



HM Government

Post Office Limited

Strategy discussion with Shareholder Executive team

March 2014

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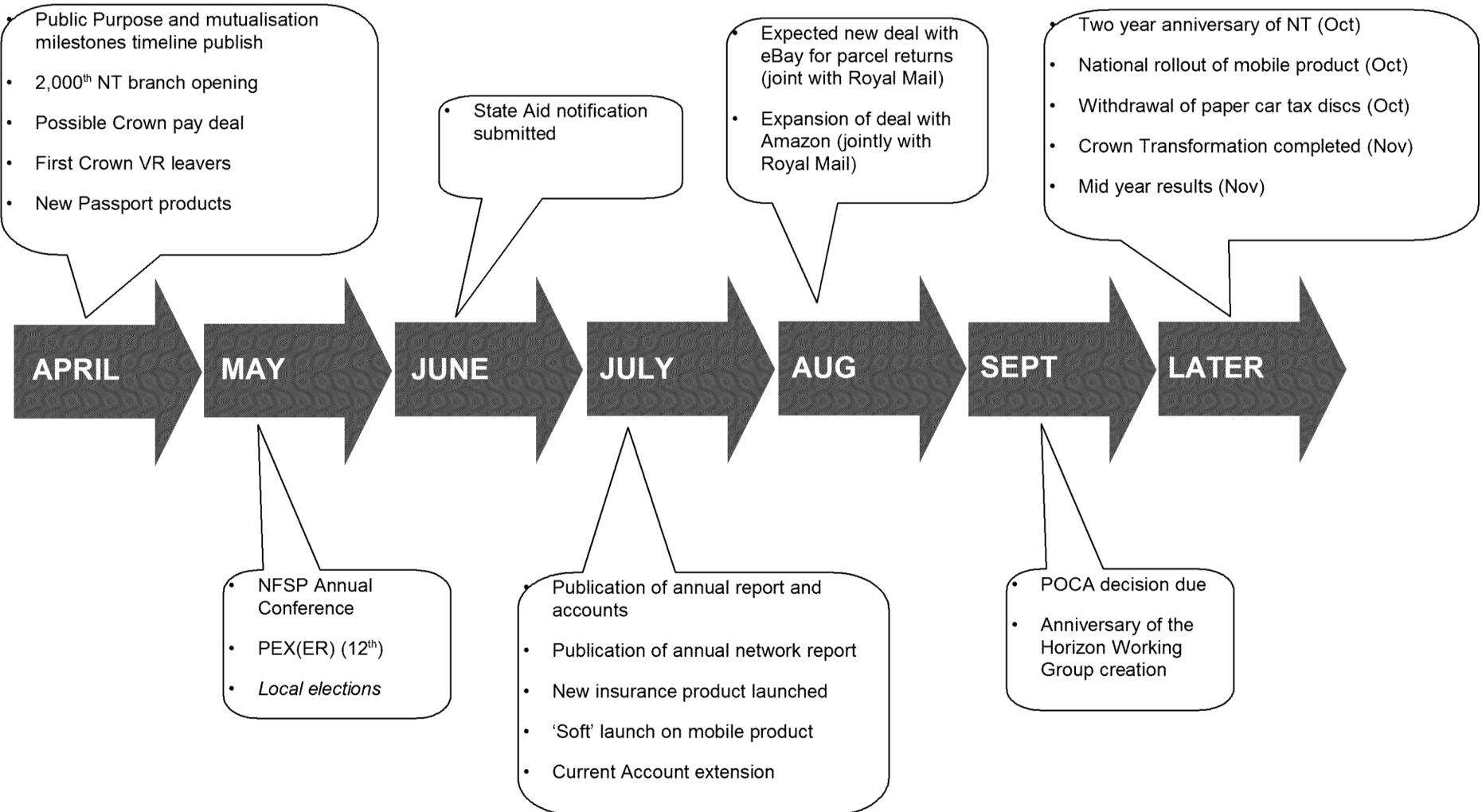
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1

Forward look



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Project Sparrow

A small but vocal minority of ex-SPMs have consistently raised concerns about the integrity of POL's accounting software...

...an independent review in 2013 found "no systemic issues" but areas for improvement in training...

...POL has established a mediation scheme for aggrieved ex-SPMs, overseen by a working group. But the working group is currently paralysed and POL is keen to break the deadlock

- A small minority of ex-SPMs, represented by the Justice for Subpostmasters Alliance (JFSA) had historically raised concerns about the integrity of POL's accounting software, Horizon
 - POL appointed independent forensic accountants, Second Sight, to investigate the claims. Their report, published in July 2013 found there were no systemic issues, but proposed a number of measures about subpostmaster support and training
- POL established a Working Group, independently chaired by Sir Anthony Hooper, comprising POL, Second Sight & JFSA to consider cases put forward by ex-SPMs
 - The Working Group received 147 submissions from ex-SPMs
 - It is the role of the Working Group to consider the applications, and to decide whether the cases merit mediation
 - The Working Group is not a judicial body, and cannot overturn court judgements
- The Working Group is not working
 - The Working Group was established in September 2013, and the deadline for applications was November 2013
 - So far the Working Group has yet to consider a case
 - Second Sight appear unable to process and prepare cases quickly enough, or to a sufficiently high standard. They have also admitted to POL that they have become emotionally involved in specific cases, and their independence and objectivity is almost certainly compromised
 - It is imperative that a suitably professional organisation is introduced to the process to enable cases to be considered in an appropriately timely manner.
 - However, attempts to replace Second Sight would be likely to be seen as POL interference and could see the JFSA walk away from the process. Retaining JFSA involvement is important in giving credibility to the process
- Legal advice from Linklaters is clear that POL does not have the same duty of care towards subpostmasters as compared to employees, and that it is not obliged to pay ex-SPMs for their human error in processing transactions
 - Despite this, there is a concern that claimants expectations' are rising, and POL will need to respond quickly to ensure the Working Group begins processing cases.
- You will need to consider your involvement and any public support for POL
 - The Horizon system and the training and support provided to SPMs is an operational matter, and Ministers have maintained an appropriate distance. However, if POL is unable to break the deadlock they may look to you to provide support for their position.

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Network Expansion and competitor networks (CONFIDENTIAL)

As part of last year's negotiations, POL agreed to grow the network to 12,000 outlets by 2015...

...the company is exploring a number of possible models, specifically designed to address gaps in the market...

...this is not an ideological move. POL's competitors networks for the first time outnumber POLs network, and the POL must respond to protect its revenue base

▪ **Competitors have aggressively expanded their networks**

- For the first time in POL's history, its retail mail competitors networks are in aggregate larger than POLs. This growth has been fuelled by the rapid increase in home shopping returns, which is forecast to continue to grow strongly

	2010	July 2013	December 2013	% increase since 2010
Post Office Ltd	11,905	11,726	11,719	-1.6%
Competitor networks	c.3,500	c.10,000	c.15,050	+330%

▪ **POL's 2020 strategy and funding plan stated**

- “Network expansion will be necessary to maximise the mails market opportunity and resist competitive expansion, it must be balanced with a commitment that we will not cannibalise our subpostmasters' businesses. Our strategy therefore include a commitment to increase our physical reach through the development of access points rather than full service post offices.”

▪ **The principles behind network expansion are**

- To challenge competitors networks, which are aggressively expanding to meet market demand for innovative and accessible services (such as parcel collection and return)
- To enhance the Post Office brand, and to complement the services provided by existing branches
- To protect POL revenue from competitors – there is a need to respond to the changing market
- To move quickly. From a standing start today, POL is targeting 400 new outlets by 2015, and 2,000 by 2020

▪ **Network Expansion won't be without its critics**

- The NFSP opposed the concept of expansion during last year's negotiations, fearing that an expansion of access points could cannibalise their members revenue streams.
- POL and BIS need to demonstrate that not responding to the expansion of competitors networks will see POL lose market share, and this will weaken both the company and subpostmasters. Expansion is crucial to maintaining POL market share

▪ **POL will trial new concepts this year**

- Automated access point – an unmanned self-service kiosk providing access for postage and letter / small parcel drop off. This could be operated by a local subpostmaster, with them deriving additional, or protecting existing revenue
- Post and parcel shop – a self-service and manned counter service, co-located with selected retailers to provide basic mails and other core services.

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Mutualisation

Mutualisation of POL will be the largest and most complex transaction of its type ever undertaken...

...although slow, progress is being made – from a standing start in 2010 POL has sought to work collaboratively with stakeholders in ways neither side are used to...

...the company is preparing to publish its "Public Purpose" following the work of the Stakeholder Forum

- Mutualisation of POL will be the largest and most complex transaction of its type ever undertaken...***
- ...although slow, progress is being made – from a standing start in 2010 POL has sought to work collaboratively with stakeholders in ways neither side are used to...***
- ...the company is preparing to publish its "Public Purpose" following the work of the Stakeholder Forum***
- In its response to the public consultation, Government stated it wants “clear progress to have been made towards mutualisation of POL by the end of this parliament”. But identified four key targets to be met before mutualisation:**
 - (i) a mutual needs to be both financially and commercially sustainable, minimising the need for Government intervention in the event of financial distress
 - (ii) the right culture needs to be developed, encouraging stakeholder engagement and marking a move away from the established “top-down” style of management
 - (iii) POL’s strategic plan needs to be delivered successfully – this plays a role in making POL sustainable and viable
 - (iv) Government must endorse a mutualisation (which represents VfM), and Parliament must vote for an ownership transfer
 - POL established the “Stakeholder Forum” to define the company’s Public Purpose. POL is preparing to publish the Public Purpose imminently. The Public Purpose reads**

*The Post Office is unique: a commercial business set apart by its public purpose.
We are driven by a belief in the importance of connecting communities and enhancing the powerful role they play in all our lives.
We will stay true to this commitment by delivering key products and outstanding customer service through our unrivalled local presence across the UK.
To deliver our public purpose we run our organisation by the following four principles:
• Keep customers at the heart of everything we do
• Build relationships based on trust
• Treat everybody with fairness and honesty, responding to each individual’s specific needs
• Make a positive social and economic contribution to all the communities in which we work.
As an organisation we pledge to:
• Maintain ethical attitudes in all our behaviours
• Invest in the organisation to secure the business for the future
• Listen with care to the views of customers, colleagues and others with an interest in the Post Office, and support their development distress*
 - POL has recently established the Post Office Advisory Council (POAC) with the purpose of engaging staff, subpostmasters, customers and other relevant parties on matters of mutual interest. It is a forum where new ideas can be generated and discussed, feedback received and a means of beginning to embed mutual behaviours. This will include understanding how the Post Office can retain its public purpose while becoming and operating more commercially.**
 - The POAC held its first meeting on Wednesday 19 March. It is made up of 25 members covering a broad spectrum of interests and skills, and representing a wide variety of stakeholders. The NFSP, CWU, and Consumer Futures are all represented.

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2014-15 Budget

POL is forecasting growth across all key revenue pillars in 2014/15, meeting the strategic plan target...

...key drivers are in mails and financial services, with government services revenue expected to be broadly flat...

...however this is dependent on the successful launch and growth of new products to counter the decline in traditional services

Pillars	2012-13 Outturn	2013-14 Budget	2013-14 Q3 forecast	2014-15 Strat Plan	2014-15 Budget	2014-15 Budget vs Strat Plan	2014-15 Budget v 13/14 Q3
Mails and retail	404.0	414.6	397.9	430.0	423.9	(6.1)	26.0
Financial Services	279.6	277.4	277.4	295.0	295.2	0.2	17.8
Government Services	133.2	115.9	114.5	117.0	117.0	0.0	2.5
Telephony	45.0	50.4	50.7	60.0	61.8	1.8	11.1
Other	40.7	36.7	39.1	38.0	36.5	(1.5)	(2.6)
Income contingency	0.0	5.0	0.0	(15.0)	(9.4)	5.6	(9.4)
Total Net Income	902.5	900.0	879.6	925.0	925.0	0.0	45.4

1. The Budget is stretching and ambitious.
2. As 2013-14 has not delivered expected revenues, there is greater pressure on POL to deliver higher growth to meet 2014-15 budget. There is minimal contingency held against the plan (c.1%)
3. Poor 2013-14 mails performance due to Royal Mail pricing policy is addressed by the introduction of the shoebox product. 2014-15 growth of 6.5% forecast, key dependency on working with Royal Mail to launch a successful home shopping returns product.
4. Falling staff costs linked to Crown staff VR programme, and introduction of automation across the Crown estate will realise savings
5. Network Transformation will continue to deliver savings, but momentum must be maintained to realise these. The new branch operating models will more closely align POL agent costs with income.
6. POL is not progressing the home energy proposition, this is partially offset by increased expectations for the mobile product
7. The network subsidy payment in 2014-15 falls to £160m (out of total funding of £330m), in line with 2010 funding agreement

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Network Transformation

Network Transformation is seeing the widespread restructuring of POL's estate, changing how customers interact with branches and how POL interacts with its network...

...while POL has experience of delivering large transformation programmes, the scale of the current strategy is unprecedented...

...since November 2013 POL has modernised branches more quickly, but this pace of change must be maintained

- **Network Transformation was developed in 2010/11 as a 5 year strategy to transform and modernise the agency network**
 - increases the viability of branches operated by subpostmasters, improves the customer and in-branch experience, delivers financial benefits and flexibility to POL and ensures a reduced reliance of POL and the network on HMG funding
- **The voluntary programme rolled out in October 2012, with an expectation that POL would meet interim targets towards 6,000 modernised branches by March 2015**

	March 2013	March 2014	March 2015
Anticipated conversions	1,200	3,600	6,000
Actual conversions (contract)	1,450	c.3,200	c.4,400
Actual conversions (open)	507	c.2,100	c.3,350

- **However soon after rollout of the strategy the rate of conversions started to fall behind expectations. POL has addressed this in its new strategy, which is supported by the NFSP. There are a number of changes to accelerate conversions**
 - More funding has been secured to incentivise the right behaviours among subpostmasters (e.g. increased compensation and investment) and the timeline has also been extended by one year – completion is now expected by March 2018
 - Although SPMs retain an element of choice, the profile of conversions has also changed. Fewer than 6,000 branches are now expected to convert by March 2015, but the overall target to convert all branches that can be viably converted remains
 - A new “Community” designation has also been introduced that will ensure that where branches should not convert (e.g. due to the impact on their viability) they will not be forced to do so. Service provision among this population will be protected
- **Following these changes, POL is more confident that the programme is deliverable and can meet the following targets**

		March 13	March 14	March 15	March 16	March 17	March 18
Contracts	Worst case	1,450	c.3,200	c.4,150	c.5,350	c.7,600	c.8,300
	Best case	1,450	c.3,200	c.4,800	c.6,350	c.8,150	c.8,300
Openings	Worst case	507	c.2,100	c.3,250	c.4,580	c.6,000	c.7,800
	Best case	507	c.2,100	c.3,700	c.5,350	c.7,900	c.8,300

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Crown Transformation

The Crown Transformation Programme is in full roll out with over a third of retained branches modernised...

...the programme is due to complete in November 2014, but it is expected that a small number of branches will not be franchised...

...the key risk affecting POL's ability to meet the core objective of run-rate breakeven by March 2015 is revenue growth

- 2014-15 is a critical year for the transformation programme. Delivery against the plan is dependant on the successful execution of
 - c.300 branch modernisations and 70 branch franchising
 - The voluntary redundancy programme that will remove between 500 and 600 FTEs
 - New automation (rollout of NCR self service kiosks)
 - Growth in revenues
 - Industrial relations, reaching a pay agreement and ending the strike action that has been occurring since March 2013
- Transformation is running broadly to plan
 - POL has successfully transformed around 120 branches, and remains on course to complete the programme by November
 - 22 (out of 70) branches are franchised but five branches will not be franchised, POL is working to develop alternate strategy
- The voluntary redundancy programme is supported by the unions and is oversubscribed
 - POL and the CWU management are confident of meeting the savings targets identified under the VR programme. The programme was oversubscribed by a factor of 2 to 1. The first tranche of 100 staff leave in April.
 - POL and CWU negotiations have turned to performance management of staff who are not suitable for the future role of counter staff. Work continues towards a joint strategy to help these staff leave the network, rather than be managed out
- Pay negotiations with the CWU are at an advanced stage, but risks remain
 - POL has resisted offering a consolidated pay increase, as it would undermine the ability to meet break-even in 2015. They have offered non-consolidated cash bonuses worth £3,300 over three years linked to meeting performance targets.
 - This position was rejected by the CWU, and there were 26 days of strike action between March and December 2013.
 - In December the CWU accepted that our consolidated pay rise must be entirely self-funded and consistent with the breakeven position. Since then both parties have been intensively engaged to reach a solution.
 - POL believes it is close to reaching agreement on a consolidated pay offer, but believes this must be agreed before the CWU conference in late April, as that risks hardening the CWU position.