

Post Office Limited – Strictly Confidential

**POST OFFICE LTD BOARD MEETING (Company Number 2154540)**

**Meeting to be held at 9.00am on 9 April 2013**  
**at 148 Old Street, London, EC1V 9HQ in the Board Room**

1 Network Transformation Kevin Gilliland

**BREAK**

2 Strategy and Funding Sue Barton/Chris Day

3 Any other business Alice Perkins

**CLOSE**

Present:

Alice Perkins (Chairman)

Neil McCausland (SID)

Tim Franklin (NED)

Virginia Holmes (NED)

Alasdair Marnoch (NED)

Susannah Storey (NED)

Paula Vennells (CEO)

Chris Day (CFO)

Gill Catcheside (Assistant Company Secretary)

In Attendance:

Kevin Gilliland (item 1)

Robin Nuttall, McKinsey

(item 1)

Sue Barton (items 1 & 2)

Apologies:

Alwen Lyons (Company Secretary)

# Transforming the Post Office Network

Pre-read for Board discussion  
9<sup>th</sup> April 2013



## Context for Phase II

### Context for design

- The approach to network transformation presented in this pack, which involves introducing mandation to the network transformation process, is the **optimum commercial solution for POL**
- We believe that this continues to be the **right approach for POL to deliver network transformation by 2020**, taking into account the counterfactual position, and the strategic direction of the business
- However, there are **significant challenges associated with the delivery** of this solution, particularly around managing the potential objections from sub-post masters, the NFSP, MPs and the general public
- **Evidence-based assumptions** have been used in the design of this strategy, and these require further testing and challenging in order to refine the financials and the implementation path
- **Next steps:** We are already in the process of stress-testing the potential risks and the assumptions made, in order to develop contingency plans and alternative approaches for different scenarios

### Our asks of you

- As the POL Board, we ask you to:
  - Re-endorse this approach to achieving network transformation and our long-term business objectives
  - Acknowledge the risks associated with this approach, and the need for an adaptive strategy to combat these risks
  - Input into planning the mitigation of these risks, both today and on an on-going basis



# This is our assessment of what it would take for the next phase of Network Transformation to be successful from a commercial viewpoint

## What we believe

1. Conversion to our set of models – Mains, Locals, Basics, Community and Outreach – is essential to the viability of the Post Office
2. Compulsion to convert or exit is essential for the success of the transformation programme
3. We should not offer a period of enhanced compensation for leavers from a commercial point of view
4. We can convert the majority of Mains onsite and with existing agents
5. Over 2,000 Locals would be viable businesses after conversion and the majority could occur onsite with same agent
6. Post Office should adopt a strategic approach to partnering with a set of convenience retailers (symbols and multiples), and rebalance its network towards where customers are shopping locally - i.e. towards multiples and symbols and away from unaffiliated independents
7. We can find replacements for 3,200-3,700 leaver Locals conversions, the majority of which would be offsite
8. Post Office sustainability should be the objective, rather than 6,000 conversions
9. There are several risks that could challenge the successful roll-out of this model (including stakeholder reaction, multiples/symbols' buy-in to Locals model, and technology risks) and to which POL is developing mitigating strategies (including a robust comms plan)

## Why we believe this

- Conversion to these models results in superior customer experience, a stronger position against competition, a lower and more flexible cost-base and a Post Office with higher and more robust profitability
- As long as Core Tier Payment remains in place, most of our candidate Locals and some of our Mains, will choose to stay as is
- Enhanced compensation may encourage high-performing agent partners to exit - the very partners we are striving to retain - and could be expensive (potentially >£60m, and can be £140m if becomes applicable to all leavers)
- 70% of our Mains would either see an increase in income post conversion or a borderline decrease and so are expected to remain viable
- 40-50% of the ~5,300 candidates for Locals have solid retail businesses such as convenience or general stores, forecourts and pharmacies, and the majority of these, (~2000) are expected to convert on-site as viable branches
- Risk of retailers (and specifically multiples) choosing to leave though expected to convert under current plan, to be assessed and mitigated (point 9.)
- Moving to compulsion in other geographies (e.g. Germany) has been followed by large scale conversion rather than exit
- Symbols and Multiples have been growing sales by ~10% p.a (and number of stores by 4%) in recent years, while independents are on a steady decline
- A strategic approach could unlock value for Post Office – retailers gain access to a trusted brand and realise ~15% sales uplift from having Post Offices in-store
- >3000 Locals sites have >1 retailer within 0.5 mile
- Local model provides significant additional footfall and sales to retailers (20-25% additional footfall in case studies)
- We believe that achieving the 6,000 by 2015 will be extremely challenging, would entail delivery risk and not necessarily align with POL's strategic aims
- The network transformation involves a significant degree of change for our agents, retail partners and other colleagues – as well as the deployment of new technologies
- Mitigating actions are being developed, including engagement with multiples/symbols and a communications programme



## ① Six key operating models form the basis of the network, each of which has a distinct purpose and delivers a specific customer need

Crowns	Mains	Locals	Community	Outreach	Basics
Purpose	Profitable, directly-managed branch offering complete range of products with a focus on driving FS sales and delivering government services	Service-focused branch delivering a full range of products with clear incentives to capture sales opportunities	Low-cost access to majority of services with enhanced customer convenience and opening hours, including via targeted delivery models e.g. assisted self-service	Supports the role of the Post Office in rural communities with no other retail or community services	Access to Post Office services in remote locations in which other models are impractical or uneconomic
Value to customer	Full range products and services within professional "PO in a bank" environment, with rapid service via automation or counters	Full range of products and services delivered through an efficient, customer-focused environment with high retail standards	Convenient, extended local access to 90% of core Post Office products and services in urban and rural areas over a retail counter	Local access to Post Office product and services, in communities where no other retail products or community services are offered	Local and reliable access to a broad range of Post Office products and services via a tailored model
Value to retailer	POI as retailer	Retail offering built around Post Office products and services as the core offering of the business	Drives footfall through retail business, provides competitive advantage, and allows expansion of retail offering	Provides subsidised access to rural communities, if retail offering is present	Provides low-cost access to remote communities, if retail offering is present
# branches in 2020 network	300	2,700	5,297	1,940	1,568

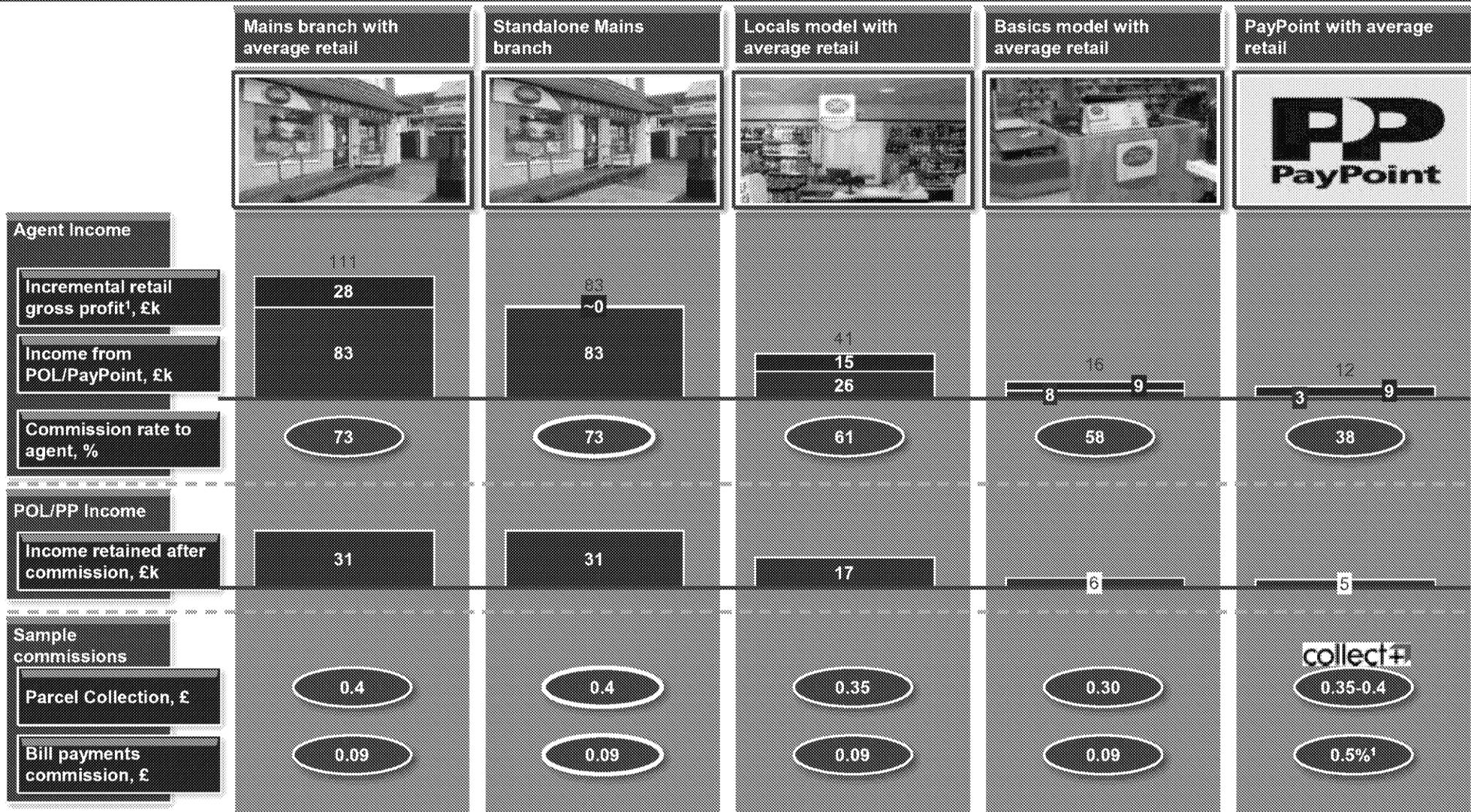
Of which ~2,000 could potentially be Mails hubs  
(Locals structure with full Mails proposition and additional store capacity e.g., through Post and Go)

Total network  
excluding Basics:

11,805



## ① The economics for the models are compelling and competitive



<sup>1</sup> Based on average customer sessions per model, 25% conversion of POL footfall into retail sales, average basket size of £5 and gross margin of 30%

<sup>2</sup> 0.5% of value of bill paid, capped at £0.13

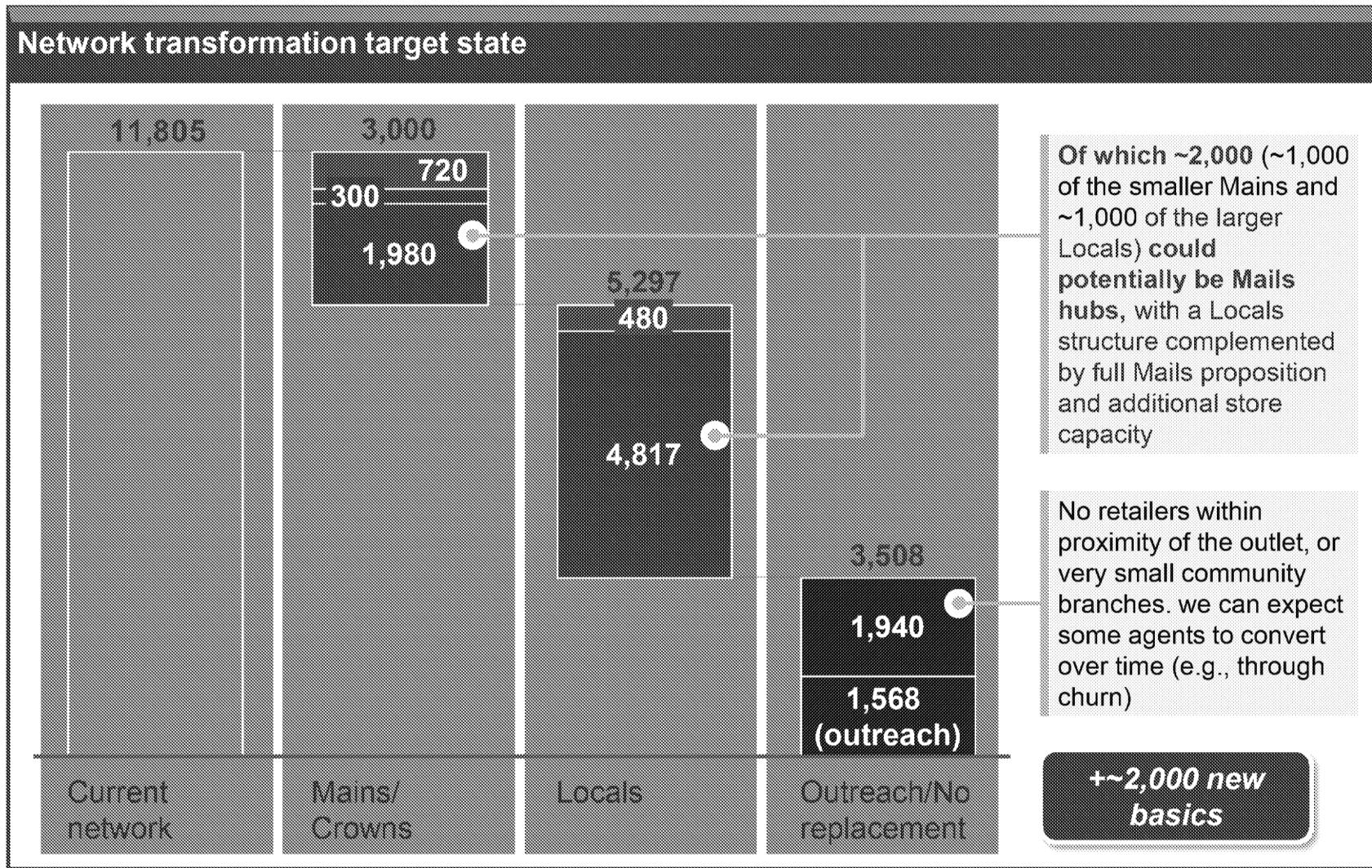
Source: POL internal agent pay and commission rate assumptions; PayPoint annual report 2012; Canada Post retail assumptions

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## ① This is the target state for the network in 2020 under base case growth

- Already converted
- Unconverted
- Cannot be mandated

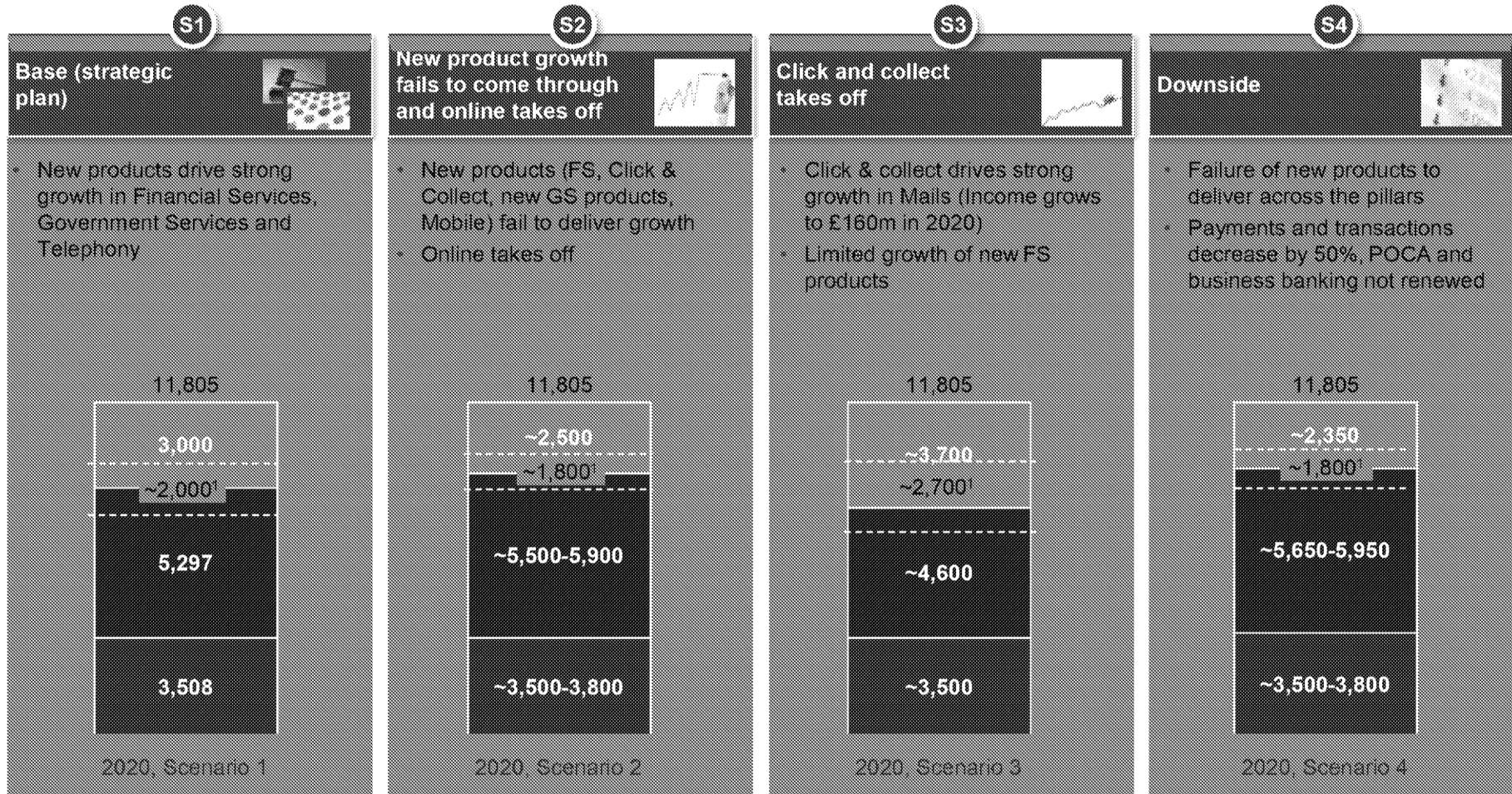


Source: POL data base; team analysis



## ① Under different POL growth scenarios the balance between models will shift

Community and Outreach   Locals   Mains including Crowns   Potential Mails hubs



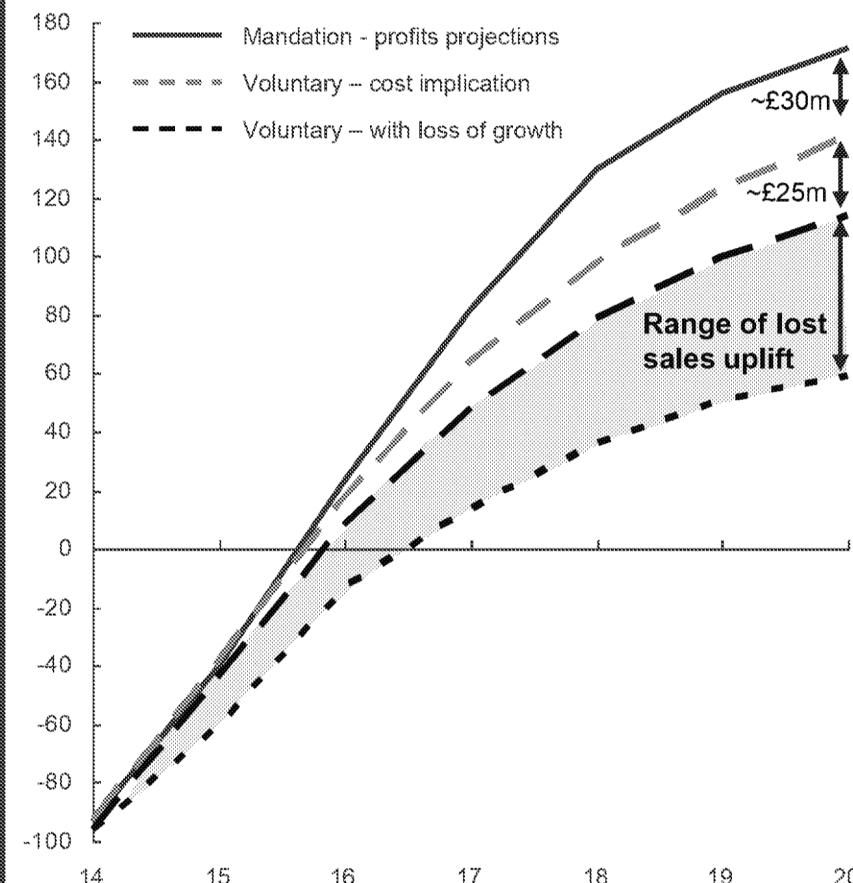
1 Potential Mail Hubs considered using total income from Mails per branch between £40k and £65k, comparable to average of 13215 Mails transactions per day

Source: Financial projections 2014-2020 from finance; 2013/2014 projection from pillar heads; Team analysis; Network team assumptions



## ② Mandation programme delivers greater and more robust profitability for POL

POL profits projections, (excluding NSP) 2013/14-2019/20, £m,



### The counterfactual facts – voluntary option versus mandation

- **Cost base** - the voluntary scenario would have a higher ongoing operating cost of ~£30m
- **Resilience to potential downturns** -
  - POL's cost base will remain largely fixed. This will make POL less resilient to market downturns
  - POL would be in an unfavourable position after losing the economies of scale from the growing branches (who would convert to variable pay) while continuing to subsidise those that are uneconomic (who will not choose to convert) where there are viable alternatives available
  - The compensation payable for exit would not be eliminated (removed in new contracts according to government direction)
- **Loss of targeted sales uplift** -
  - Competitive position – without mandation POL could lose growth opportunities to competitors such as PayPoint and Collect+
  - Continuing Post Office operations in poor retail environments (not upgraded through strategic partnerships, investment in converted branches and upgrade of our agents pool)
  - Fewer incentives for our Agents to grow their business
- **Customer experience and brand** - our unconverted branches would not offer improved service for customers (e.g., longer opening hours, reduced queue times) which is important to retain our market presence
- **Sum of the parts** - Converting only ~4,500 branches would not be sufficient to deliver the overall transformation effect and brand change, and so could impact major retailer and government decisions (e.g., losing contracts, and not attracting better retail partners) and not change customer perception of POL Mandation is time critical as the retail Mails market decides on online channel strategies

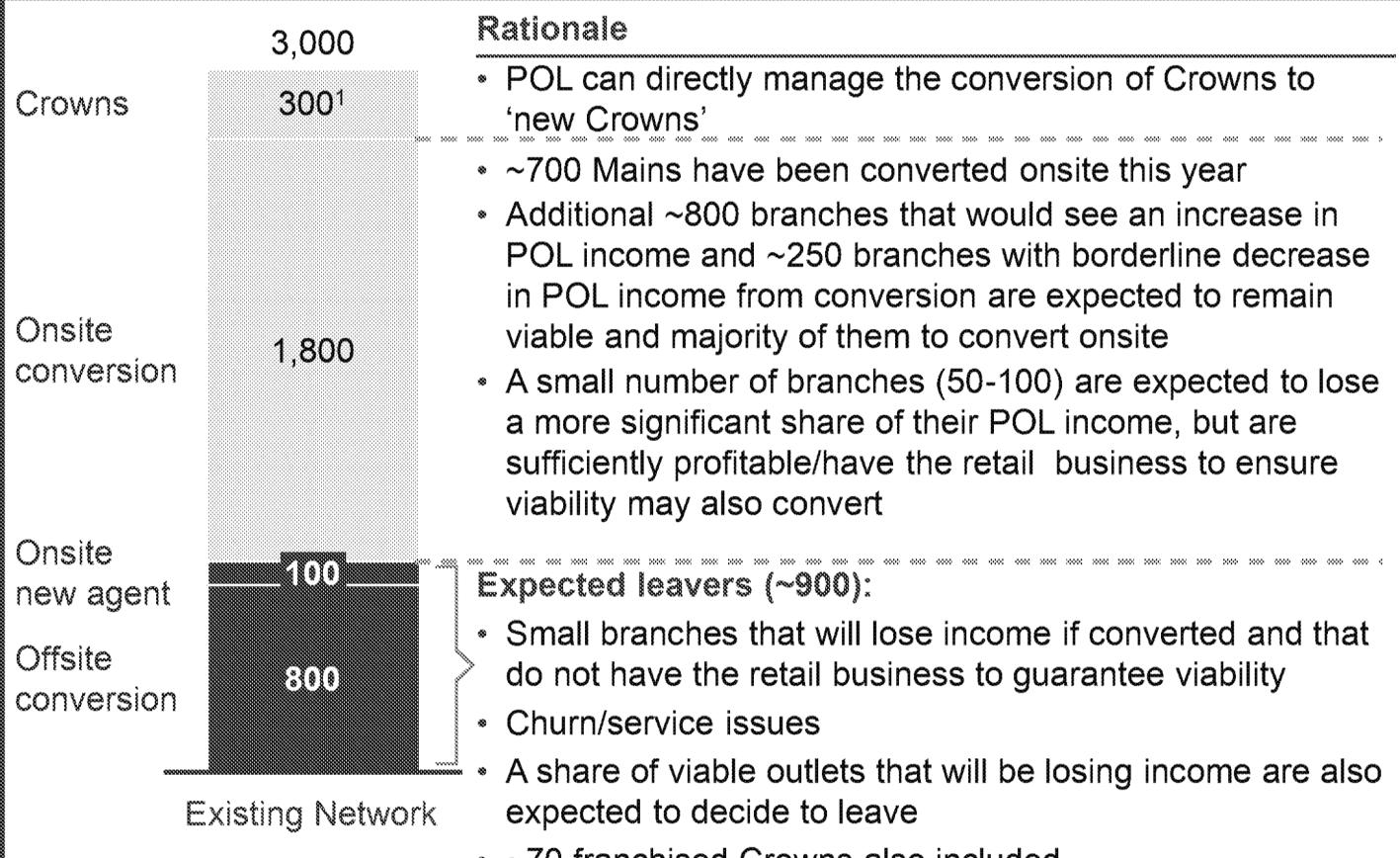
NOTE: Total OPEX benefits calculated for Total Costs cover 7 year period 2013/14 -2019/20. Income projections were decreased, upper bound for revenue impact assumes that mortgages, POLO and insurance would decrease by 10%, Collection and returns decrease by 25% from the base case. Lower bound for income assumes 10-20% decrease in all FS products, 70% decrease in Collections & returns and 25% loss of assisted digital from the base case with effect post 2013/14. More aggressive downward scenario is possible to develop (e.g., radical decrease in POL's share of parcel). Voluntary assumes 2243 mains (incl. Crowns) conversions and 2250 voluntary converted locals by 2020, mandation assumes 3000 converted mains (incl. Crowns) and 5300 locals by 2020. The financial impact of the conversions in a given year has been delayed by 9 months from the mean number of conversion contracts signed in the previous year.

SOURCE: Financial projections 2014 -2020 from finance; 2013/2014 projection from pillar heads; Team analysis; Network team assumptions, Financial team and Payment and Remuneration team



### ③ We expect 70% of candidate Mains to be same-agent, on-site conversions

#### Expected breakdown of onsite/offsite, leavers/converted agents for candidate Mains, # of outlets



- Only ~30% of Mains candidates are expected to require a replacement
- Based on the attractiveness of the Mains model, feedback from our existing partners and the trajectory of the on-going conversion process, it seems appropriate replacements for the ~900 estimated leavers can be found in a short timeframe

<sup>1</sup> Remaining Crowns are franchised and included in offsite conversion total or identified as 'Special branches' and not mandated

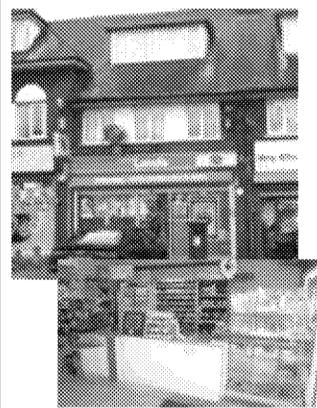
Source: Based on POL agents survey 2007 of rural outlets; analysing 2,000 agents of the 7,700 surveyed that are current existing Local candidates dated 2007)

## ⑤ Turning to Locals, many of the current branches for sale appear to have substantial retail businesses ...

EXAMPLES

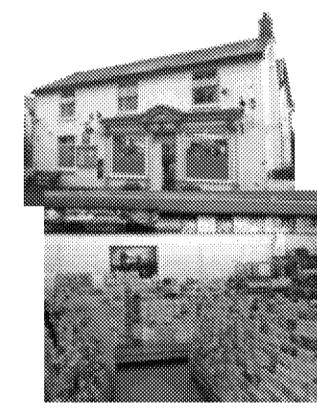


### South Birmingham



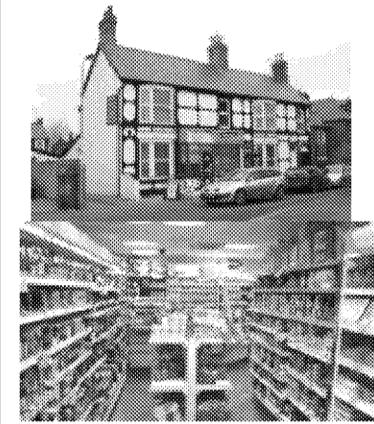
- Asking price: £140,000
- Independent/multiple/symbol: Symbol - Londis
- Retail offer: Convenience store
- Retail turnover: £450,000
- Post Office income: £50,000 incl. lottery and external ATM
- % total profit from POL<sup>1</sup>: 21%
- Store size: 1,000ft<sup>2</sup>

### Warwickshire



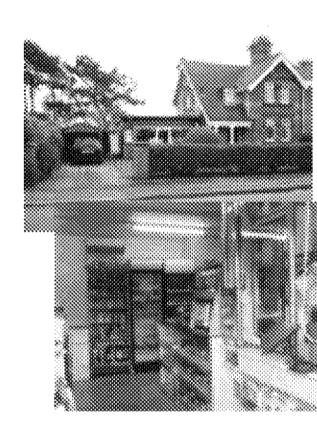
- Asking price: £385,000
- Independent/multiple/symbol: Independent
- Retail offer: Cards and stationary
- Retail turnover: £291,199
- Post Office income: £15,500
- % total profit from POL<sup>1</sup>: 11%
- Store size: ~800ft<sup>2</sup>

### Denbighshire



- Asking price: £195,000
- Independent/multiple/symbol: Symbol
- Retail offer: Convenience store
- Retail turnover: £858,000
- Post Office income: £37,245
- % total profit from POL<sup>1</sup>: 9%
- Store size: ~1,500ft<sup>2</sup>

### Nottinghamshire



- Asking price: £289,000
- Independent/multiple/symbol: Independent
- Retail offer: Off-license
- Retail turnover: £104,000
- Post Office income: £14,500
- % total profit from POL<sup>1</sup>: 25%
- Store size: ~600ft<sup>2</sup>

<sup>1</sup> Net retail profit margin assumed to be 15% of retail turnover, net POL profit margin assumed to be 35% of Post Office income

Source: Humbertons; <http://www.business4sale.co.uk/Buy/Post-Offices-For-Sale-in-the-UK>; <http://uk.businessesforsale.com/uk/search/Post-Offices-for-sale>, margin assumed at 20%

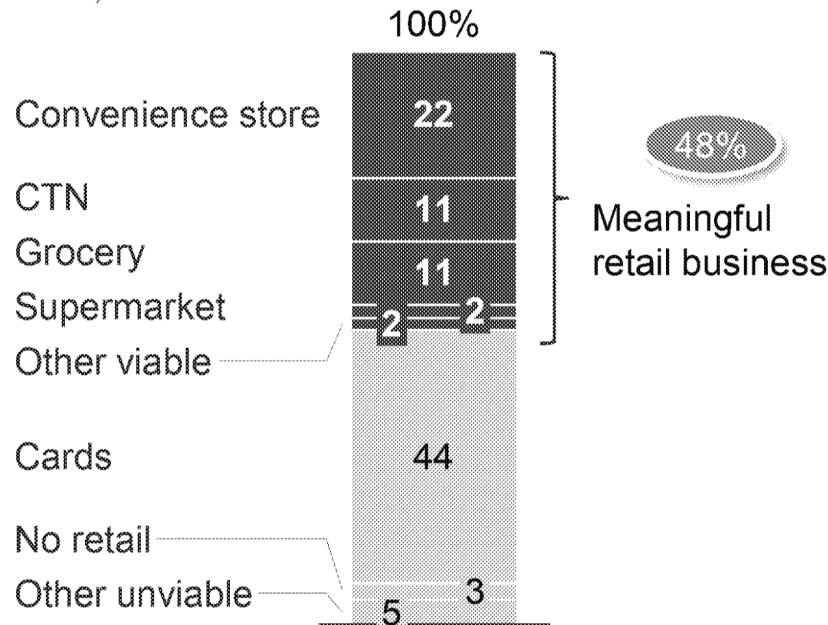


## 5 ... and this is supported by our broader analysis of candidate Locals

~50% of local agents have a meaningful retail business and are expected to be viable independent of CTP

### Sample of candidate locals from Rural survey<sup>1</sup>

2007, %



Majority of viable retailers are expected to opt to convert versus leave, given the contribution of POL to retail business

- For an average Locals retail business the value of the incremental footfall from POL customers is ~£7k<sup>2</sup>, complemented with POL profit of ~£9k<sup>3</sup> totalling ~£16k p.a..
- Given small space required for Local proposition (1.5m<sup>2</sup>) this implies an augmented value of £10.7k per year per square meter which is significantly higher than any retail proposition
- 20-40% of 'viable after conversion' agents might leave due to attractiveness of leaving package, personal reasons or higher than typical fixed costs, resulting in overall 60-70% leavers rate

Note: Meaningful retail business defined as convenience store, CTN, Grocery, Supermarket, and included in other viable: PFS, Off-license and General store

<sup>1</sup> Using results for ~1,600 current Locals candidate branches based on POL survey of ~7,700 rural branches conducted in 2007

<sup>2</sup> Assuming average footfall from POL customers of 800 per week, basket size of ~£5, ~25% probability of purchase and ~15% net profit margin

<sup>3</sup> Average local commission income without fixed payment and ~35 % net margin

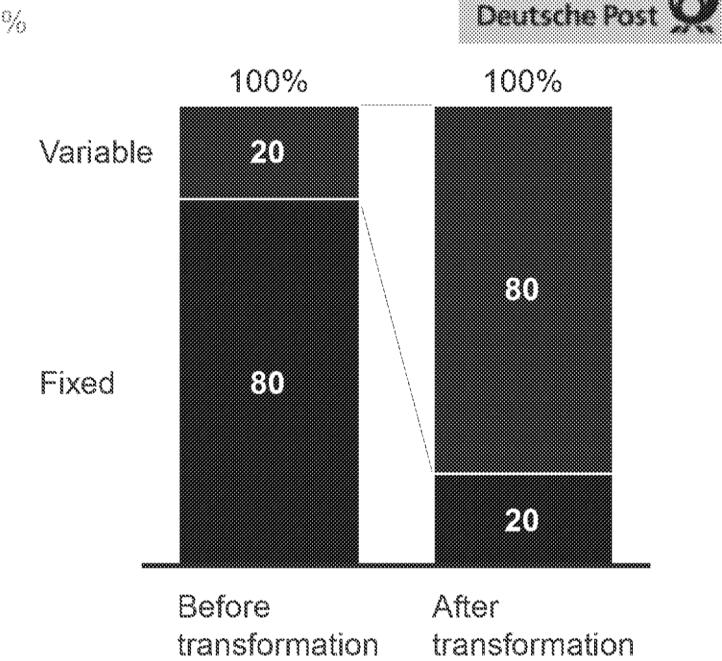
Source: POL Strategic Plan 2011-15; Funding agreement letter, Proximity Analysis, P&L model, Rural survey data 22/03/2007, Eurostat



## 5 The German example suggests that a compulsory process that results with reduced and variabilised pay for smaller outlets can be accomplished with few agent leavers

Deutsche Post shifted its agents' pay structure toward variable and increased its postal desk opening hours up to 24/7

Deutsche Post agent pay structure before and after transformation



DP also required partners to open postal desk at same hours as retail side, going up to 24/7

Few agents exited, even though smaller agents incurred a loss of up to 35% post office income and additional costs from extended opening hours

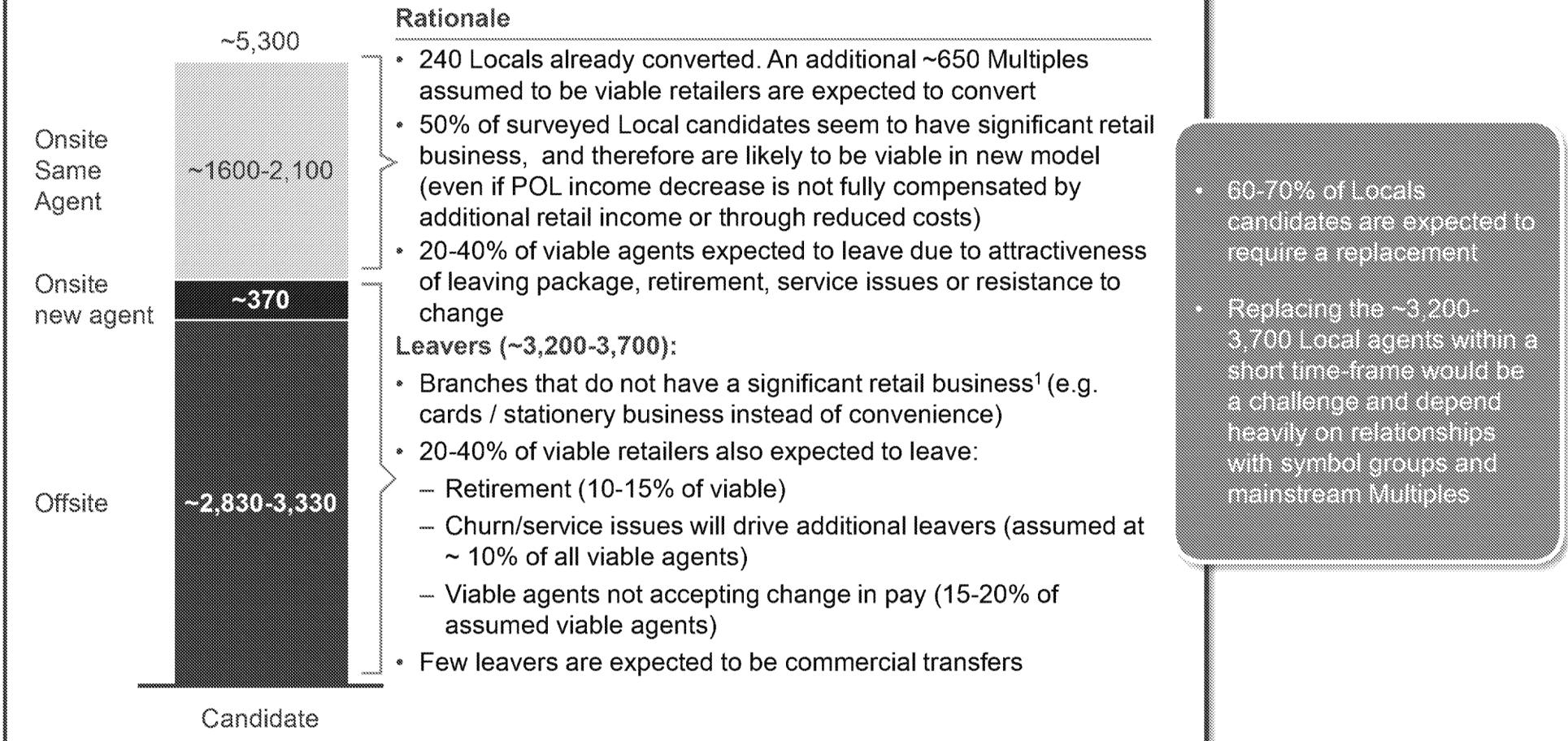
- **Smaller agents incurred loss of income:** The larger / higher traffic agents were significantly better off than under the previous contract. In contrast, lower traffic / rural agents received up to 35% lower total pay
- **Implementation through compulsion:** There was no room to negotiate the contract, nor to refuse it. Agents that did not sign the new contract were exited. DP offered six-months compensation for acceptance of the new contracts
- DP communicated major benefits of a postal counter as the additional traffic for the retailer and that Partners should not expect profit from providing postal services
- In rural areas, municipalities often stepped in and took over running the agencies with their own staff
- **Few agents left as a result of process:** After significant resistance and threats, the vast majority of smaller agencies signed the new contracts

Contracts review started in 2003, additional compulsory changes to opening hours were implemented in 2008



## ⑤ We therefore expect 30-40% of Locals conversions to be same agent on-site conversions

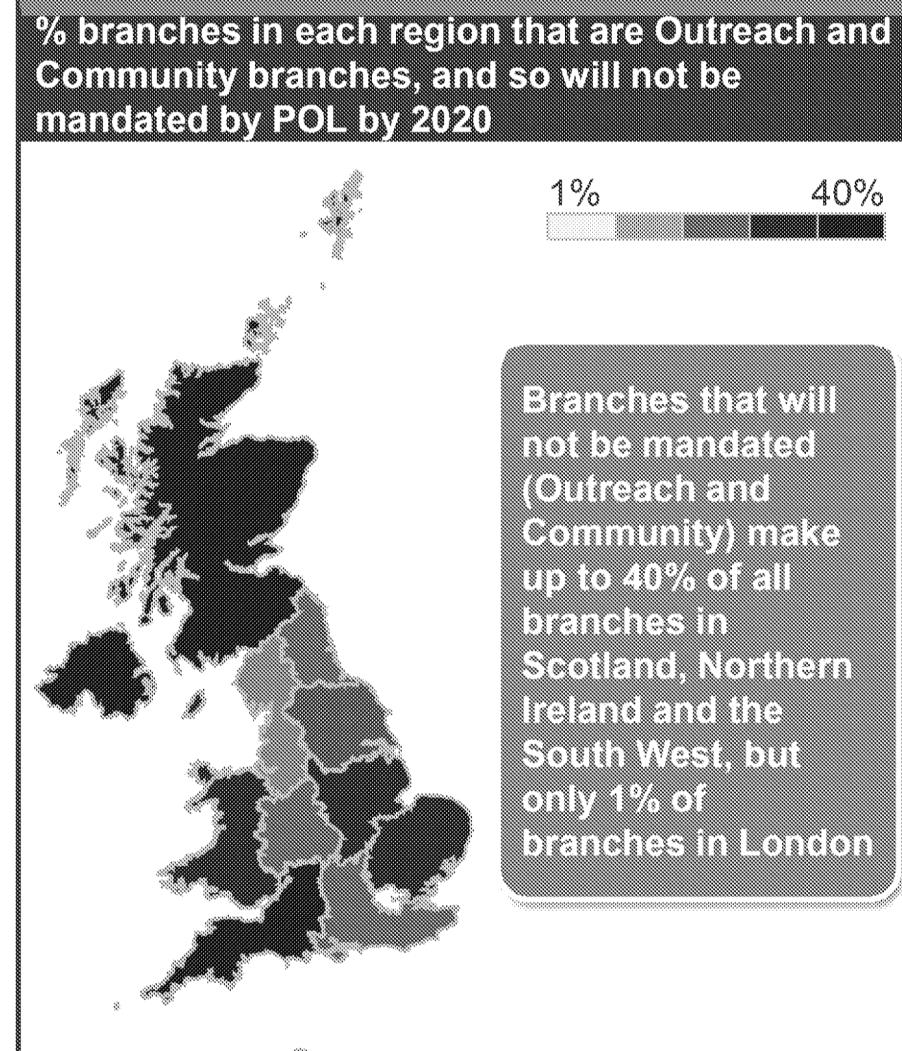
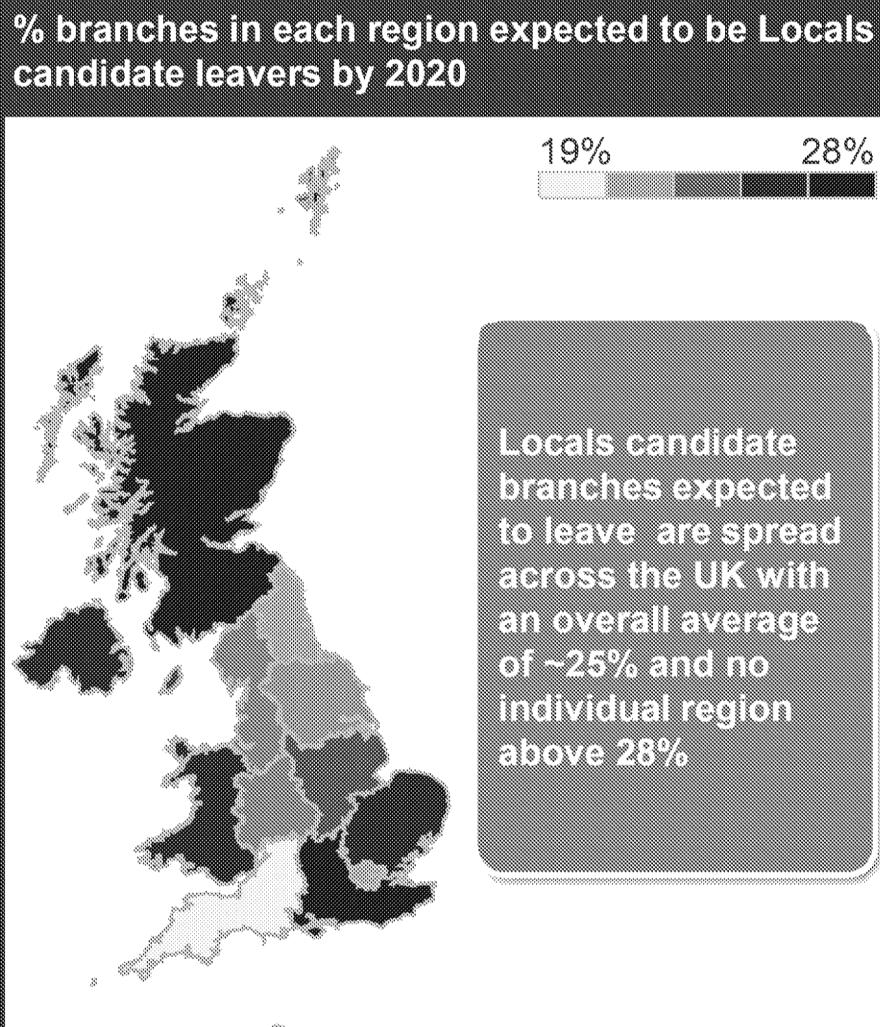
Expected breakdown of onsite/offsite, Leavers/converted agents for candidate Locals,  
# of outlets



<sup>1</sup> Based on POL agents survey 2007 of rural outlets ,analysing over 1,500 agents of the 7,700 surveyed that are current existing Local candidates dated 2007)



## ⑤ Geospatial analysis shows that the Local leavers are fairly evenly distributed across the UK



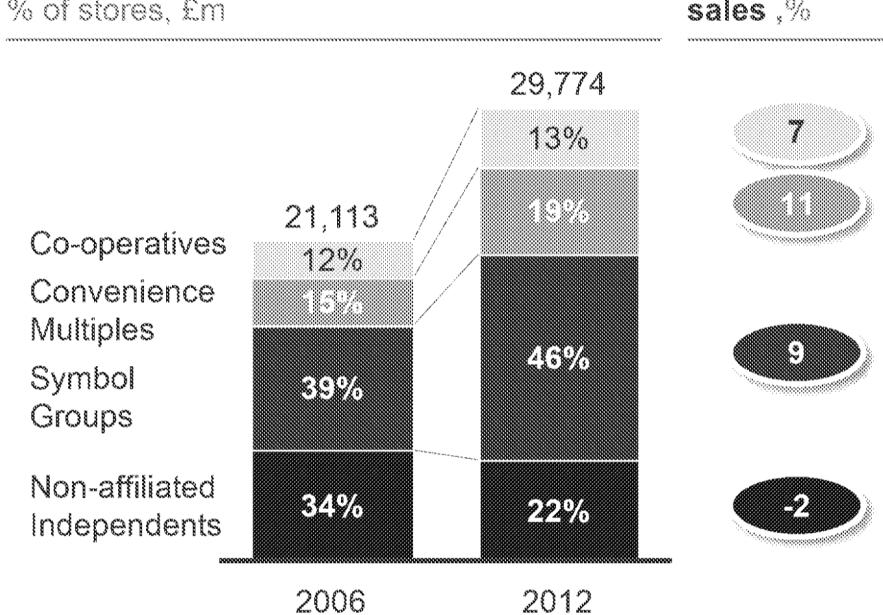
Source: POL geospatial analysis



6 In replacing these Locals leavers, symbols and multiples provide a sustainable basis for the future with strong sales growth and higher sales per store

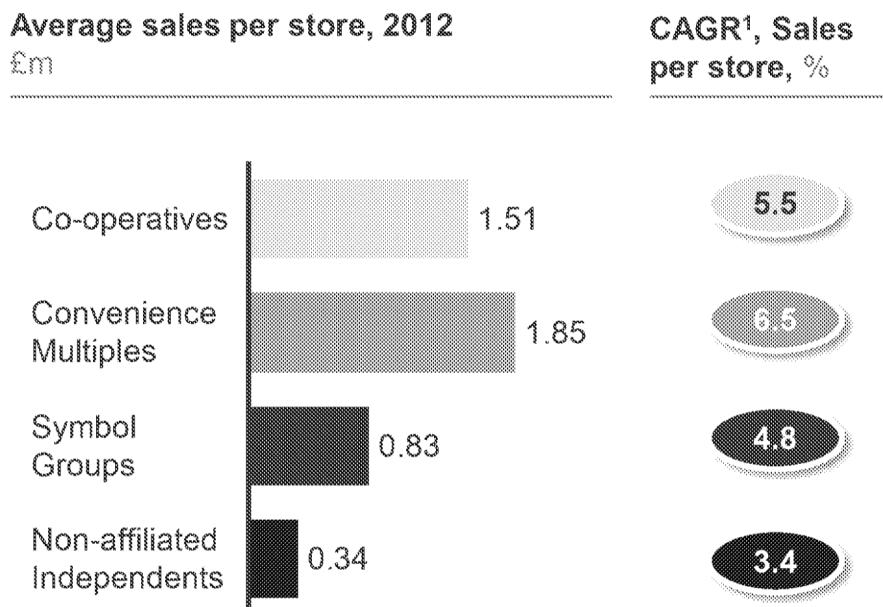
Growth in the convenience sector is tilted toward multiples and symbol groups, while sales in independent stores are declining year-on-year...

Convenience sector sales by segment,  
2006 – 2012,  
% of stores, £m



...Multiples and symbols also achieve a higher average sales per store than independents, which means they are able to maximise the incremental retail income generated by Post Office footfall

Average sales per store, 2012  
£m



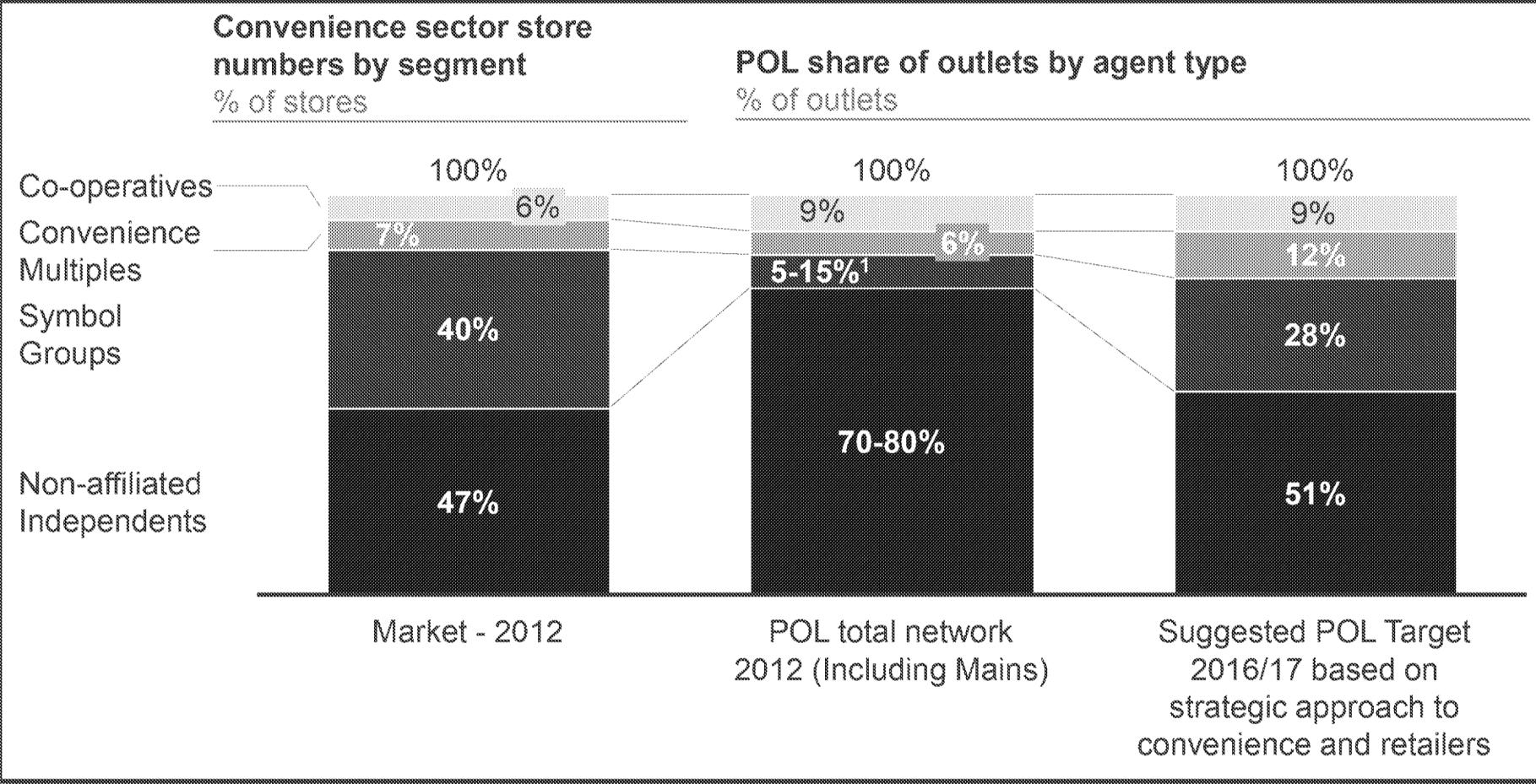
<sup>1</sup> CAGR 2006-2012

Source: IGD convenience retailers 2012



6 POL is currently strongly over-indexed towards unaffiliated independents, and so should use the transformation as an opportunity to rebalance towards symbols/multiples

POL should leverage the transformation to rebalance its Local agent mix to align with shifts in customer behaviour



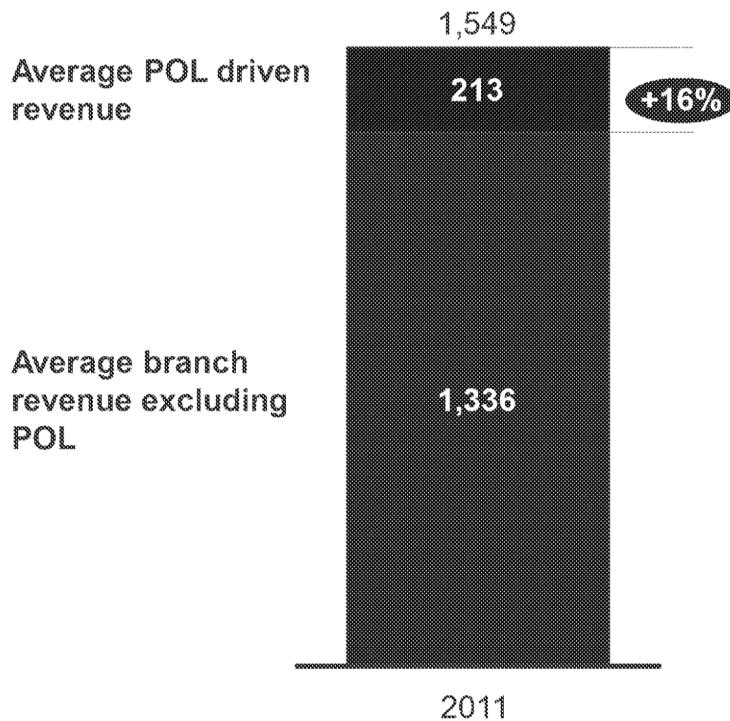
<sup>1</sup> Current number of symbols in POL network to be determined as it is not tracked based on difficult of gathering information, see page 17, further analysis required  
Source: POL agent records



## ⑥ Partnering with symbol/multiple groups to replace the leaving Locals agents represents clear value to both POL and the symbol/multiple groups

Multiples and symbols with Post Office earn on average 15% more than stores without a Post Office

WHSmith case example (POL research<sup>1</sup>, 2013) –  
Branch average revenue, £k



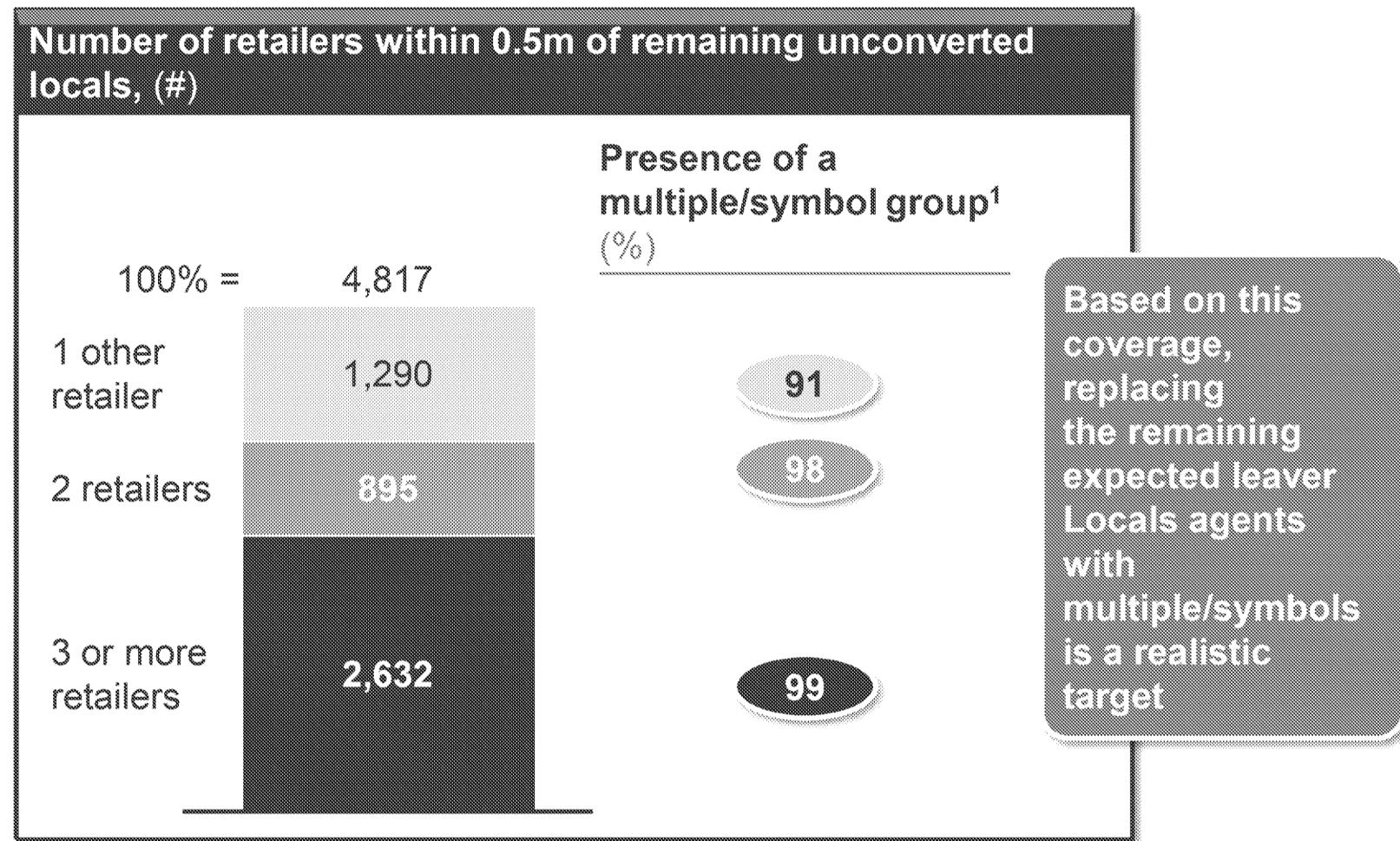
### Value of multiples and symbols to POL

- Moving to multiples and symbols rebalances POL's network to reflect changes in customer behaviour - towards shopping in multiple/symbol group convenience stores
- Multiples/symbols are more economically robust than independent retailers - sales of multiples/symbols have grown at 10%/9% over the last 5 years, while independent sales have fallen 2% in a sector with overall growth of 4.6%
- Multiples and symbols allow POL to realise operational efficiencies - The central operations of multiples and symbols enable POL to manage relationships with hundreds of branches efficiently
- Added customer value/convenience - Better locations, parking, stay open longer hours, have more customer appeal, customer focused, clean/bright stores, and have better sales skills
- Allow quick movement and roll-out

<sup>1</sup> Analysis based of WHSmith trading reports and feedback from branch visits



## ⑥ Geospatial analysis finds that our candidate Locals are well covered by multiples and symbol groups



<sup>1</sup> To estimate presence of multiples and symbols group certain categories were excluded, such as Public Houses, Garage Services, Charity shops, Baker shop, Juice Bars, Hairdresser, Jewellers, Delicatessen, Booksellers

Source: POL internal database; POL geospatial analysis



## 6 Key multiples, symbols and cooperatives have expressed interest in the new Post Office models, and are well-placed to take the opportunity

Convenience landscape	Chains	Number of stores #	Number of stores with existing PO # stores	Number of stores within 0.5 m of a PO <sup>2</sup> # stores	Appetite for new models
Cooperatives 2,601	<b>The co-operative</b>	~4,250 <sup>1</sup>	518	~3,500	Don't yet understand Local model and how it might work for them, interested in P&G
	<b>TESCO Express</b>	1,427	71	~1,000	• Tesco Express Interested in P&G, including offer to pay for machine
	<b>One stop</b>	521	151	~450	• One stop Committed to local model, but yet to realise full operational efficiencies
	<b>ASDA</b>	487	2	~450	• ASDA Interested in P&G, including offer to part-fund machine
	<b>Waitrose</b>	302	-	~200	
	<b>Premier</b>	~500 <sup>1</sup>	22	~350	
	<b>best-one<sup>3</sup></b>	288 <sup>1</sup>	-	~200	
	<b>SPAR</b>	2,700		~2,000	
	<b>MUSGRAVE</b> <sup>3</sup>	2,511	Challenge to identify all symbols in network as explained on the right	~200	There are challenges around identifying which branches are affiliated with symbols – a branch may apply for a Post Office as an independent, and align at a later date without informing POL
	<b>life style express</b>	2,427		~2,000	
	<b>Martin McCall</b>	2,224		~1,500	
	<b>WHSmith</b>	2,198		~100	
Convenience/ newsagents		1,268	420	~600	Martin McCall piloting Mains, and suggest P&G may be attractive though not yet convinced by Locals model
		618	84	~500	

<sup>1</sup> Including non-convenience formats <sup>2</sup> Indicative number based on geospatial analysis <sup>3</sup> Includes Londis, Budgens, Mace  
Source: IGD Convenience retailing research; Company websites; POL internal database; POL geospatial analysis



## ⑧ There are three key assumptions we have made in designing the path to implementation

	Options	Considerations
<p><b>What is our multiple and symbols strategy?</b></p>	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> Bilateral negotiations</li> <li><input checked="" type="checkbox"/> Strategic approach to convenience retailers</li> </ul>	<ul style="list-style-type: none"> <li>• To achieve our Locals conversion targets and to unlock the true value of POL to multiples, we would need to create strategic partnerships with symbol groups and mainstream multiples. This would require providing higher certainty of available outlets to partners and shifting from a reactive, branch-by-branch approach to a franchise strategy (e.g., by allowing our preferred partners to exclusively bid on large bundles of target outlets). This has the potential to attract widespread symbol/multiple interest and take-up.</li> </ul>
<p><b>How do we phase/time the “convert or leave” mandation programme?</b></p>	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> Regional</li> <li><input checked="" type="checkbox"/> Big Bang</li> <li><input checked="" type="checkbox"/> By business viability/ Other business specific criteria</li> </ul>	<ul style="list-style-type: none"> <li>• Divide the network into regions/areas. Phase transformation rollout to complete conversion (contracts signed) of 1,500-2,500 agents each year</li> <li>• Regional implementation would: <ul style="list-style-type: none"> <li>– Reduce execution complexity and risk (High pace but phased and thoughtful allowing learning in process)</li> <li>– Provide sufficient time to find the optimal replacements (to ensure most viable network in target state)</li> <li>– Align with multiples'/symbols' regional strategies</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> No enhanced compensation time window</li> <li><input checked="" type="checkbox"/> Limited time window with enhanced compensation for volunteer leavers</li> </ul>	<ul style="list-style-type: none"> <li>• A purely commercial approach would be unlikely to involve an enhanced compensation period, though a period of enhanced compensation with a credible time limit would have the advantage of encouraging early exit of unviable businesses in significant volumes, and support the franchise strategy</li> <li>• Key risks in implementing an enhanced compensation period include; <ul style="list-style-type: none"> <li>– Costly to POL (and the public purse) – additional 8 months compensation to leavers during limited time window and applied retroactively could cost an additional £50-70m (assuming a total of 1,500-2,000 leaving agents receiving enhanced deal)</li> <li>– Loss of viable agents due to the appeal of the enhanced compensation offer. Deal would be more attractive to higher income agents (especially multiples)</li> <li>– Loss of time that might have been better used for mandation</li> </ul> </li> </ul>



## 8) Mandation roll out starting in 6 months with no enhanced compensation window could deliver targeted network conversion by 2016/17 and would require total of ~£750m

		April 2013	April 14	April 15	April 16	April 17	April 18	April 19	
		9 months							
Already converted		Plan and Prepare		Mandation programme rollout					
		continue conversions							
Conversion process		<ul style="list-style-type: none"> <li>Complete detailed planning of mandation programme <ul style="list-style-type: none"> <li>Business case criteria</li> <li>Support for retailers</li> <li>Partnership approach</li> </ul> </li> <li>Complete legal analysis</li> <li>July 1<sup>st</sup>, announce mandation programme</li> <li>Gather business plans and assess agents' viability</li> </ul>		<ul style="list-style-type: none"> <li>Roll out a cross network conversion mandation programme (excluding community outlets) phased by region and driven by assessment of business viability <ul style="list-style-type: none"> <li>Providing viable, agents will be asked to convert</li> <li>If not viable, the agents would be asked to leave/sell providing an appropriate replacement is found</li> </ul> </li> </ul>					
		Commence mandation		6,000 conversions					
Conversion path		2013/14		2014/15		2015/16		2016/17	
Mains	Onsite	655	350	300	795 <sup>1</sup>	-	-	-	2,100
Mains	Offsite	90	100	150	400	160	-	-	900
Mains	Total Mains	745	450	450	1,195	160	-	-	3,000
Locals	Onsite	240	100	200	450	450	415	-	1,855
Locals	Offsite	215	150	350	700	1,050	980	-	3,445
Locals	Total Locals	455	250	550	1,150	1,500	1,395	-	5,300
Total converted in year		1,200	700	1,000	2,345	1,660	1,395	-	8,300
Cumulative converted		1,200	1,900	2,900	5,245	6,905	8,300	8,300	8,300
Total Investment (incl Crowns) £m		35	46	66	28	20	-	-	194
Total Compensation £m		42	82	115	95	68	-	-	402
Overheads £m		29	37	37	20	20	6	-	149
Total NT spend £m		105	166	218	143	107	6	-	745

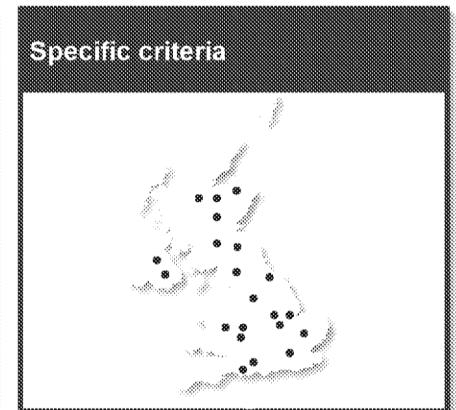
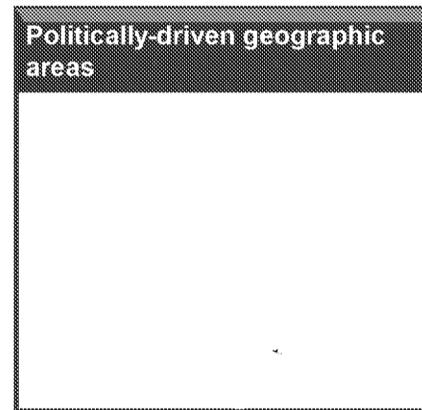
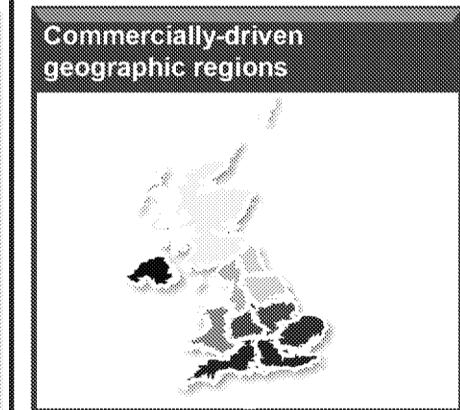
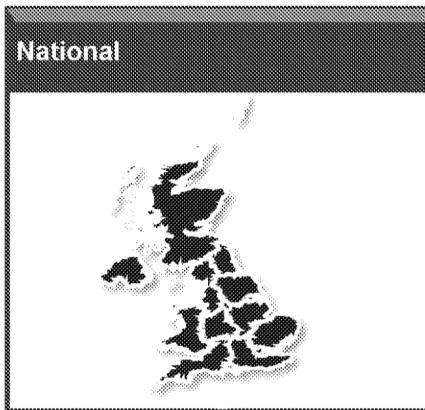
### Key assumptions

- Onsite conversions continue in first half of 2013/14 according to current plans
- On 1<sup>st</sup> of July we will announce mandation program which will be rolled out starting Oct 2013. From that point onward all conversions and leavers are considered mandated
- Leavers flow depends on finding replacements for Locals offsite conversions and relies on relationships with symbols and multiples
- All leavers are compensated for 18 months (no enhanced compensation)
- All expenditure is assumed to be at contract signature date. In practice some costs are at branch opening
- Offsite conversions may result from service issues which do not incur compensation. For prudence all offsite are compensated
- £5m in 2013/14 investment into Basics is not included in core network transformation



## ⑧ Four options for rolling out mandation programme

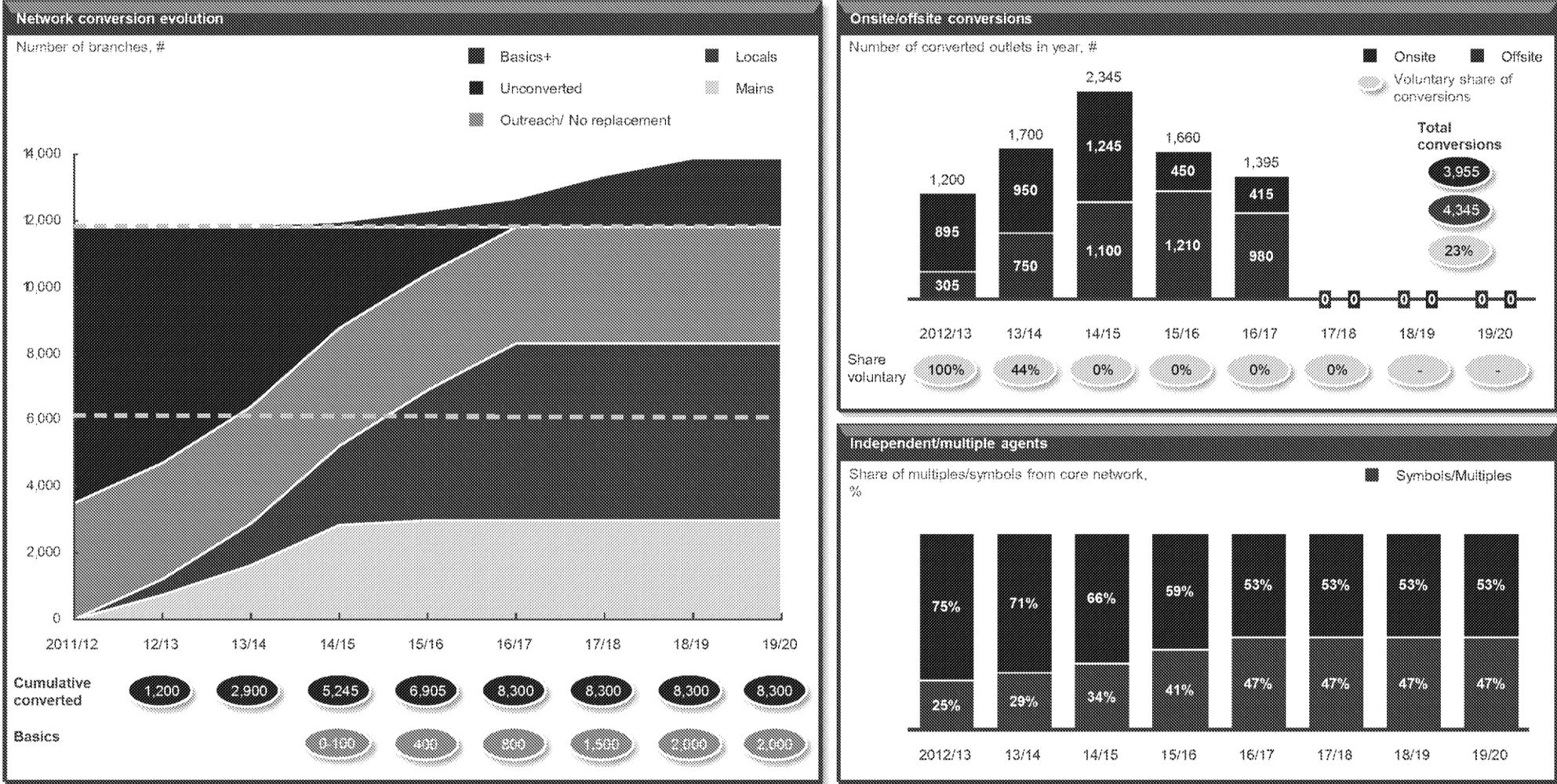
Recommended approach



	National	Commercially-driven geographic regions	Politically-driven geographic areas	Specific criteria
Description	<ul style="list-style-type: none"><li>Mandate all relevant branches to submit business plans within the first 3-6 months of the programme</li><li>Business plans processed and reviewed on a first-come, first-served basis, with conversions/leavers rolled-out strategically</li></ul>	<ul style="list-style-type: none"><li>Phase mandation of areas within a particular geographic region to submit BPs, e.g. Area South East 1 in week 1, SE 2 in week 2 etc. until SE region is complete</li><li>Roll-out conversions/leavers as a phased process in close collaboration with retail partners</li></ul>	<ul style="list-style-type: none"><li>Phase mandation of areas of branches, spread across different regions to submit BPs, e.g. Area South East 1 would start the process in week 1, followed by Midlands 1 in week 2, etc., until South East 2 would begin in week 11</li></ul>	<ul style="list-style-type: none"><li>Mandate all branches that fit a specific criteria to submit a BP regardless of geography e.g. Mains candidate/ urban location etc.</li><li>Sequence conversions and leavers strategically to manage capacity and replacement time</li></ul>
Pros	<ul style="list-style-type: none"><li>Allows national strategic offer to be made to partners</li><li>Engages every PO in the process from day 1</li></ul>	<ul style="list-style-type: none"><li>Compelling regional strategic offer can be made to partners</li><li>Manages central workload</li><li>Can sequence regions according to partner priorities</li></ul>	<ul style="list-style-type: none"><li>Manages local workload</li><li>Allows on-the-ground teams to work within a specific region</li><li>Manages central workload</li></ul>	<ul style="list-style-type: none"><li>Allows POL to manage time sensitivities in the network e.g. replacement time to ensure conversions are completed by 2014/15</li></ul>
Cons	<ul style="list-style-type: none"><li>Creates a time lag between BP submission and action</li><li>Likely to require significantly greater central and local resources</li></ul>	<ul style="list-style-type: none"><li>Requires local teams to relocate to different parts of the country</li><li>Cannot offer national view of opportunities to partners</li><li>Potential for regional protest campaigns on an area-by-area basis</li></ul>	<ul style="list-style-type: none"><li>Cannot offer any aggregated view of opportunities to partners</li><li>Potential for organised protest campaigns on an area-by-area basis</li></ul>	<ul style="list-style-type: none"><li>Might carry more risk for judicial review</li><li>Creates a time lag between BP submission and action</li><li>Little clarity for partners</li><li>Difficult to manage workload</li></ul>



## ⑧ The resulting network evolution during the implementation path



<sup>1</sup> Includes part of the 2012 conversion investment cost (agents who have signed the contract but not started any refurbishment work)

<sup>2</sup> Estimated based on the Agents' Remuneration difference vs latest P&L projections



⑧ Targeting 6,000 conversions by 2014/15 would be a stretch to the implementation plan and would require POL to make compromises that are not commercially driven

**Enhanced execution risk**

- Forced to deliver “Big Bang” mandation (compulsion to leave or convert) of 4,000 agents in 18 months; a rushed process could push more of our viable agents to choose to leave and would allow only limited learning and flexibility
- Risk of sub-optimal replacement, or retention of unviable agents due to need for ~2,000 offsite conversions within 18 months
- Front-loading conversion of on-site Mains in order to reach target, resulting in a network without the flexibility to shift according to changes in demand

**Sub-optimal multiples strategy**

- Retaining all existing viable agents without involving Multiples and other partners in potential replacement discussions (offering our partners the opportunity to compete and replace only the least successful retailers)
- Puts individual retailers in strong bargaining position versus POL
- Large-scale disruption of 6,000 changes could cause significant customer and client disruption with associated service issues

**Customer risk**



## 9 There remain several risks that could derail the successful roll-out of this model

### 1 Stakeholders

#### Ongoing risks

- NFSP obstructs the progress, either by coordinating members to refuse to submit business plans, or by mobilising agents and the public to petition HMG
- MPs/political parties unite in opposition to mandation in the run-up to the general election in 2015

### 2 Independent agents

- Local communities of SPMs mandated to leave the business boycott the replacement multiple
- Long-term negative publicity campaign for POL, conducted by converted branches incurring loss of income
- Multiples choose to leave the network and take compensation when mandated to convert or leave

### 3 Multiple and symbol agents

- A single multiple running 1,000+ branches in the network uses the threat of leaving to bargain with POL over commission rates etc.
- Partnerships with symbol groups fail to achieve the operational efficiencies expected
- EPOS integration is not delivered within a reasonable time frame
- New provider of Post & Go machines cannot make developments and ramp-up production within a reasonable time frame
- Conditions around the delivery of volumetrics with Royal Mail are not acceptable to POL

### 4 Technological

#### Potential mitigation

- Involve NFSP and SPMs in process throughout
- Work with NFSP to understand and support trade association shift
- Engage stakeholders on narrative around network sustainability and mutualisation agenda
- Consider election in implementation plan
- Encourage/incentivise on-site conversions to minimise public perception of service disruption
- Comms plan around cost of service provision, and impact of boycott
- Provide retail support to branches who are expected to see decrease in income to help them build enough retail business to compensate for loss in POL income
- Consider additional compensation for onsite conversions
- Engage existing multiples/symbols to understand appetite for conversion and potential reaction to mandation. Ensure conversion package is attractive to multiples/symbols
- Make clear business case for new models to multiples
- Link conversion to potential for expansion via Leavers
- Contractual restrictions about number of multiples branches from one partner able to leave per year, justified by network stability
- Identify priority symbols with high level of central control
- Identify check-steps and carefully manage relationship with Fujitsu
- Engage with NCR on strategic plan and potential rollout at earliest possible date
- Develop strategic plan for engaging Royal Mail and achieving acceptable terms



## ⑨ There are several important activities to be completed before a public announcement can be made (e.g. July-2013)

### Strategic approach to convenience retailers

- Engage current and potential partners to identify wants and needs
- Develop a partnership strategy e.g., design an offer for preferred partners in accordance with Legal and commercial constraints, refine delivery models to fit partner needs, shape POL team to enable relationship focus with strategic partners, study other relevant cases (e.g. UK rail franchising, 2012 Olympics sponsorship)

### Implementation and network planning

- Complete detailed planning of implementation path. Stress test implementation plan including implications on costs and conversion targets, and taking into account lack of control around replacement and opening of new branch timeline
- Complete mapping of risks (Legal, execution, brand and etc.) and finalise mitigation plan

### Resources and capabilities

- Identify resources required to deliver the implementation plan, including resources needed to support agents in business plan development and viability assessment

In addition POL is developing the approach to stakeholder alignment , the communication plan, and how this relates to the mutualisation agenda

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**COMMUNICATIONS STRATEGY –**

**MAKING THE CASE FOR COMPELSION AND THE 2020 STRATEGY**

**1. Background**

- 1.1. This document sets out a communications strategy aimed at supporting the process of securing Government agreement for the McKinsey proposals for a switch to compulsion in the network transformation programme. It comprises key messages, target audiences and timelines.
- 1.2. It is closely linked to the delivery of messaging around our future strategy, which will include any changes to our approach to network transformation. Through our discussions with BIS, we need to give key politicians a compelling narrative around which they can 'own' our strategy and build support for our proposals within Government and, eventually, beyond.
- 1.3. The context for this is an extremely challenging economic climate and a fragile political situation with a general election looming which will be hard to read. BIS ministers will also be sensitive to the impact on the future of the Royal Mail, industrial action in the Crown network and the way the proposals will be perceived, firstly across the wider Government (and any potential for tension within the coalition) and secondly by the Opposition.
- 1.4. Preliminary discussions with BIS officials have indicated both general support for the strategic direction and questions about how the strategy, and particularly the changes around network transformation, can be positioned with ministers. This paper seeks to address this latter point.
- 1.5. Persuading ministers to compulsion within network transformation will be extremely challenging. They have committed in Parliament and beyond to the process being voluntary (see Annex C). We will only succeed in making the case for change if we can support the compelling commercial case with a narrative which secures political support (and highlights the nature of the alternative approach).
- 1.6. It is therefore critical that we focus on key policy drivers in order to secure traction and support: such as mutualisation, localism (Big Society), social, digital and financial inclusion, public service reform, support for small business and sustainable communities.
- 1.7. The narratives in Annex A and the messaging in Annex B start to flesh out these points. The commercial case and improved network sustainability – necessary to protect the future of the Post Office – are at the heart of these approaches. They also make some assumptions about commercial positioning in relation to the network criteria, community post offices, the future development of our approach to

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mutualisation and the development of small business services. Developing the narrative on some or all of these points will be crucial if we are to persuade ministers to support our approach. It should be stressed that these annexes are designed to address the network transformation changes alone: they do not go into the broader strategy messaging (see point 2.1)

- 1.8. The success of this approach will also depend on preparing the stakeholder environment in advance of public announcements, and showing ministers that we have plans for communicating the changes and mitigating risks. A delivery plan is included at Annex D.
  
2. **Communications objectives and approach**
  - 2.1. The aim of this communications strategy is to set out the top line messaging and stakeholder activity necessary to secure support for the Post Office Strategy should we decide to adopt a compulsory approach to network transformation
  - 2.2. The approach taken is to combine the commercial case for the strategy with policy drivers which are likely to offer Government a compelling case which can be used in public to support the strategy.
  - 2.3. We have a number of tactical approaches open to us in order to support this strategic approach, including supporting media and stakeholder activity.
  - 2.4. The overall transformation of the Post Office as a whole, and our journey towards becoming a multi-channel business, must form of the basis of our messaging. We need to position the strategy as building on the Coalition's commitment to the business in 2010, not replacing it: we must avoid it appearing as a change of direction.
  - 2.5. Instead the tone should be one which accentuates a fresh surge of activity within the context of this overall transformation: having stabilised the network, we are now proposing innovative development of the approach to ensure a healthy – and financially sustainable - future for the Post Office in a digital age.
  - 2.6. The innovation within the strategy is embodied by our switch from channel business to retailer – but we need to work hard to make this commercial concept 'live' for a Government and political audience. We will do so by positioning the Post Office as a commercial business with a social purpose, actively working to connect communities while also providing essential services which help to make people's lives simpler.
  - 2.7. This will require greater flexibility, both in terms of how we operate as a business – therefore signalling organisational change – but also in terms of how we serve our customers: taking our business to them and the places where they shop.
  - 2.8. If therefore the themes at the core of the strategy are about stepping up the pace and flexibility around transformation and innovation, we need to provide ministers with totemic representations of this approach. Ministers will want to consider how the 'sell' the strategy to the media and general public.
  - 2.9. This is all the more crucial given how difficult it will be to persuade ministers to support compulsion in the network. We need to build a story for ministers which

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allows them to support this change: this needs to balance economic necessity with policy innovation.

**3. Messaging**

- 3.1. Our key messaging will be contained within the executive summary of the Strategy document. The messaging set out here is specifically aimed at showing how we could position the move to compulsion.
- 3.2. Annex A sets out a proposed core script for making this case.
- 3.3. This messaging focuses on:
  - Value for money: this package of proposals reduces reliance on the taxpayer at a critical time
  - High Street/rural renewal: we would need to make a commitment to High Street renewal: a Post Office Promise or Charter to stay in communities and commitments around support for the development of Community Post Offices
  - SME support and growth: we should ensure we are in a position to announce a package of measures for small business alongside the strategy
  - The conditions for commercial sustainability as a step on the road towards mutualisation: it is critical for political reasons that we keep mutualisation on the agenda: we can do so by setting out the conditions – the stake in the ground - we need to reach in order for mutualisation to be achievable

**4. Stakeholder approach**

- 4.1 There are two phases to this strategy:
  - Securing Government support: with BIS in the first instance, and beyond as required
  - communicating the strategy to broader stakeholders
- 4.2 This paper focuses on messaging, positioning and tactics in relation to the first phase of this process. The second phase will incorporate the messaging set out in this first phase, with tactics designed to fit.
- 4.3 The key audience is BIS. Ministerial support will be critical to securing the changes we need to make in terms of mandation. In order to win the support of BIS ministers we need to present them with a strong case, powerful messaging and support (or at least neutrality) from other stakeholders.
- 4.4 This therefore means securing the support of ShEx officials in the first instance, and providing them with the case they need to persuade ministers.
- 4.5 Jo Swinson is the key minister and we are actively pursuing all avenues of engagement: while the ShEx route is important, it is also critical that we try to engage her through other routes: political allies, third parties etc... The same goes for the Secretary of State. It is unclear how close an interest he takes in Post Office issues – but we have engaged his special adviser and have an opportunity to set out the case to her.

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- 4.6 Ministers are likely to be extremely wary of mandation. The approach set out in Annex A provides a narrative which may be enough to secure their support. It would be crucial to tie this approach to a package of attractive new announcements (such as a new package for small business).
- 4.7 But we are likely to be walking a very fine line – BIS ministers would be wise to seek political cover from other departments (notably HMT, No 10 and the DPM) for the move to mandation. If they do not do so, the strategy could unravel in the face of political opposition (Coalition ministers will not relish the prospect of opposition taunts suggesting they are strong-arming subpostmasters into unwelcome change, particularly in the light of Parliamentary commitments around the voluntary nature of Network Transformation).
- 4.8 We will therefore need to be in a position to provide BIS ministers with a way through this issue. The narrative set out in Annex A seeks to do so, but we might wish to consider further steps.
- 4.9 We could, for instance, bring Consumer Focus into our confidence. It has supported Crown Transformation and – with the right level of engagement – might support the move to mandation (although this would need to be carefully tested in advance of any approach). If we were able to tell ministers that our plans were supported by Consumer Focus it would make a big difference.
- 4.10 We may take the same approach with other key stakeholders such as Age UK and the CAB. Others might include small business representative groups, CBI, High Street Task Force etc...
- 4.11 The RMG angle is also critical: we would need to be in a position where colleagues at RMG were briefed with the strong messaging around the necessity of this change, and its impact on the future health of RMG. Clearly there is also a BIS angle to this and we should seek BIS advice on approaches to the relevant minister.
- 4.12 The support of the NFSP would also be significant in persuading ministers to support our proposals: but we should manage expectations around this. Should we be able to secure NFSP agreement to the approach, this is likely to take the form of silence rather than active support. There is also the risk that even neutrality from the NFSP would not prevent vocal protests by 'splinter' groups of subpostmasters.
- 4.13 We should also use our growing support base in Parliament: we could hold Chatham House briefings to outline the proposals to key MPs, such as the chair of the BIS committee and possibly further (DCLG for example). Supportive briefings to ministers from Lib Dem and Conservative MPs would also help build support for our plans.
- 4.14 We will also be able to emphasise to BIS ministers how we are changing perceptions of the Post Office through positive coverage around Network Transformation so far. We are producing a booklet to support this work.
- 4.15 We could go a step further and seek to bring a big media player into the tent. This would be a high risk approach. But we could use trusted contacts to set out (at the appropriate time), the case for change and our broader agenda. In order to win this support – and therefore a neutral stance in relation to mandation – we would need to be prepared to give the relevant media outlet a strong story: probably in the form

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of a solid commitment at the heart of both the high street renewal and community Post Office agenda.

- 4.16 Whether we take this step or not, we need to start shaping the views of key commentators to prepare the ground for the new approach.
- 4.17 If we are successful in securing BIS support we should place the emphasis on BIS to do the work necessary to secure broader government support. But we should ensure that we are engaged in any process to do so: there is a significant risk that BIS support alone will not be enough to secure the change we need.
- 4.18 If BIS does not seek to secure wider support for instance (and this is probably preferable in terms of making the policy change we need), there is a risk of the process derailing once it becomes public. While we will be able to present the change in a very positive light, it will without doubt be portrayed in a negative light by the media and some external stakeholders. Media coverage will focus on the prospect of Post Offices being at risk as subpostmasters are forced out of the business, and case studies will be used to support this and win public sympathy. The move to mandation is a page one story – our objective would have to be to see it through in such a way that it didn't become a lingering issue.
- 4.19 Timing is critical to this latter point. We should choose the timing of any public announcement very carefully so as to reduce the possibility of it dominating headlines for a prolonged period. Further advice will follow on this area.
- 4.20 The CWU will seize on the changes to present arguments around the future of the Post Office and will seek to use them to amplify their concerns around pay and franchising. As noted above, we may be able to get the NFSP into a position of neutrality but even this could change in the face of a significant media backlash.
- 4.21 If by this stage, wider Government stakeholders have not been engaged at a political level, it will be all too easy for HMT, No 10 and DPM to distance them from the decision and force its reversal. This would, of course, be the worst possible outcome.
- 4.22 It is therefore recommended that we encourage BIS to secure broad Government support for the changes and to do so in tandem with us (only Post Office can explain in detail the reasons for the change and provide the messaging necessary to support it).
- 4.23 Political support will be critical: while officials may support the logic of our proposals, the potency of the Post Office to spark political reaction is significant: we therefore need to work hard at a political level to secure the support we need.

**Mark Davies  
Communications Director  
April 2013**

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**ANNEX A**

**The following script seeks to set out how we could try to sell compulsion to ministers, with a view to how they might sell it on to other elements of government, Parliament and the media.**

**There are a number of elements in this which need further discussion and detail, and consideration, in the context of the McKinsey work. It should therefore be read as indicative of the kinds of areas we might wish to explore to help secure support for compulsion.**

**Positions in square brackets are suggested approaches which will require further discussion.**

The Post Office is stepping up its programme to transform its business as part of a new strategy aimed at developing products and services into new areas of everyday life.

The approach is aimed at cutting the burden on the taxpayer while continuing the dramatic and successful transformation of the Post Office network. The move underpins the future of the Post Office – protecting it for the nation.

The 'Post Office Promise/Charter' approach will mean a review of the existing network – backed by a commitment to ensure Post Office services continue to be delivered to strict criteria, and a strategic approach which will guarantee Post Office services in key towns and villages. The Post Office will commit to maintaining at least xxx offices across the UK.

The package provides enough funding to guarantee the ongoing provision of xxx existing Post Offices in rural communities.

[The Post Office has also announced/is examining the creation of a fund and resource to support communities setting up mutual Post Offices in addition to the existing 150 community post offices across the UK].

It means continuing the existing network transformation plan, which has so far introduced xxx new Post Offices with longer opening hours and more modern environments, but introducing a planned approach which will mean new models will be introduced alongside compensation for existing subpostmasters who leave the business.

This step is crucial to enable the Post Office to reduce its reliance on the taxpayer and secure its future. The Post Office Promise/Charter will mean, however, that Post Office services will continue to be provided, to the same levels, at the same number of outlets as at present.

The change is also crucial to enable the Post Office to compete in increasingly tough markets, offering longer opening hours in order to be able to make a strong play in the collections and returns market.

The Post Office also commits further to its role at the heart of communities, connecting customers and small businesses with the vital services they need. [In doing so, working with

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Consumer Focus, it will review its existing mechanisms for overseeing the provision of Post Office services in key areas.]

New approaches to support the growth of small businesses across the UK will also be rolled out over the coming years.

[To ensure that subpostmasters and others running Post Office services have the support they need to help their businesses to grow, the Post Office will investigate the creation of a new independent trade body to represent subpostmasters.]

The new strategy also makes clear that the Post Office can only move further towards becoming a mutual if and when the conditions are right – which means achieving economic sustainability as a commercial business.

The new strategy will mean significant growth in the Post Office's financial services business, investment in the digital capability of the Post Office and a drive to cut central costs and introduce a leaner, more agile business model.

The alternative to this approach – a continuation of the voluntary approach to network transformation – would hamper the Post Office's ability to compete in increasingly competitive markets such as collections and returns.

It would mean the transformation of network transformation would stall, meaning customers would not benefit from improved environments and longer opening hours.

In order to maintain the network at the current size it would not be possible to reduce reliance on the taxpayer. Without driving through the changes which have proved so successful so far in terms of the new models, it will also be difficult for the Post Office to achieve a sales uplift in new product areas such as financial services.

It also means that the goal of commercial sustainability is put at risk – meaning any future aspirations around a mutual Post Office are put under pressure.

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**ANNEX B**

**This sets out an overall view of how we could message the overall 2020 strategy to Government.**

1. Government investment and ambition, and strong leadership at the Post Office, has saved the network for the nation and put this commercial business with a social purpose on course towards a dramatic transformation.
2. Like all businesses it faces massive challenge – the fragile economy, the growth of digital services, ever-tightening margins. But with challenge comes opportunity – and the Post Office is determined to seize every opportunity to build on the solid progress it has made as an independent business.
3. So we have a Strategic Plan which builds on our existing approach of growth, modernisation and customer excellence, and which preserves our unique network and role as Government's 'front office' but which also proposes some new innovations aimed at enhancing the Post Office's unique place in the social fabric of the nation.
4. We will continue to transform our network of branches, working with subpostmasters and colleagues in our Crown branches to improve customer experiences, and will introduce more flexibility, mandating subpostmasters to start this process so we can complete network transformation as quickly as possible to deliver improved accessibility and service for customers and also to get our business to a position of commercial sustainability, an important step on the way to mutualisation
5. We will build on our proven record of success in moving into new markets by offering consumers and small business men and women a wider range of essential services at key moments in their lives (starting a family, moving house, students, travelling etc...) – particularly in financial services - through a multi-channel business: and do so in a way which is fair and transparent at a time when trust in business can be hard to find.
6. We are making changes because we need the flexibility to be able to adapt to changing retail environment – to develop in the places where customers are shopping and to position the Post Office alongside strong retail businesses and the synergies this brings with longer opening hours and improved service.
7. We will do our bit to support the rebuilding of the wider economy too: work with Government to help reduce overheads in front office services, support the digital inclusion agenda through innovative products and services, support, build and help connect local communities, and radically review our structure to cut our central costs.
8. We will build on our mutual ways of working, work with stakeholders and the public to define the public purpose of the Post Office.

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9. We believe our plan puts us on the right path towards a sustainable future for the Post Office: our desire is to make a reality of the Post Office as a commercial business with a social purpose: less reliant on the taxpayer but with a clear definition of our public purpose; therefore underlining our unique position in society.

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**ANNEX C**

**Government commitments around the 'voluntary' NT scheme**

**May 2012 - Norman Lamb speech to the NFSP Conference**

Norman Lamb addressed the NFSP conference in May 2012. Part of the speech covered Network modernisation where he said -

"The Federation has played a key role in shaping the structure and terms of the transformation programme - in particular in ensuring its wholly voluntary nature and in the negotiations with Post Office Ltd on the compensation and transitional remuneration terms for those who choose to participate."

**September 2012 – written Parliamentary Question response**

In response to a written parliamentary question Jo Swinson highlighted the voluntary nature of the programme -

**Tom Blenkinsop:** To ask the Secretary of State for Business, Innovation and Skills what estimate he has made of the potential number of post office closures that will occur as a consequence of the abolition of core-tier fixed payments to post offices. [119162]

**Jo Swinson** *[holding answer 5 September 2012]:* The Government has made a clear commitment that there will be no programme of post office closures. This is supported by £1.34 billion funding to maintain a network of at least 11,500 branches, and also to modernise around 6,000 post offices by 2015 in a process known as Network Transformation.

This is a completely voluntary process, no sub-postmaster is being forced to change their contract and for those who do not opt to change, we are not abolishing the Core Tier Payment. It should be noted that Post Office Ltd has reported an encouraging level of interest in converting to the new operating models under Network Transformation from existing sub-postmasters.

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**November 2012 – Jo Swinson letter to all MPs**

In November 2012 Jo Swinson wrote to all MPs with a dear colleague letter providing an update on the Post Office, including the award of the DVLA contract, the post office modernisation and the moves towards mutualisation. As part of that letter Jo wrote -

“It is important to note that this programme is wholly voluntary and that no subpostmaster is being forced to adopt either of the new models. The days of closure programmes are over – the Post Office network is now at its most stable in over a quarter of a century.”

**November 2012 – Government response to BIS Select Committee**

In November 2012 the Government submitted their response to the Business, Innovation and Skills Select Committee’s report on ‘Post Office Network Transformation’. In that report they said -

“It is also important to note that participation in the Network Transformation programme, which begins this autumn, is wholly voluntary for subpostmasters.”

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**ANNEX D**

**Delivery plan**

This plan is aimed at providing BIS ministers with assurance that Post Office Ltd has considered the positioning of the change to compulsion in detail.

It also sets out our proposals for key stakeholder engagement during the next six weeks.

**Stakeholder engagement**

Our proposed approach is to secure support from BIS in the first instance, playing in HM Treasury to support.

In addition to regular meetings with our day to day Shareholder Executive contacts (primarily Will Gibson and Tim McInnes) A series of meetings with key BIS officials are taking place over the coming weeks: they include

- Howard Orme
- Mark Russell
- Anthony Odgers
- Martin Donnelly

We believe these meetings will help to prepare the ground for the policy change and provide us with useful advocates for the change.

At a political level, we propose that at this stage we restrict contact to ministers and advisers in BIS and HMT.

Meetings are in the diary in April with:

- Danny Alexander (Chief Secretary to the Treasury – April 5) (Paula Vennells)
- Jo Swinson – Post Office Minister (April 30) (Paula Vennells)

This latter meeting is crucial. In this first phase of activity we are preparing the ground in order to be able to present Jo Swinson with compelling arguments, a sense of stakeholder reaction and evidence of a planned communications approach.

To support this approach we recommend further contacts with the following in advance of April 30:

- Tessa Munt (PPS to Vince Cable) (Paula Vennells and/or Martin Edwards/Mark Davies)
- John Foster (Special Adviser to Danny Alexander) (Mark Davies)

We have a good relationship with Tessa Munt and would be able to have a frank, off the record conversation with her in order to test the water and take her advice.

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We do not at this stage recommend seeking a meeting with Vince Cable himself. He is not closely engaged in Post Office matters and it might be regarded by Jo Swinson as going over her head. We should instead seek to engage him through Ms Swinson. We could, at the right time, engage his special adviser, Emily Walch, with whom we have good links.

We believe that this is the right approach at this stage: we should be prepared to engage with No 10 and the DPM's office at the right time, but believe it is important to first of all take BIS through the proposals, with HMT input as necessary. Assuming we can secure support at this level, it will then be important – as noted in the main body of this paper – to engage more widely across Whitehall in order to ensure we have the fullest possible political cover for the changes.

Given the read across to Royal Mail, we will also want to consider playing in this angle at civil servant level, probably through BIS officials.

We further recommend that we have Chatham House-style conversations, in advance of the Jo Swinson meeting, with:

- Royal Mail
- Consumer Focus
- Age UK
- NFSP (subject to ongoing discussions)

The purpose of these conversations would be to seek support, or at least neutrality, for the move towards compulsion, supported by the long term benefit for customers – a guarantee of services continuing, with improved environments and longer opening hours.

Depending on the outcome of these conversations, we would then be able to give the minister some assurance around the reaction from key stakeholders once the policy change goes public.

We would also seek to present Jo Swinson with a further communications strategy which would include:

- Further stakeholder engagement with a broad range of groups in advance of any announcement e.g. CBI, Federation of Small Business, high street forums, rural and community groups, Citizens Advice, Women's Institute etc..
- A full media plan for announcement, including tactical considerations around timing and leadership of press announcements (with the expectation that Post Office would take the lead)
- A strategic engagement plan for all MPs and local councils in advance of the changes, to include Chatham House briefings, strategic segmenting of MPs by region, potential interest in the issue, existing Post Office services, reactions to Network Transformation etc... (including lessons learned from Crown transformation)
- A tactical delivery plan for changes following commencement of the new programme including regional PR plans, advertising, door drops

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**POST OFFICE LTD BOARD**

**April Board Strategy Session**

**1. Purpose**

This paper provides the Board with a response to the actions arising from the Board Strategy Session on the 27<sup>th</sup> February 2013.

**2. Background**

The Board met on the 27<sup>th</sup> February 2013 to discuss the Post Office Strategic Plan and associated Funding Request. At this meeting, the Board raised a number of questions/ actions – these were summarised in a subsequent discussion paper – see attached Annex A. This paper presents an update/ response on each question/ action.

**3. Addressing the Board questions/ actions**

**Action 1a:**

Produce a simple and clear communication for the Vision which explains what the Post Office will be in 2020

**Response:**

This has been addressed through two actions:

- Strategic Plan redraft which now includes a vision section that presents a clearer and single view of the Post Office in 2020
- An internal and external communications version of the Strategic Plan which is being produced by the Strategy and Communications teams. This will be completed once plan approval has been obtained with BIS and shared with the Board in advance of publication.

Status: on-going

**Action 1b:**

Set the context for the plan by emphasising the fast changing commercial environment in which the business operates and the need for flexibility to build commercial success

**Response:**

This has been addressed in the Strategic Plan redraft.

Status: complete

**Action 1c:**

Highlight the importance of providing services for small businesses

**Response:**

This has been addressed in the Strategic Plan redraft and the inclusion of the SME presentation pack

Status: complete

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**Action 1d:**

Ensure network story is clear with a vision of a sustainable network by 2020 and the journey of how to get there from the network which exists today

## Response:

This has been addressed in the Strategic Plan redraft and the McKinsey implementation pack

Status: complete

**Action 1e:**

Plan should redefine SGEI and access criteria with as few fixed points as possible, avoiding targets which would restrict flexibility, e.g. network by office type

## Response:

The Strategic Plan looks to limit the number of targets which are committed in relation to network transformation. The definition of SGEI is related to State Aid discussions and submission and will be addressed jointly with BIS as part of funding discussions. (See Action 6b)

Status: on-going

**Action 2a:**

Revisit the mails income plan to challenge for the overall ambition and pace on click and collect

## Response:

There are three lines within the Mails Income Briefing pack that relate to the growing opportunity associated with e-commerce. These are:

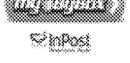
	11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19	19/20
Postage labels (covering USO parcels)	£89m	£120m	£120m	£121m	£122m	£123m	£125m	£126m	£127m
Collections & returns	£8m	£9m	£13m	£20m	£24m	£40m	£52m	£66m	£82m
Retail services					£5m	£10m	£25m	£40m	£50m
Total	£97m	£129m	£133m	£141m	£151m	£173m	£202m	£232m	£259m
Annual growth %		33%	3%	6%	7%	15%	17%	15%	12%

As you will see from the table above, we are targeting significant growth in this market over the plan period through to 2020. This starts off with relatively low levels of growth in the early years with overall growth accelerating as we increase our service offering in collections and returns and also ecommerce related retail services.

In considering the Board's challenge, we have reviewed all our underlying assumptions and concluded that a stretch target for 13/14 and 14/15 is not appropriate. We are confident that the overall ambition and assumptions about speed at which this market will develop are solid.

The table below shows the current market for collections and returns via a 3<sup>rd</sup> party host, the click and collect volumes are very small as this market has yet to be established. This is because it is not yet embedded consumer behaviour, retailers are not actively marketing it as they prefer in store click and collect and the revenue expectations of the 3<sup>rd</sup> party hosts are too high.

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Collections and Returns UK Outlets 2012/13				
				
Total Volume of Parcels 2012/13	210m (online only)	3.3m	3m	18m
Collections Volume 2012/13	8.5m	1m	200k	Negligible
Home Shopping Returns Volume 2012/13	1.5m	1.75m	400k	Negligible
Number of Outlets 2012/13	11.2k	5k	3.3k	2.3k
2012/13				
collect+				
Total Parcel Transactions	3.3m			
Total Parcel Revenue	£7.5m			
Total Business Loss	£1.4m			

Post Office  
IN THE STRICTEST COMMERCIAL CONFIDENCE

Collect+ are now consistently aiming their marketing at small business and C2C markets as their click and collect product is delivering very little volume, this emphasises the importance of our small business initiatives. POL aim to lead the growth of the click and collect market through partnership with RMG, bringing forward any move to open the POL network to other carrier's volume for click and collect risks pushing RMG volume to other mails retailers and actually developing the market outside of POL. Furthermore POL would be putting at risk large amounts of mails income in search of a relatively small part of the market without guaranteeing additional volume from other carriers.

We believe that the overall ambition is aggressive and will require POL to innovate to influence and create a market that does not currently exist to any significant degree. This will likely involve POL working directly with retailers on click and collect hub and spoke operations to help retailers cut distribution costs, POL working on ways to offer timed evening deliveries for consumers/retailers and POL offering the more traditional collections hubs to support parcels carriers in reducing their cost base as the parcels market continues to grow driven by the online shopping boom.

Status: complete

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**Action 2b:**

Revisit the income projections to validate the percentage income growth and ensure assumptions in the plan are realistic

## Response:

All income projections have been reviewed and confirmed – no adjustment was required with the pillar teams signing up to deliver their targets

Status: complete

**Action 2c:**

Provide a contingency risk provision within the plan

## Response:

We have included an income contingency risk factor within the plan. This will be held centrally with our overall P&L being adjusted accordingly.

To ensure that we continue to meet the commitments laid out in our previous Strategic Plan submission, the contingency has been included from 14/15 onwards as follows:

£m	13/14	14/15	15/16	16/17	17/18	18/19	19/20
Income as per Board presentation 27th Feb '13	927	976	1,071	1,208	1,294	1,393	1,471
Central contingency		-20	-40	-60	-80	-100	-120
Adjusted income	927	956	1,031	1,148	1,214	1,293	1,351
Required growth %		3%	8%*	11%*	6%	7%	4%

The total provision by 2019/20 of £120m represents ~21% of the growth forecast between 13/14 and 2019/20 (£562m).

\*While the 15/16 and 16/17 income growth projections are significant, it should be noted that these are related to the completion of the insurance transactions within the FS area. There has been no adjustment to these.

Status: complete

**Action 3a:**

The model should be tested and the following questions answered:

- How resilient are the models in the proposed network to changes in total income, changes to income mix and changes in channel mix?
- How would implementation cope with lower churn than expected (less applicants)?
- Can we consider a scenario where we could not mandate until after the general election?
- Can we consider a scenario where we transform mandated offices first (get the bad news done quickly)?
- How many people are we likely to have to mandate and what is the geographical spread?
- What is the risk and implication of a judicial review?

This analysis should look at the new models and ensure they provide success for the sub-postmaster and Post Office to ensure the network being proposed is sustainable

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**Response:**

After the February Board meeting, McKinsey were commissioned to complete Phase 2 of their network transformation project. This has considered all of the above points. The detail of their conclusions has been issued as a separate report. The high level points in relation to the above questions are as follows:

- McKinsey are recommending six 'store formats' for our network. These have been developed after consideration of the income projections contained within the Strategic Plan and discussion with the Pillar teams. They believe that the economics of these models are compelling and competitive for the Post Office and retailers.
- McKinsey have developed a target end state for the network using the income projections from the Strategic Plan. This has been stress tested to understand the implications of three alternative income scenarios. This has shown that Post Office will be able to address any future income scenarios with these store formats. It will be the responsibility of the network team to monitor any forecast changes in income mix and adjust the network composition accordingly.
- In the previous report, McKinsey were proposing a solution which mandated only 'leavers'. Having considered this in more detail, McKinsey are now proposing a solution which would mandate all agents to enter into the transformation process. It is believed that this approach will achieve the same outcome while being more politically acceptable and also reducing the risk of judicial review. In this context, the shift to mandated change will be communicated as soon as possible. Technically, under this new mandated approach, Post Office would be compelling everyone who is not yet in the assessment process.
- Geographical analysis of the leavers population has shown a relatively even spread. Locals expected to leave are evenly spread with an overall average of 25% and no individual region being above 28%. Branches that will remain make up to 40% of all branches in Scotland, Northern Ireland and the South West with London only having 1%. Analysis has also shown that replacing 3,000 to 3,500 leaver local agents with a multiples/ symbol group is a realistic target.
- We are currently awaiting legal response on the judicial review point.

Status: awaiting legal advice on judicial review – all other actions complete.

**Action 3b:**

Produce a one page summary showing the targets and commitments made in the current plan to: the Government, Brussels and internally.

**Response:**

Please see 'Network Targets and Commitments Summary' paper provided under separate attachment.

Status: complete

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**Action 3c:**

Consider what BAU changes can be made to the network alongside the transformation plan for inclusion in the strategy

Response:

We are currently working through the detailed implications of the revised network implementation plan – as provided by McKinsey. Once this is complete, the Network and Pillar teams will review jointly and at that stage, consider the need and feasibility of accelerating changes as part of BAU.

Status: on-going

**Action 4a:**

Consider more radical cost reduction options for the plan including outsourcing?

Response:

Over the past six months, Post Office has taken action to transform the current tactical cost reduction into a more strategic approach:

- Accenture presented to the ExCo explaining the alternative options for the structuring and sourcing of support services. This provided a number of frameworks that could be applied to Post Office.
- A Post Office cross functional team applied the Accenture frameworks to the Post Office business to produce an initial view of possible alternative models and associated cost savings.
- Capita has conducted a desk based review of a number of our support functions to provide an independent view of possible options for delivery and also the possible scale of savings.

While all of the above activities have highlighted opportunities, we have faced real challenges in progressing. The reality is that we are midway through migrating our support functions and systems from Royal Mail into Post Office and there is insufficient time to pursue a number of these alternative approaches in the short term. The exceptions are:

- Supply Chain/ business of cash where the Post Office Supply Chain and Strategy teams have continued to explore opportunities to improve the net value of this operation. We are now taking forward three streams of activity. The first is a pilot to assess the feasibility and cost savings that could be delivered through reducing the frequency of deliveries within some elements of the network. The second is getting an externally benchmarked view of the competitiveness of our cost base. The final element is conducting a market assessment as to the opportunity for us to expand presence in the external ATM provision marketplace – this will assess level to which we would be competitive and the overall likely commercial return.
- Call centres where the internal team are in the process of migrating the internal call centre support which is currently providing by Royal Mail to our own in-house operation. In parallel with this, the team are conducting an end to end review of our call centre requirements both internal and customer facing. The primary purpose is to develop a view of our requirements which can then be taken to market. The team are working to a timetable that would see a shift to an outsource model some time after the third quarter of 2014.

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To address the broader question of how Post Office delivers significant reductions in our cost base, we are now taking an alternative approach. Rather than start with the business today and projecting forward – we are using the 2020 Strategic Plan to develop a picture of the future Post Office organisation and then working backwards. This is proving to be a much more valuable approach as it is driving discussion around our organisation structure, our franchise model, and more fundamentally how we are building value in our business.

This work is being taken forward by a core working group of Paula Vennells, Chris Day, Susan Crichton and Sue Barton. There will be a working session with the full ExCo at the end of April. The desire is to move this work forward with pace to allow us to deliver a step change in operational costs in 14/15. The inclusion of a 25% reduction in central costs within the plan will ensure that the business remains focused and committed to drive this change through and face what are likely to be some challenging decisions.

Status: on-going

**Action 4b:**

Align the reduced income risk contingency with cost savings that could be realised?

Response:

The income contingency has been provided for at a central level rather than at individual pillar or product level. We have therefore used a central assumption to reflect this in our costs showing it as a separate item in our P&L statement. This has been set at 60% of the contingency income allowing for the fact that all of the costs are likely to be variable. This means that the income contingency impact on EBITDAS is 40% of the full contingency

In addition to the above factor, McKinsey have updated their modelling of agents' compensation to align with their proposed revised roll-out of Network Transformation. The impact of this is two-fold:

- 1) As we are planning on rolling out fewer Mains branches, there will be a saving in agents' compensation – this will be delivered in the early years of the plan
- 2) As the branches that are not converted will continue to receive fixed pay to support them, there will be lower savings in the later years of the plan

The combination of the introduction of the income contingency factor and the changes in the agents' compensation profile compensate for each other and therefore the net impact on EBITDAS is initially relatively small. However, later in the plan the income contingency input does flow through to the profit line, as can be seen from the table below:

£m	13/14	14/15	15/16	16/17	17/18	18/19
EBITDAS as per Board presentation 27th Feb '13	-98	-61	0	57	103	134
Central income contingency		-20	-40	-60	-80	-100
Costs related to income contingency		12	24	36	48	60
Changes in Agents pay with new rollout profile		8	15	20	21	11
Adjusted EBITDAS	-98	-61	0	53	92	105

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**Action 5a:**

The Board asked that no link be made in the plan between Mutualisation and funding at this stage. Ownership should not be considered until the business is financially sustainable.

**Response:**

This was discussed at the March Board meeting and additional clarity given. As a result the funding ask will include short term funding along with the need to shift our network subsidy payment on to a contractual basis. This latter point will be linked to the achievement of Post Office commercial sustainability and will NOT be linked to mutualisation.

Status: complete

**Action 5b:**

Organise a Board engagement event for key stakeholders

**Response:**

This was discussed at the March Board meeting. The suggestion was that this was picked up as part of Board meeting scheduling.

Status: on-going

**Action 5c:**

Ensure that the Minister is not surprised by the mutualisation and network position in the funding document

**Response:**

BIS have been briefed on both of these topics and are managing Ministerial messaging accordingly. An initial meeting has already taken place between BIS and McKinsey to allow BIS to ask questions and understand scope of work. An additional meeting will be organised when the work is concluded.

Status: on-going

**Action 6a:**

Produce a counter factual case to show the costs of voluntary network transformation to help prove the case for a mandatory option

**Response:**

McKinsey's analysis has indicated that if we continue with the voluntary programme, our network conversions by 2020 will be limited to ~4,490 (~2,240 Mains and 2,250 Locals). This compares with a conversion level of ~8,300 under the mandated option. This is the basis for our counter factual case.

The counter factual case facts:

- Government funding: as we are converting a smaller number of offices in the voluntary scenario, this will reduce the level of required Government Investment funding by around £320m. While on the surface this could be seen by Government as an opportunity, it is in reality a risk. Under this option, a significant proportion of the network would remain on the higher fixed cost operating model. Our calculations suggest that the voluntary scenario would have a higher on-going operating cost of ~£32m. This would impact our future NSP funding. Through discussions with BIS we understand that this shift will be unattractive as they would prefer to be investing in transforming the business to make it sustainable rather than subsidising to keep it running.

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- Market competitiveness: with a smaller number of converted offices, we will lose a significant proportion of the commercial value of the conversion programme. Indeed with less than 40% of our network transformed, it is questionable whether the market impact that was envisaged for the programme could be delivered. Most significantly:
  - Our cost base will remain largely fixed and unchanged. This will make us less resilient to market downturns and over time less competitive in the transactional markets which still account for a significant proportion of our income;
  - Our agents will have less incentive to grow their business. The reality is that under the voluntary programme, it is our best agents who will look to transform their branches as they have the opportunity to gain from the transition to a variable pay model. Post Office will therefore be in the worst possible situation – losing the economies of scale from the growing branches while continuing to subsidise those that are uneconomic.
  - Our branches will not offer customers the improved service which we believe is important to retain our market presence. All our research is showing positive outcomes for our customers. Longer opening hours, low queue times and improved satisfaction. Without these it is unclear whether we will lose growth opportunities to competitors such as PayPoint and Collect+. If this risk does materialise, it would increase the shortfall highlighted in funding section above.

The fundamental point in our counter factual case is that without a move to mandation, it is impossible to see how commercial sustainability could be achieved. This is the key point around which we will build our counter factual case for BIS.

Status: on-going. McKinsey are currently developing a counter factual case for inclusion in our Strategy Workbook.

**Action 6b:**

Consider redefining 'post office' in relation to SGEI and access criteria ensuring as much flexibility as possible

Response:

**Access Criteria:**

At the moment, Post Office, with our current network of 11,500 branches, comfortably meets the HMG's 2007 Access Requirements. As our current network transformation plan is based on a principle of "no closures" and with conversions expected to be either on-site or within 0.5 miles of an existing branch, we believe that we will continue to meet these requirements going forward. There is therefore no immediate need to revise the access criteria. However, should Government want to get to a position where the NSP is reduced, then this will need to be revisited.

**Definition of a Post Office:**

We do however believe that there is merit in seeking a change to the definition of a post office. HMG's Access Requirements are specific in defining access relative to proximity to a 'post office outlet'. If we can gain flexibility within this definition, it is likely to open up opportunities for us to reduce the cost of our network provision and possibly even increase the size of our network. We are currently considering the value of redefining a 'post office outlet':

- to include Basics models,
- to limit the cash and banking requirements of a proportion of the network to allow assisted self-serve machines to function as a Post Office, and
- to identify a proportion of the network (~3,500 branches) as outreach and community branches, with any reasonable adjustments to minimum services to make these

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branches viable for POL going forward and to reduce the requirement for NSP.

If HMG accepts the new definition, the Access Requirements could potentially be met with a smaller network of higher cost Mains and Locals branches, with Basics, assisted self-serve, and outreach/community models making up the rest of the network.

To make these changes, we would need to address all three sources of the definition of a Post Office, i.e. SGEI, the HMG/POL Funding Agreement and POL's Strategic Plan.

Action status: on-going

**Action 6c:**

The cash-flow statement and P&L need to be redrawn once the network decisions have been finalised

**Response:**

See P&L and Cash Flow statements which have been provided under separate attachment.

Action status: complete

**4. Conclusion**

This paper provides the Board with a summary position on each of the key actions. Where additional papers are referenced these will be issued as separate Board papers.

**Susan Barton**  
**April 2013**

## Post Office Profit and Loss 2013-20 (£m)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>Net Income (inc. Profit Share)</b>							
Total Mails	415	413	425	448	482	515	546
Total FS	277	292	319	392	421	457	484
Total GS	116	131	158	174	173	190	206
Total Telephony	51	69	94	119	137	145	150
<b>Total pillar income</b>	<b>858</b>	<b>904</b>	<b>996</b>	<b>1,132</b>	<b>1,213</b>	<b>1,307</b>	<b>1,386</b>
Other	39	40	42	41	44	44	44
-Other income	8	8	8	8	8	8	8
-Supply chain	31	32	34	33	37	37	37
<b>Total income exc FRES</b>	<b>895</b>	<b>944</b>	<b>1,038</b>	<b>1,173</b>	<b>1,257</b>	<b>1,352</b>	<b>1,430</b>
-FRES profit share	32	32	33	35	37	41	41
<b>Total Net Income (INC FRES)</b>	<b>927</b>	<b>976</b>	<b>1,071</b>	<b>1,208</b>	<b>1,294</b>	<b>1,393</b>	<b>1,471</b>
-Income contingency		-20	-40	-60	-80	-100	-120
<b>Total Net Income (INC FRES and after income contingency)</b>	<b>927</b>	<b>956</b>	<b>1,031</b>	<b>1,148</b>	<b>1,214</b>	<b>1,293</b>	<b>1,351</b>
<b>Costs</b>							
Agents Pay	-480	-492	-505	-527	-543	-579	-606
Staff Costs	-251	-242	-228	-222	-222	-219	-216
central	-58	-52	-47	-44	-44	-41	-41
supply chain	-47	-47	-47	-47	-47	-47	-47
other	-146	-144	-135	-132	-131	-131	-128
Non Staff Costs	-294	-295	-322	-382	-405	-450	-486
<u>Existing business costs</u>	-294	-273	-262	-253	-248	-245	-245
IT running costs	-81	-71	-67	-66	-66	-66	-66
Central (incl. Interbusiness)	-83	-75	-69	-64	-63	-62	-62
Supply chain	-48	-47	-47	-47	-47	-47	-47
Other	-81	-80	-79	-76	-73	-70	-70
<u>New income costs</u>	0	-22	-60	-129	-156	-205	-241
Non IT costs	0	-20	-54	-120	-148	-196	-232
New IT running costs	0	-2	-6	-8	-8	-9	-9
<b>Total Costs</b>	<b>-1,026</b>	<b>-1,029</b>	<b>-1,055</b>	<b>-1,131</b>	<b>-1,170</b>	<b>-1,248</b>	<b>-1,308</b>
- Costs related to income contingency		12	24	36	48	60	72
<b>Total Costs after income contingency</b>	<b>-1,026</b>	<b>-1,017</b>	<b>-1,031</b>	<b>-1,095</b>	<b>-1,122</b>	<b>-1,188</b>	<b>-1,236</b>
<b>EBITDAS</b>	<b>-98</b>	<b>-61</b>	<b>0</b>	<b>53</b>	<b>92</b>	<b>105</b>	<b>115</b>
<b>NSP</b>	<b>200</b>	<b>160</b>	<b>130</b>	<b>80</b>	<b>80</b>	<b>80</b>	<b>80</b>
<b>EBITDA</b>	<b>102</b>	<b>99</b>	<b>130</b>	<b>133</b>	<b>172</b>	<b>185</b>	<b>195</b>

**Post Office Cashflow Statement 2013-20 (£m)**

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>EBITDAS</b>	-98	-61	0	53	92	105	115
NSP	200	160	130	80	80	80	80
<b>EBITDA</b>	102	99	130	133	172	185	195
Capex (tangible and intangible)	-168	-216	-162	-69	-62	-53	-47
Other cash movements	-6	-7	-7	-7	-7	-7	-7
<b>Operating cash (outflow)/inflow</b>	-72	-124	-39	57	103	125	141
Reserves, Provisions & Exceptionals	-	-	-	-	-	-	-
non NSP funding	236	87	118	135	88	3	-
	215	170	80	80	0	0	0
<b>Underlying cash inflow/(outflow)</b>	-92	-41	-78	2	16	122	141
Working Capital	226	53	-112	105	-5	-25	30
<b>Total Cash inflow/(outflow)</b>	134	12	-190	107	11	97	171

## **Post Office Board: Funding and Finance**

February 2013

## **Funding and finance background briefing**

This includes the following:

- Investment summary
- Cash-flow summary to 19/20
- Key funding milestones

We have also included:

- a reminder of our previous funding submission
- an overview of the change in depreciation treatment that will be needed during the plan period.

## Key considerations

### Network Subsidy Payment

- Should we increase beyond 2017 to £80m (from previous level of £50m) given the larger number of 'unconvertible' offices?
- Should we try to make this a more formal, long term payment or continue with the current calculation?

### Funding Network Transformation ("non-NSP")

- In addition to the NSP the 2010 plan projected a further requirement of £80m in each of 2015/16 and 2016/17 to complete the transformation by converting the remaining offices. Should we ask for this funding (as expected by BIS & Treasury) or offer to pay for it ourselves out of cash reserves? This is linked to the headroom points below.

### Headroom

Historically Post Office has included headroom (contingency) of £200m in its funding requests. This has been accepted by both Shareholder and Post Office for almost 10 years. Post Office reserves are currently £290m above £200m Headroom.

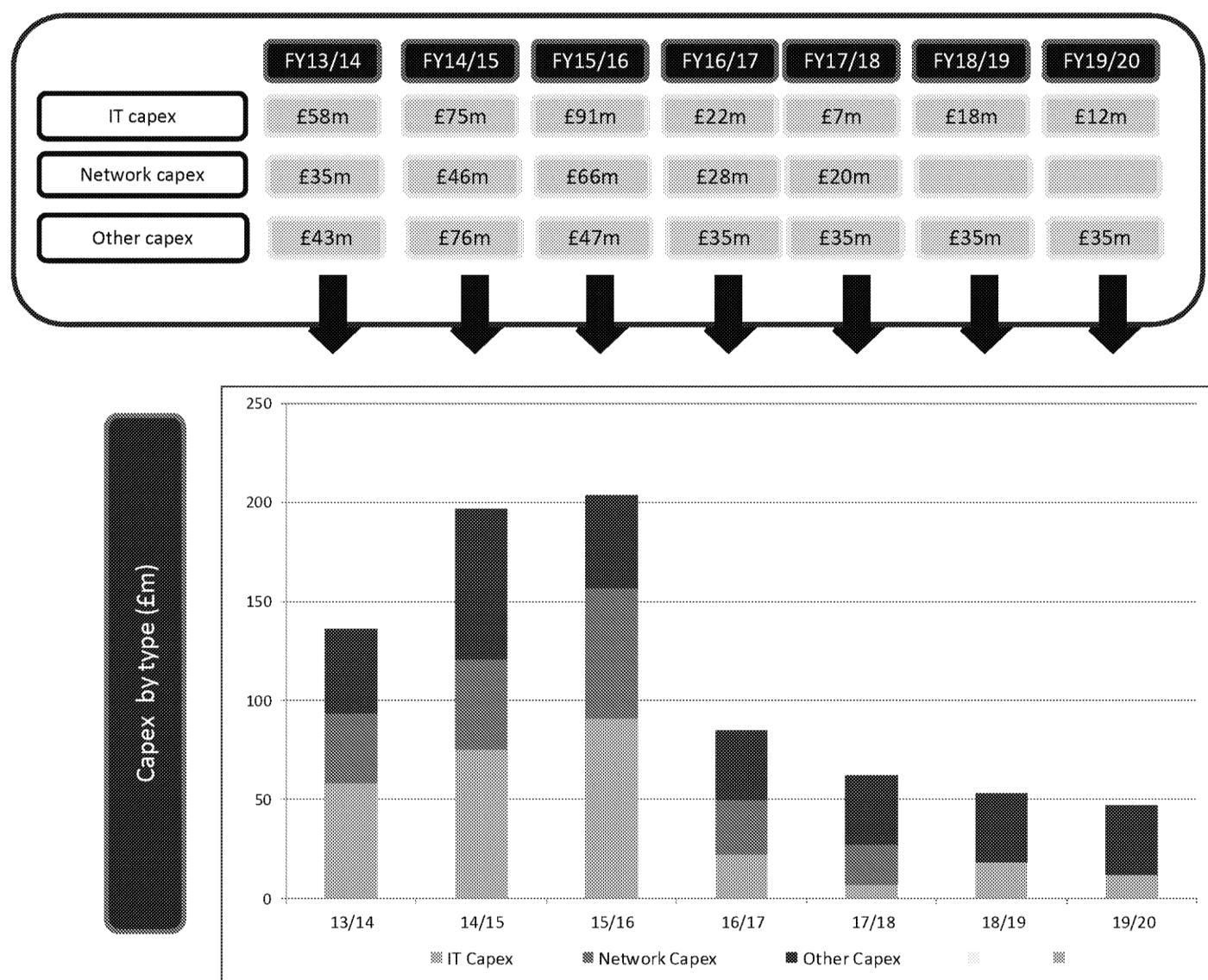
- Should we use these reserves to reduce our funding request? If not then we will need a strong case to retain and reinvest it in the business and we may potentially need examples of what we may use these for.
- Should we retain them a contingency fund for Network Transformation? We may want to set aside funds to allow flexibility in delivering network transformation

### Working Capital Facility

- Post Office will require a facility to fund working capital. The current facility of £1.15bn (providing backed by security) is available to 2016. Not regarded by EC as state aid. This needs to be extended but as security has been a maximum of c£1bn (and frequently lower) we could reduce the limit, potentially to as low as £750m, with no financial impact on Post Office. Historically ShEx have regarded reducing the limit as important so this could be a valuable "give".

## Understanding our additional investment requirements

- IT capex – systems replacement/upgrade including Horizon and CSM and new systems required to grow the new income streams e.g. CRM.
- Network capex – discussed further in the channel section.
- Other capex – includes general replacement capex; increase in 14/15 driven by Financial Services new income streams, principally £15m for the insurance business buyout from Bank of Ireland and £9m for an insurance contact centre.



## P&amp;L summary to 2020

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>Net Income (inc. Profit Share)</b>							
Total Mails	415	413	425	448	482	515	546
Total FS	277	292	319	392	421	457	484
Total GS	116	131	158	174	173	190	206
Total Telephony	51	69	94	119	137	145	150
<b>Total pillar income</b>	<b>858</b>	<b>904</b>	<b>996</b>	<b>1,132</b>	<b>1,213</b>	<b>1,307</b>	<b>1,386</b>
Other	39	40	42	41	44	44	44
-Other income	8	8	8	8	8	8	8
-Supply chain	31	32	34	33	37	37	37
<b>Total income exc FRES</b>	<b>885</b>	<b>944</b>	<b>1,038</b>	<b>1,173</b>	<b>1,257</b>	<b>1,352</b>	<b>1,430</b>
-FRES profit share	32	32	33	35	37	41	41
<b>Total Net Income (INC FRES)</b>	<b>927</b>	<b>976</b>	<b>1,071</b>	<b>1,208</b>	<b>1,294</b>	<b>1,393</b>	<b>1,471</b>
-Income contingency		-20	-40	-60	-80	-100	-120
<b>Total Net Income (INC FRES and after income contingency)</b>	<b>927</b>	<b>956</b>	<b>1,031</b>	<b>1,148</b>	<b>1,214</b>	<b>1,293</b>	<b>1,351</b>
<b>Costs</b>							
Agents Pay	-480	-492	-505	-527	-543	-579	-606
Staff Costs	-251	-242	-228	-222	-222	-219	-216
central	-58	-52	-47	-44	-44	-41	-41
supply chain	-47	-47	-47	-47	-47	-47	-47
other	-146	-144	-135	-132	-131	-131	-128
Non Staff Costs	-294	-295	-322	-382	-405	-450	-486
<b>Existing business costs</b>	<b>-294</b>	<b>-273</b>	<b>-262</b>	<b>-253</b>	<b>-248</b>	<b>-245</b>	<b>-245</b>
IT running costs	-81	-71	-67	-66	-66	-66	-66
Central (incl. Interbusiness)	-83	-75	-69	-64	-63	-62	-62
Supply chain	-48	-47	-47	-47	-47	-47	-47
Other	-81	-80	-79	-76	-73	-70	-70
<b>New income costs</b>	<b>0</b>	<b>-22</b>	<b>-60</b>	<b>-129</b>	<b>-156</b>	<b>-205</b>	<b>-241</b>
Non IT costs	0	-20	-54	-120	-148	-196	-232
New IT running costs	0	-2	-6	-8	-8	-9	-9
<b>Total Costs</b>	<b>-1,026</b>	<b>-1,029</b>	<b>-1,055</b>	<b>-1,131</b>	<b>-1,170</b>	<b>-1,248</b>	<b>-1,308</b>
-Costs related to income contingency		12	24	36	48	60	72
<b>Total Costs after income contingency</b>	<b>-1,026</b>	<b>-1,017</b>	<b>-1,031</b>	<b>-1,095</b>	<b>-1,122</b>	<b>-1,188</b>	<b>-1,236</b>
<b>EBITDAS</b>	<b>-98</b>	<b>-61</b>	<b>0</b>	<b>53</b>	<b>92</b>	<b>105</b>	<b>115</b>
<b>NSP</b>	<b>200</b>	<b>160</b>	<b>130</b>	<b>80</b>	<b>80</b>	<b>80</b>	<b>80</b>
<b>EBITDA</b>	<b>102</b>	<b>99</b>	<b>130</b>	<b>133</b>	<b>172</b>	<b>185</b>	<b>195</b>

## Cash Flow to 2019/20

	March						
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>EBITDAS</b>	-98	-61	0	53	92	105	115
NSP	200	160	130	80	80	80	80
<b>EBITDA</b>	102	99	130	133	172	185	195
Capex (tangible and intangible)	-168	-216	-162	-69	-62	-53	-47
Other cash movements	-6	-7	-7	-7	-7	-7	-7
<b>Operating cash (outflow)/inflow</b>	-72	-124	-39	57	103	125	141
Reserves, Provisions & Exceptionals	-	236	-	87	-	118	-
non NSP funding	215	170	80	80	0	0	0
<b>Underlying cash inflow/(outflow)</b>	-92	-41	-78	2	16	122	141
Working Capital	226	53	-112	105	-5	-25	30
<b>Total Cash inflow/(outflow)</b>	134	12	-190	107	11	97	171

### Key milestones

15/16 EBITDAS (Earnings Before Interest Tax Depreciation And Subsidy) neutral before subsidy

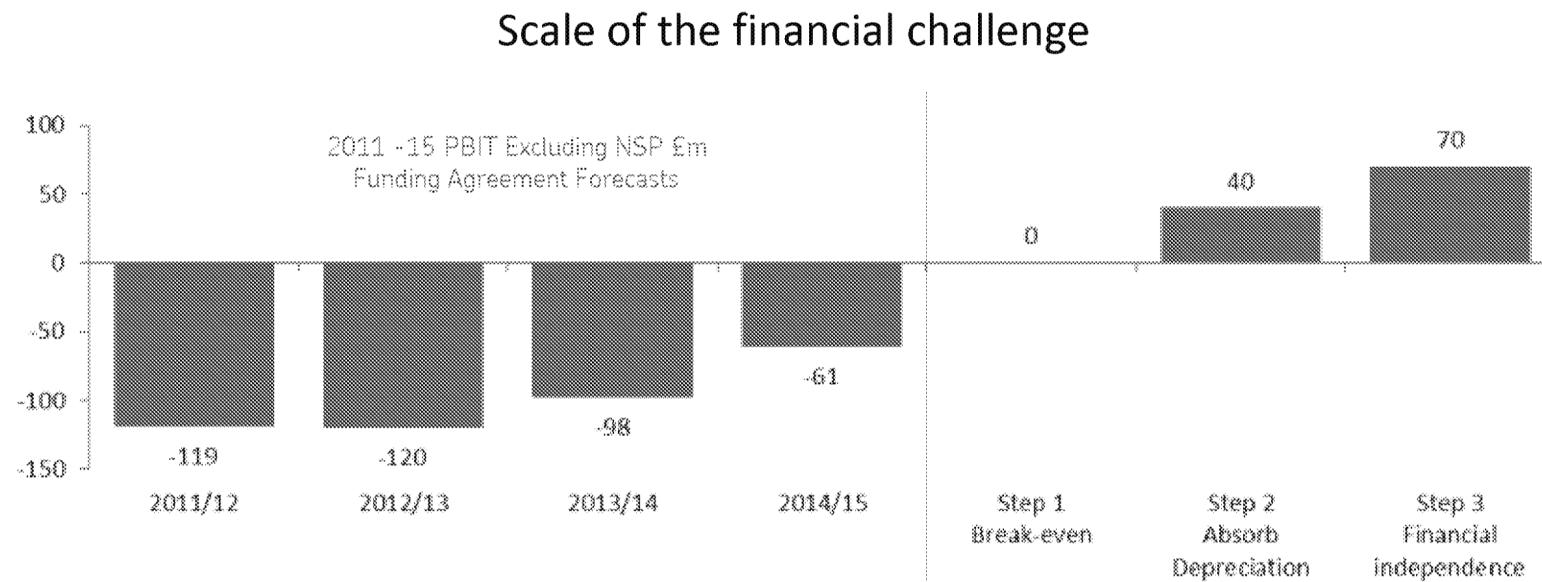
16/17 Operating cashflow positive after NSP

17/18 Operating cashflow positive before subsidy

19/20 Fourth year of positive cashflow

NB Cashflows above include NSP funding after March 2017 at £80m/annum, which reflects the increase above the 2010 Funding Agreement profile to recognise the greater number of 'unconvertible' branches

The financial challenge is considerable if we are to meet Rothschild's report financial conditions required for mutualisation



### Summary of the Rothschild Report

“Commercial sustainability” will ultimately drive long-term “financial stability”, assuming POL has an appropriate capital structure at the point of transfer from Government ownership. As a standalone, independent entity, a mutualised POL must, in principle, be able to access third party capital as Government may no longer be available as a “lender”

To be considered a “bankable credit”, POL must have as a minimum:

- A strategy and market position that enables POL to compete effectively in its chosen markets
- An appropriate cost base and business model with the flexibility to withstand revenue volatility
- Free cash flow to allow on-going investment in the network to maintain commercial competitiveness
- The freedom and ability to respond quickly through corporate actions to unforeseen changes in its markets
- A robust track record of profitability and cash generation
- A viable long-term future

# Annexes

A reminder of 2010 funding ask - though Post Office Ltd only has funding agreed to 2014/15, there was a plan and funding requirement established to complete the network transformation in the following two years

Year covered	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18 ONWARDS
NSP	£180m	£210m	£200m	£160m	£130m	£80m	£50m
Equity	£0m	£200m	£215m	£170m	£80m	£80m	£0m
Total	£180m	£410m	£415m	£330m	£210m	£160m	£50m
March 2010 Funding Deal				October 2010 Funding Deal Total = £1.156B			
				Funding announced by Government = £1.335B			
				Total Funding required for 2011-17 Plan = £1.71B			
Working Capital Facility of £1.15B							

- EBITDA exc NSP in Oct 2010 Funding agreement

10/11	(£118m)	14/15	(£60m)
11/12	(£149m)	15/16	nil
12/13	(£125m)	16/17	£56m
13/14	(£97m)	17/18	n/a

## As Post Office moves to a cash generative position, our current practice of impairing assets will need to be evaluated and changed

### Background

- We have historically written off almost all assets upon purchase, with only a small depreciation recognised on c£150m.
- This is because Post Office had operating losses (until 2008/09), net cash outflows from operating activities and a high reliance on NSP
- As we become sustainably cash generative and less NSP reliant, this will no longer be possible
- There are two approaches when we cease impairment as shown below – Outcome A and Outcome B
- In the last board financials, an approximation of Outcome A was used, with depreciation charge of £100m

### Outcome A

All the assets that have historically been impaired are recognised on the balance sheet at their revised carrying value – with depreciation charged on these assets going forwards. This value, in 2016/17 is likely to be ~£250m

### Outcome B

Impaired assets are not reinstated and depreciation is charged on any capital expenditure going forwards. This means in 2016/17, only Capex from that year (£100m) will show depreciation

Initially Outcome A was assumed to be the correct accounting treatment – further analysis and case studies make it almost certain Outcome B will be used

### Impact of Impairment vs Depreciation

	'11/12	'12/13	'13/14	'14/15	'15/16	'16/17	'17/18	'18/19	'19/20
Capex	(36)	(68)	(212)	(117)	(107)	(100)	(41)	(48)	(42)
Outcome A (Starting NBV £250m)	(1)	(1)	(1)	(1)	(1)	(134)	(91)	(74)	(58)
Outcome B (Starting NBV £0m)	(1)	(1)	(1)	(1)	(1)	(25)	(35)	(47)	(58)

### Key Takeaways

- Post Office is likely to cease impairment in 2016/17 when sustainable cash inflows are generated.
- There are two possible outcomes from this under accounting rules
- The impact this may have is likely to be £25m that year increasing to £58m in 19/20
- This is just an accounting change and makes no difference to funding requirements
- For consistency sake future financial analysis will show EBITDA

**File note:**

**Meeting between Sue Barton, Will Gibson & Tim McInnes**

**27/03/13**

**Context:**

The meeting was organised at Post Office's request to ensure alignment of expectations on the Strategic Plan submission, in terms of:

- Document format
- Engagement between the Post Office and BIS teams prior and subsequent to formal document submission
- Timetable for funding discussions and agreement
- Level and duration of funding request.

**Key points from discussion:**

1. **The Post Office strategy submission will comprise two documents.** The first will be a word document setting out the high level strategy and funding request. The second will be a supporting workbook of presentation material that provides the working detail behind each element of the strategy. The workbook will be built from the material that has been prepared for, and shared with the Board, e.g. the income papers.
2. **We will do a page turn on the documents with BIS in advance of our formal submission.** This will allow us to ensure the documents cover the areas required, to highlight additional information requirements as soon as possible in the process, and to provide the context around the submission with key strategic messages.
3. **BIS will use independent advisors to support them in this process:** The tender process to appoint these advisors has started but has not yet concluded. The advisors will work alongside them reviewing our plans and submissions providing an independent perspective. This is the approach that has been used previously.
4. **After plan submission, there will be a series of joint Post Office & BIS sessions:** these will allow BIS and their independent advisors to do a deep dive into each area of the strategy. Historically these have tended to focus on the financial elements of the plan. We will look to establish the schedule and agenda for these meetings in the next couple of weeks so dates can be blocked out of diaries and there is not unnecessary delay between submission and the first meeting.

5. **There is a desire on both sides to conclude this process quickly:** Post Office highlighted a desire to move this process forward quickly. This was agreed by BIS. BIS is working to a timetable that would see the first year of funding (as a minimum) being signed off by the end of June.
6. **Post Office is to submit a strategy with financials through to 2020 with an expectation that the first two years will be approved in this funding round:** the BIS team have had discussions within BIS and Treasury on the necessity for a funding deal which extends beyond one year. As a result there is a strong belief that as a minimum we will receive a two year funding deal.
7. **The concept of long term funding/ contractualisation of the network subsidy payment is understood to be a necessary part of the creation of a commercially sustainable Post Office:** the Rothschild report has been shared informally with BIS team and they therefore understand the need to move funding on to a more contractual and long term basis. Raising this as part of the Post Office strategy submission and funding request would not be an issue and was encouraged. No certainty around whether this would/ could be considered as part of this funding approval process.
8. **BIS have not and are not planning to develop their own definition of commercial sustainability:** BIS see this as a Post Office responsibility and are not planning on commissioning work in this area. Post Office confirmed that it will formally share the Rothschild report once it has been updated to reflect the latest financial projections from the 2020 Strategy. It was agreed that there may be value in agreeing the possible parameters for continued Government support in advance of commissioning this update, for example, would Government be prepared to lend to Post Office on commercial terms or is complete financial independence a necessity.
9. **BIS are using a working assumption that the Post Office funding request will as a minimum be in line with the previous plan submission:** the previous Strategic Plan included an indicative funding ask of £210m for 2015/16 and £160m for 2016/17. BIS are assuming this will be our minimum “ask”. Internally they are managing expectations that we may need a greater amount. Post Office has not given any indication or response to this, stating that until the McKinsey work is complete, it is impossible to provide a view.
10. **Post Office funding ask must continually reduce over the plan period:** as stated above, there is an expectation we may ask for more funding that was originally envisaged in our previous strategic plan submission. However it is essential that any request is below our 2014/15 funding of £330m. As a general point, BIS would like to see a funding request which had a downward trend from the £330m over time. BIS also stated that from a messaging perspective, investment funding is a more positive story than subsidy payment.
11. **The need to move the network programme on to mandation is understood:** the BIS team understand the need to move the network transformation programme to mandation. There was joint recognition of the challenge around this but BIS confirmed the Minister has been briefed on the high level story and believe there was understanding and acceptance. The request is that Post Office build the ‘story’ around this in the most positive light, focusing on

the value and benefit of the transformed network rather than the negatives of the status quo. Albeit the negatives will be needed within the analysis. There was consensus that if mandation was not achieved through this process, it would be disastrous for the Post Office goal of commercial sustainability. Statistics, quotes and sound-bites around the success of the new models will be helpful in selling this story.

- 12. The definition of commercial sustainability will need to be agreed jointly:** agreeing the definition/ parameters of commercial sustainability was accepted as a key foundation step for mutualisation. As highlighted in (8) above, BIS are not developing their own view of this and are expecting Post Office to lead discussion. There was an understanding that joint agreement on the final definition would be required. Post Office did not conclude the point on this needing to then be made publically available but this is now being followed up by email.
- 13. Commercial sustainability has to be the priority for the plan as without it Post Office cannot deliver on mutualisation:** Post Office tested out the messaging on mutualisation explaining that the business priority had to be commercial sustainability as this was a key step on the journey to mutualisation. This was agreed and understood.