

In Strictest Confidence

**POB(98)10th
PO98/123 to 138**

POST OFFICE BOARD

**Minutes of the meeting held on 8 December 1998
at 148 Old Street**

Present

Dr Neville Bain	Chairman
John Roberts	Chief Executive
Richard Close	Managing Director Finance
Jerry Cope	Managing Director Strategy & Personnel
Mike Kinski	Non-Executive Member
Dr John Lloyd	Non-Executive Member
Miles Templeman	Non-Executive Member
Rosemary Thorne	Non-Executive Member
Richard Adams	Secretary
Scott Childes	Notes

Richard Dykes, Managing Director Royal Mail
Stuart Sweetman, Managing Director Post Office Counters Limited
Kevin Williams, Managing Director Parcelforce Worldwide

Others attending: David Morphey, POCL Commercial Director, for item PO98/129
Dick Wheelhouse, POCL Lottery Director, for item PO98/130
Dom McKenna, International Transaction Team Leader, for item PO98/131
Barrie Stephens, Royal Mail Delivery Review Director, for item PO98/132

**MINUTES OF
PREVIOUS MEETING**

PO98/123

The Board approved the minutes and separate record of proceedings from its meeting of 10 November 1998.

MILES TEMPLEMAN

PO98/124

The Board welcomed Miles Templeman who had been appointed a Non-Executive Board Member for a three year period from 6 October 1998.

GRO

In Strictest Confidence**MATTERS ARISING
POB(98)78****PO98/125**

The Board noted the matters arising from the meeting of 10 November 1998.

Liberalisation of
Postal Markets &
PO Regulatory
Strategy
(PO98/113)

- (i) A meeting had still to be held with the General Secretary of the CWU. A further report would be provided after this meeting had been held.

**CHAIRMAN'S
BUSINESS****PO98/126**

- (i) The Chairman highlighted the sensitivity of discussions on the Lottery and the need to maintain strict confidentiality.
- (ii) The announcement on the outcome of The Post Office Review and the positive benefits it outlined were in no small measure the result of the efforts of John Roberts, Jerry Cope and the Review team.
- (iii) The detail behind the statement would be contained within a White Paper due to be published in January. The media reaction had been lukewarm with some disappointment that privatisation had not been announced. However, a share sale would have resulted in at least two years of further uncertainty as legislation was progressed.
- (iv) The announcement that an annual cash dividend of 40% of post tax profits would be introduced was welcomed, as was the reduction in next year's EFL from £335m to £207m, although both had already been built into the existing Corporate Plan. It was understood that a threshold of £75m would be placed on investment projects below which Government approval would not be necessary. Government would approve normal investment cases above £75m provided they could be shown to be commercially robust. This was a significant improvement.
- (v) The new financial regime was expected to be introduced from April 1999.

noted further that

In Strictest Confidence

- (vi) The emphasis on a rolling five year strategic plan, which would be agreed with Government, was significant. It would detail the five year capital programme and development capital spend. Significant one-off investments not within the plan would be referred to Government for approval, with an assurance that a response would be provided within 28 days.
- (vii) The importance of the White Paper was recognised as was the need for the Secretary of State to remain firm on his stated position.
- (viii) The announcement to proceed within the public sector would be welcomed by the CWU and it would now be important to work with them to develop relationships and agreements, building on the impetus of the statement.
- (ix) No further detail had been provided with regard to regulation, although it was known that an interim arrangement with the DTI acting as regulator was a possibility.
- (x) The embargo on Crown Office conversions had been lifted and The Post Office Minister, Ian McCartney, had supported The Post Office position that the network should not be based on a specific number of offices but rather the volume of business transacted through the directly owned network. He had accepted a volume figure of 15%.
- (xi) The Board's consideration of project Sapphire (PO98/131) was of fundamental importance to the future of the organisation and the realitively weak financial case had to be balanced against its strategic importance.
- (xii) Horizon had reached a critical stage with ICL having until 9 December to reply to the letter from Stephen Byers, Chief Secretary to The Treasury, which sought agreement on an acceptable Heads of Agreement with POCL and the Benefits Agency.
- (xiii) The Chairman recognised the difficult commercial conditions within which the businesses were trading. Nevertheless a clear commitment to achieve the Group budget remained essential, with the failure of one business being detrimental to the image and perception of the others.

In Strictest Confidence

CHIEF
EXECUTIVE'S
REPORT POB(98)79

PO98/127

- (i) Financial Performance. With the exception of Counters, October had been a poor month financially. A successful Christmas was therefore of increasing importance.
- (ii) Pay Settlements. The Executive Committee of the CWU had agreed Royal Mail's pay award which was now to go to an individual membership ballot. The deal was within budget and the negotiating remit, adding 3% to the paybill.
- (iii) Royal Mail Pricing. The DTI had received Royal Mail's pricing proposals but a response was not expected until later in the month.
- (iv) Horizon. (a) The letter from Stephen Byers (PO98/126) had been met with surprise by ICL who to date had not responded on how they intended to finance the programme. It was important that, in the event of Horizon being ceased, Counters could work with the Benefits Agency on an alternative automated solution. Counters could not afford to lose the BA income, at least in the short term.

(b) Day to day management of the programme was now compounding other difficulties. ICL had just confirmed that software due to be released shortly would require further laboratory testing. This would delay the programme by between 1 - 2 months and move rollout from July to September. This would further damage ICL's credibility.

(c) Authority to negotiate had been transferred from ICL to the parent company Fujitsu. Funding requirements had increased with the latest estimate being £800m, an increase of £200m since November.

(d) News of the additional delays and increase in funding made it appear increasingly unlikely that the programme would proceed. It now had to be regarded as doubtful that Fujitsu would be prepared to proceed when the financial risks were so great.

(e) Government was taking legal advice on terminating the programme, something Counters had already undertaken.

(f) Ceasing Horizon would not necessarily impact on Counters' vision, but it would have network implications.

In Strictest Confidence**FINANCIAL
SUMMARY**

(g) In a post Horizon environment the Benefits Agency would press for the introduction of Automated Credit Transfer (ACT) with benefits payments being paid directly into a bank account. This was unlikely to be an attractive proposition for banks.

PO98/128

- (i) Profit for October was:
 - Royal Mail £40m
 - Parcelforce £(1.9)m
 - POCL £6m
 - SSL £1.9m
- (ii) Royal Mail's poor performance was the result of increased staff costs which, on current performance, would result in a variance of £25m from the full year forecast. Remedial action was being taken to eliminate the overspend, and the expected introduction of a productivity deal with the CWU would be of assistance. It was hoped that the current advertising campaign would also increase revenue.
- (iii) Royal Mail's risks currently outweighed opportunities.
- (iv) Debts over 90 days old remained stubbornly difficult to reduce within Parcelforce with £18.12m outstanding at the end of November. With no experience in this area the business had found it difficult to reduce the level of debt although a great deal of work was being focused on doing so, including the use of sales staff.
- (v) Negotiations with Hewlett Packard on a settlement figure were continuing although it was likely that a payment of £4.2m (plus VAT) would be agreed with £2m paid in this financial year and the remainder in 1999-00.
- (vi) Trading conditions were extremely difficult with PF48 seeing monthly growth of £0.5m moving to a reduction of £0.5m in October. Competitors were also facing financial pressures.
- (vii) Manpower reductions of 2,500 would occur as a result of lower volumes and every effort would be made to exit 1998-99 at a level appropriate for 1999-00.

In Strictest Confidence

- (viii) Parcelforce's cumulative performance was nearly £10m below budget at -£20.1m. Income across the board was disappointing although the business was anticipating the award of a number of contracts. Notwithstanding these it was now unrealistic to expect the original budgeted loss of £12m to be achieved.
- (ix) It was agreed that Richard Close would report to DTI forecast outturns of £478m for Royal Mail, £(20)m for Parcelforce and £35m for Counters.

**POST OFFICE
VISION AND
STRATEGIC
DIRECTION FOR
POCL POB(98)80**

PO98/129

- (i) POCL's Vision and strategic direction had first been exposed to the Board at its July Awayday. It had been developed to ensure the viability of the business beyond the current business plan.
- (ii) Work had focused on the development of three areas: wholesale cash and banking, as a gateway between individuals and Government, and maintenance of its traditional mails and distribution business.
- (iii) Three key enablers bound these activities together: the strength of the network, the use of smartcard technology and the strength of POCL's trusted brand image.
- (iv) The Vision provided a one-stop location for customers to carry out banking, interact with Government and conduct postal business. They would use a post office because it was close, it provided a number of services in one location and it was trusted and regarded as being independent from Government.
- (v) Implementing the Vision would be a considerable challenge, not least because funds would need to be found, as would partners, whilst continuing to achieve targets.

noted further that

- (vi) The business was targeting a return on turnover of 2.5%. Even allowing an asset turn of six times, this would only achieve a 15% return on investment. POCL needed to compete for funds with other internal initiatives and if partners could be found to provide 75% of the funding a return of 18% would be achieved. Further work on

In Strictest Confidence

the mix of funds was therefore required.

- (vii) The Vision, with the possible exception of cash, aligned well with the Group vision; the key issue for Counters would be attaining business to sustain the new operation.
- (viii) Counter's believed it could develop a role as a front end provider of services for banks who were continuing to reduce the scale of their own networks. Pilot operations with Lloyds TSB were already underway and the business had strong links with Girobank, the banking arm of Alliance & Leicester and the Co-operative Bank. Whilst an important element of the Vision was to retain income from the Benefits Agency, it was reliant on also developing a new client base.
- (ix) The provision of excellent customer service would be a fundamental requirement if banking business was to be secured. The rural network was also important, often providing services for communities that had no banks or supermarket outlets.
- (x) Whilst telephone banking and electronic payment of bills was increasing, Counter's research had concluded that for the majority of its customers (C2, D and E's) a post office was the favoured means of drawing cash, benefits etc. Research also showed that as people aged their shopping habits altered and they were more likely to want an outlet providing the services Counters was proposing.
- (xi) Government Gateway held the greatest element of risk for the business and pilot exercises were being utilised to demonstrate its viability.
- (xii) The Vision could not be introduced overnight. It needed to be developed over the coming five years during which time the credibility of the proposed initiatives would be proved or disproved.
- (xiii) The Secretary of State's announcement on the outcome of The Post Office Review had highlighted Counters' social role and in looking at this with a view to grow its market the business would want to consider working with external organisations to improve standards of literacy across the country.

In Strictest Confidence

- (xiv) The Counters network was of considerable importance to the mails businesses and it would be important to try and defend this position should a regulator seek to open the network to competitors.
- (xv) Developing appropriate partnerships which would still provide the strategic flexibility for Counters to operate as it wanted would require careful consideration.
- (xvi) Thanked Stuart Sweetman for his clear and informative paper
- (xvii) Supported the broad strategic direction proposed, noting that further work on the financial viability and deliverability within the context of Group wide initiatives was necessary.

Action

Stuart Sweetman

- (a) Consider how work on literacy being progressed by Royal Mail could be linked to Counters' social obligation within the community.
- (b) Bring to the Board an update paper on the Government Gateway exercise.

Secretary

- (c) Consider the possibility of a demonstration of new technology (such as Gateway) after a Board meeting, or, perhaps of visiting one of these pilot venues.

THE NATIONAL
LOTTERY
PROJECT
POB(98)81

PO98/130

(Secretary's note: The minute of this discussion has been circulated to Members on a personal basis)

PROJECT
SAPPHIRE
POB(98)88

PO98/131

(Secretary's note: The minute of this discussion has been circulated to Members on a personal basis).

In Strictest Confidence

ROYAL MAIL
DELIVERY
REVIEW - THE
WAY FORWARD
POB(98)82

PO98/132

- (i) The work done to date did not encompass Royal Mail's top 1000 customers or rural deliveries and developed the issues discussed by the Board at its July Awayday.
- (ii) Considerable research had been conducted to determine the delivery preferences of a wide range of residential and business customers (SMEs and SOHOs). The research concluded that residential customers wanted improved punctuality and reliability within the existing specification. Business customers endorsed this view.
- (iii) A number of delivery options had been considered and following discussions at the Executive Committee the proposal for an early delivery plus a 'sweeper' second delivery, had been endorsed. Additionally, the Second Class specification would be altered to an on day two service for all second class products. This would eliminate customer confusion around what the service specification was.
- (iv) New arrangements for Second Class traffic would be introduced and to reduce disruption and lower the risk of customers down trading from First to Second Class the changes would be introduced on a phased basis. Customers switching from First to Second Class was likely to have a negative impact of £40m, although in the worst case this could be up to £95m.
- (v) In the context of the preferred option, two time spans were considered feasible - delivery between 0630 and 0930 or delivery between 0700 and 1000. An 0630 start would allow more customers to receive their mail early, would fit with existing specification and customer need, and provide a time window to handle unexpected operational difficulties. The main uncertainty with this option was the desirability of an 0630 start time and its achievability. An 0700 -1000 time frame gave employees the benefit of a later start time and was easier in operational terms. It would however, result in later delivery for some customers and moving beyond 0930 would be politically sensitive.

noted further that

In Strictest Confidence

- (vi) The quality target for Second Class traffic would be set at 95% of items delivered on Day C. This was somewhat higher than that currently achieved (88%). The balance of judgement taken by the business was that Day C was achievable and preferable. Work to confirm feasibility of a 95% target would be undertaken and the brand name Second Class should be reviewed.
- (vii) An 0630 delivery start time could not be achieved in every geographical location. The number of attendance calls before 0700 would be small and not seen as a major issue.
- (viii) The impact of an 0630 start time had a significant impact on employees and managing the change through the CWU was a major challenge with no certainty of achievement. Whilst industrial relations benefits would be gained through improved long term job security and the provision of a five day working week, employee benefits were less obvious. However, the impact of greater competition announced in the outcome of the Post office Review could be a useful lever to highlight the importance of securing these cultural changes .
- (ix) Communication of the key issues of customers' needs and ultimately the future of the business, would be crucial in securing the necessary cultural changes.
- (x) Whilst research showed that customers did not seek delivery before 0700, they did want greater reliability and early delivery. An 0630 start would provide greater flexibility to cope with problems that might occur and improve the level of service for the great majority of customers. This 'contingency' was removed in an 0700 to 1000 delivery span and could result in dissatisfied customers removing business.

In Strictest Confidence

- (xi) Health and safety implications of an earlier start time had not yet been considered.
- (xii) Endorsed the planned project direction and the focus on an early delivery specification and improved Second Class specification.
- (xii) Supported the development of the project and the plan to focus on HR strategy development in conjunction with the Unions.

Action
Richard Dykes

As part of the ongoing development work, consider re-branding the re-specified Second Class product.

PO98/133

POST OFFICE
UNAUDITED
ACCOUNTS FOR
THE HALF YEAR
TO SEPTEMBER
1998 POB(98)83

- (i) The half year accounts had been reviewed by the Audit Committee at its meeting on 27 November. Ernst & Young, the Post Office's Auditors, had also reported their observations.
- (ii) In the half year ending 27 September 1998, the Group operating profit was £205m. The trading profit (after net interest receivable but before taxation) was £283m.
- (iii) The 1998-99 half year trading profit was £46m less than that recorded last year. This was largely the result of increased staff costs in Royal Mail.
- (iv) Publication would be low key with the actual date being determined in liaison with the Group Director Communications.
- (v) Authorised the signing of the letter of representation.
- (vi) Agreed that the half year results be published in the format of Appendix 1 to the paper with the date being determined by the Chairman, Chief Executive and Managing Director Finance in the light of public relations sensitivities.

In Strictest Confidence

Action
Richard Close

Prepare, in liaison with the Director Communications, a press release which addressed the reduction in profit from that reported in 1997-98.

PO98/134

**POCL AUTOMATED
TRANSFORMATION
PROGRAMME
POB(98)84x**

**Transaction
Information
Processing (TIP)
POB(98)85x**

**SAP Advanced
Distributions
Systems Project
POB(98)86x**

- (i) Automation was one of Counters key transformational enabling strategies with the automation of the network through Horizon a cornerstone of the business' automation programme.
- (ii) Within the automation programme, and highly dependent on the continuation of Horizon, were two systems: Transaction Information Processing (TIP) and Advance Distribution Systems (ADS). Both had been considered by MaPEC.
- (iii) The TIP system received transactions from Horizon, summarised them, if necessary validated them and then passed information to other Counters systems.
- (iv) SAP supported cash centre operations and utilising Horizon technology would reduce the value of overnight cash holdings within Counters outlets.
- (v) Should Horizon cease, both TIP and SAP would need to be suspended and reviewed by MaPEC.
- (vi) Endorsed MaPEC's approval of TIP at a total outturn cost of £18.8m, including sunk costs, approval in principle of £2.5m for OnLine TIP, and DFEs of £2.9m, inclusive of potential staff severance costs.
- (vii) Endorsed MaPEC's approval for a revised total authority of £17.5m, of which £10.7m at outturn prices was required to provide new and integrated logistics operational system and infrastructure to manage cash and stock products for POCL outlets.

Action
Stuart Sweetman

Avoid any new incremental expenditure on these projects until the future of the Horizon programme is settled.

In Strictest Confidence

**DIRECTORSHIP OF
POST OFFICE
PENSIONS
TRUSTEES LIMITED
(POPTL)
POB(98)87x**

PO98/135

- (i) Appointments to the corporate trustee company, POPTL, required Post Office Board approval
- (ii) Agreed that Brian Thomson be re-appointed as a Director of POPTL for a three year period until 31 December 2001.

**REMUNERATION
COMMITTEE**

PO98/136

- (i) Review commitments and the need for meetings with Mike Kinski.

Proceed as above.

Action
The Secretary

**COMMUNICATION
WITH NON-
EXECUTIVE
MEMBERS**

PO98/137

- (i) Ensure that lines of communication e.g. email, exist between Executive Members' offices and those of Non-Executive Members.

Proceed as above.

Action
The Secretary

**DATE OF NEXT
MEETING**

PO98/138

Scheduled for 12 January 1999.