticipated reductions in POCA revenues as Universal Credit is introduced.

POL may push for more support for GS – we should be clear that we will support wherever possible, but that POL must deliver quality, cost-effective services and be clear of what it can offer Government in order to win business.

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Financial services (FS)

POL's FS ambitions in its commercial plan were relatively un-ambitious. Since then they have employed a new Head of Financial Services who has taken a fresh look at the business and plans to develop the brand, sales model, and product offering in the coming years for personal FS. This includes piloting of transactional accounts, including a budgeting and current account, due in November (commercially sensitive). Most recently, POL have successfully renegotiated their relationship with their banking partner, Bank of Ireland. Amongst other things this sees better rates for POL, resulting in C£1.2 million increased revenues per month, a better platform to build the business from, and a 3 year extension of the contract out to 2023.

It's worth noting that Post Office Ltd's overall FS revenue is driven by a number of different products and services. Key examples include; bill payment; travel services; banking services (such as ATM services, and arrangements that allow people to access accounts in branch); NS&I products; and a range of personal financial services through a Joint Venture with the Bank of Ireland. They have recently announced new arrangements to allow HSBC current account holders to access current accounts in branch – C 9million customers.

Mutualisation

We published the Government's response to the "Building a Mutual Post Office" consultation document in July. Responses were cautiously positive and highlighted the need for protection of the public benefit purpose of POL, which is required in any case under the Postal Services Act 2011, and for a mutual POL to be financially and commercially sustainable. This is broadly in line with our thinking on the development of this policy.

A number of mutualisation work streams, including Cultural Change, Finance, and Governance, have now been initiated as well as a stakeholder forum to establish the definition of the public benefit purpose. POL is leading these work streams but it is important that Government is very close to their direction, and is enfranchised in decision making both as shareholder and a broader stakeholder.

POL and the NSFP have currently reached an impasse on NSFP's belief that they should have 2 seats on the stakeholder forum, which POL does not agree with. Paula/Alice may raise this with you – we do not think it would be desirable for Government to intervene at this point, and we should encourage POL and the NSFP to resolve this issue in a constructive way which supports the objectives of the forum.

Alice may set out that the process towards mutualisation has potential to interfere with delivery of POL's commercial strategy. It would be helpful to address these concerns with a reassuring, but firm steer: we agree that it is important that mutualisation is not taken forward in a way that harms the business; that there are clear business benefits in developing a more positively engaged relationship between POL and its stakeholders; and that continuing positive progress on engagement with staff and cultural change will be an important theme in the mutualisation process, and help to drive business performance.

Overall Company performance

2011/12: In a challenging economic environment, POL delivered a strong performance in 2011/12 - compared both to its own Budget and its performance in 2010/11. In particular it showed year-on-year growth in revenues for the first time since 2004/5 (of C. £17m). This

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growth was delivered from Mails and Retail, Government Services and in selected Financial Services activities (e.g. ATM and bill payments).

Tight control over the cost base resulted in operating costs which were £10m below budget. These factors provided management with the confidence to release additional capital to accelerate the Network Transformation programme. Due to these increased project costs POL's operating profit, before taking into account the £30m increase in Government subsidy, was £4m lower than in 2010/11. Including the increased Network Payment, POL's Operating Profit was £26m higher than 2010/11.

2011/12 performance provides a solid foundation for POL to grow, however pressures on management are likely to increase in 2012/13. The business needs to manage its transition to independence while at the same time deliver growth in new revenues, roll out the Network Transformation programme and continue down its path to mutualisation.

Year to date: POL recently presented us with July results, and a 2012/13 budget reforecast based on current year performance. So far, POL has performed well overall with sales and operating profit slightly above budget.

Governance

POL now has a full Board, with 3 appointments following Alice Perkins as Chair: Neil McCausland (Senior Independent Director), Virginia Holmes, and Tim Franklin (Non-Executive Directors). Susannah Storey represents Shareholder Executive on the Board.

Remuneration

Shortly after her appointment, Alice raised some concerns that the pay package for Paula Vennells was low as compared to her peers and flagging up that separation from Royal Mail group would see Paula taking on new responsibilities. Since separation, we have been working with POL to agree pay for the 2 members of the Executive Team on the Board – Paula Vennells and Chris Day (FD), which will need to be approved internally in BIS, with HMT and Ministers.

Given that Paula will also be at this meeting we think it unlikely that Alice will raise this point so have provided a point to make in case it is raised only.

RESTRICTED – POLICY AND COMMERCIAL**Annex B: Network Transformation**

1. Network Transformation is a Post Office Ltd programme that will see £585m of public money used to modernise 6,000 branches (about half of the existing network) by March 2015. The modernised branches will operate under two new operating models, known as 'Main' and 'Local', which provide subpostmasters with commission only remuneration. This is a departure from the traditional sub post office operating model where subpostmasters receive a fixed payment (known as the 'core tier payment'). The programme is completely voluntary and no subpostmaster is being forced to convert.

2. The current network of 11,800 branches comprises¹:

Crown	Franchise (ex Crown)	Sub Post Office	Outreach & Satellite	Local	Main
373	410	9,820	1,000	200 (pilots)	30 (pilots)

3. After Network Transformation, the network in March 2015 is expected to comprise:

Crown / Premier	Franchise (ex Crown)	Sub Post Office	Outreach & Satellite	Local	Main
300	500	4,000	1,000	2,000	4,000

4. The new models have been extensively piloted, and national rollout of Network Transformation will begin on 1 October 2012. Post Office Ltd has targets to achieve 1,200 conversions by 31 March 2013, and 4,800 conversions over the following two years. The following table shows the expected profile of conversions:

Model	2012 / 13	2013 / 14	2014 / 15
Local	400	800	800
Main	800	1,600	1,600

5. In November 2011, Post Office Ltd held a series of events for subpostmasters across the country to explain the new models to subpostmasters. Subpostmasters were then invited to participate in a non-binding survey, where they were asked to express their preference for three options:
- Convert to one of the new models
 - Exit the network, with compensation
 - Stay on their existing contract
6. Around 6,000 subpostmasters have expressed a preference. Over 2,000 are interested in conversion; 1,200 wish to exit the network; the remainder indicating initial preference to remain on their existing contractual terms. The survey will be rerun annually.
7. Around 3,000 branches are operated by multiple operators – i.e. The Co-op, Tesco, McColls. Post Office Ltd has relationships with the company, rather than individual store managers, and the future of these branches was not considered by the subpostmaster survey. The multiple partners have expressed a strong interest in the new models, and Post Office Ltd expects a significant number to convert over the duration of the Network Transformation programme.

¹ Please note, numbers have been rounded.

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8. Conversions are categorised as either 'on-site' or 'off-site':

On-site	Off-site
Conversion takes place within the existing premises, with either the existing subpostmaster moving to the new contract, or being replaced by a new subpostmaster who operates the new model.	Relocation of Post Office services to a nearby premises, and nearly always a new subpostmaster. Post Office Ltd will hold a public consultation for each off-site conversion (agreed with Consumer Focus).

9. The following process will be followed where a subpostmaster has expressed their preference for conversion:

- a. Subpostmaster survey: incumbent expresses preference for conversion in non binding survey.
- b. First visit: Post Office Ltd visit branch and discuss suitability for conversion.
- c. Second visit and business plan: more detailed discussed about logistics of conversion (counter size etc). Subpostmaster required to submit a business plan to demonstrate that they can sustainably provide Post Office services under the new model. Still non-binding at this stage.
- d. Public engagement: in a process agreed with Consumer Focus, Post Office Ltd will publicly consult where there is to be an off-site conversion, and communicate with customers where the conversion is on-site.
- e. Contract signing and implementation: subject to the satisfactory completion of the business plan, the subpostmaster will sign a new contract, and the branch will be converted.

10. The process for exiting the network is broadly similar. The incoming subpostmaster will be required to complete a business plan prior to conversion, and if the transfer involves the branch relocating then there will be a public consultation. Requiring subpostmasters to demonstrate financial viability through the business plan ensures public money is only invested in appropriate branches, and should prevent unplanned closures.

11. By March 2013, Post Office Ltd expects to have converted around 1,200 branches. The following table sets out how they expect to achieve this:

Type	Plan	Comments
Live branches	230	These are the existing pilot branches that are already operational.
Multiple partners	270	110 branches have scheduled conversion dates. 160 are awaiting a date, and can be flexibly deployed. These will all be on-site conversions.
Service issues	40	These will be off-site conversions where the existing premises is withdrawn following, for example, the retirement of the SPM.
Independents	950	These are cases that are planned following the preference exercise, and the majority are expected to be on-site conversions.
Total	1,490	Post Office Ltd is factoring in a 'drop out' rate following the first visit, but aims to meet the expected 1,200 conversions by March 2013.

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Annex C: Biographies

Alice Perkins

Alice Perkins was a civil servant between 1971 and 2005, spending time in the DHSS, Treasury, Department of Health and as Director General of the Corporate Development Group in the Cabinet Office (where she was head of civil service HR, reporting directly to two Cabinet Secretaries).

Since leaving the civil service she has worked as a professional coach, coaching both the current and previous Managing Directors of POL to prepare them for their interactions with government. She was a non executive director on the BAA board 2006-8 (up to the takeover by Ferrovial) and on the Taylor Nelson Sofres board 2005-8 (up to the takeover by WPP), under the chairmanship of Donald Brydon.

At TNS Alice chaired the remuneration committee. She is one of three external members of the Oxford University Council (the University's governing body) and a member of the Said Business School's Business Advisory Council.

Alice is married to Jack Straw and her son Will is editor of the blog Left Foot Forward.

GRO

Paula Vennells, Managing Director, Post Office Ltd

Paula joined Post Office Ltd as Network Director in December 2006 and was appointed Managing Director in October 2010.

Paula played a key role in developing the Post Office's new business strategy which underpinned the Government's policy statement on post offices, published in November 2010.

Prior to joining the Post Office, Paula spent 5 years with Whitbread plc as Group Commercial Director, part of the team that turned around the business from declining brewer to successful leisure operator.

In 2005, Paula was ordained a Church of England priest in the Diocese of St Albans and is currently ministering as a non-stipendiary priest in three parishes in Bedfordshire.

She is a trustee and non-executive director of Hymns Ancient and Modern; and supports Toybox (a charity supporting and rehabilitating street children in South America); Barnardos; and Christian Aid.

GRO