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To: Martin Donnelly
From: Peter Batten **GRO**
Date: 19 April 2013



Subject: BIS Permanent Secretary meeting with Post Office Ltd Chair

Purpose

1. You are meeting Alice Perkins, Chair of Post Office Ltd (POL).

Key current issues

2. Alice is likely to raise a number of key issues including current performance, development of post-2015 strategy and funding considerations, POL's network transformation (NT) strategy and progress towards mutualisation. An overview is below, and a speaking note is attached as Annex A.

2012/13 Financial Performance

3. POL delivered a strong performance during 2012/13 and is expected to report results for the full year that show revenue growth of 4%, up from £865m to £901m, and operating profits rising 54% from £61m to £95m (or rising 5% if adjusted for the £30 million increase in the Network Subsidy Payment). This maintains the trend established in 2011/12 when POL delivered its first year of revenue growth in many years. POL is also expected to outperform budget in both revenue and operating profit in 2012/13, with a particularly strong performance in the latter – this should end the year c.£10m ahead of budget.
4. This performance against budget has mainly been driven by strong revenue performances in Financial Services and Mails and Retail, offset by weakness in Government Services (where expected volumes in existing contracts did not materialise). Cost performance has also been robust, with staff costs, agent costs and overheads each expected to end the year favourable to budget. This strength is echoed in the Crown estate where POL is expected to see the losses of these branches narrow from £46m in 2011/12 to c.£38m this year (c.£2m ahead of budget expectations).
5. The ShEx POL team will continue to assess POL's 2013/14 performance and budget closely in light of this performance.

Post 2015 Funding and Strategic Plan

6. POL is developing its new strategic plan for the period beyond March 2015, which will require funding in order to see through its reforms, including completion of the NT programme (necessary to make POL financially sustainable). This will reduce POL's dependence on public subsidy but is also an important driver for mutualisation (which requires the business to be commercially sustainable). A draft has been considered by the POL Board, and was recently (verbally) presented to BIS. ShEx is appointing finance and accounting advisers to provide support in assessing this new plan and we are also in close discussions with finance to ensure this process feeds into SR discussions with HMT. We expect the 15/16 funding ask to be between £200m and £250m (a decrease from £330m in 14/15). We are seeking a funding agreement for at least a two year period (to 16/17) to ensure we only need make one state aid notification. This also ensures we are in receipt of state aid clearance for the period to 16/17 before the end of this Parliament. HMT officials have indicated they are receptive to this (although this is not formally confirmed).

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Mutualisation

7. POL's mutualisation is inextricably linked to the successful delivery of its strategy. It is both an enabler for certain initiatives, including NT, and an objective for a commercially and financially sustainable business. Jo Swinson also has a high level of commitment to mutualisation and is keen to meet Government's objective of seeing clear progress being made before the end of this Parliament.
8. There has been good progress recently and the first phase of the POL Stakeholder Forum (convened to define a Public Benefit Purpose of the business) is soon to be completed. This will provide the foundation around which a mutual can develop, and POL plan to launch public engagement over the summer to solicit wider views. We expect to see other workstreams (e.g. Cultural Change, Finance, Governance) gain momentum once this engagement, and the work of the POL Stakeholder Forum, has been completed in the second half of 2013.

Network Transformation (NT)

9. The NT programme is fully funded to March 2015, and provides for up to 6,000 post offices (around half the network) to be converted to new operating models (Main and Local). These remove the element of fixed pay that a subpostmaster traditionally receives, moving instead to a fully variable pay structure linked to in-branch transaction levels.
10. National rollout of NT began in October 2012, and at end of March 1,450 branches had signed binding contracts to convert (meeting the stretch bonus metric). Of these, 507 have physically been completed, which is fewer than expected at this stage. The company puts this down to the voluntary nature of the NT programme, and lukewarm support from the National Federation of SubPostmasters (NFSP). McKinsey are currently reviewing the 2010 strategy for POL and while their emerging findings are confirming that the models are fit for purpose, they forecast that POL will only convert 3,400 branches by 2015 without changes to the NT implementation approach.
11. POL's new strategic plan seeks to introduce a more planned basis for the conversions, which may include compulsory change. This will present political challenges for Ministers, which will need to be mitigated if they are to approve the required funding. A compelling and positive narrative around POL's future strategy is therefore crucial.

Crown Transformation

12. Staff in POL's 373 directly-run Crown branches are paid significantly more than peers in similar roles in other markets (e.g. bank clerks, franchise staff). This is a structural weakness that has been a major factor behind the recurring losses experienced by POL's Crown branches in recent years. POL has offered Crown staff unconsolidated cash bonuses tied to meeting financial targets worth up to £3,400 per person over the next three years. This offer has been rejected by the CWU who recently successfully balloted members for strike action. Strikes were held on Easter Saturday, and Friday 19 April. However, around a third of branches did open and the strikes caused minimal disruption to the operation of the Post Office network.
13. In February, POL announced plans to franchise 70 of the Crown branches. These are branches that POL does not believe it can bring into profit. Franchising is a key pillar of POL's strategy to take the Crown network to breakeven by 2015. The CWU is campaigning against the proposals, which it has linked to the strike action over pay.
14. More widely, POL has made good progress on reducing Crown losses from £46m last year to an expected c£38m this year, outperforming budget expectations. POL will be mobilising a number of further initiatives across the Crown estate during 2013/14 and 2014/15 which are expected to see the elimination of these losses.

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Front Office of Government

15. Despite POL winning a number of Government Services contracts since February 2011, it is not generating the level of revenue anticipated in the 2010 strategic plan. This is due to both lower than expected volumes and more challenging pricing, driven by high levels of competition in certain market segments (e.g. POL recently retained its DVLA contract against strong competition, but at markedly weaker rates than had been available under its previous contract).

Current accounts

16. POL recently announced that it would be launching a Current Account in partnership with its banking partner Bank of Ireland UK. The product launches on 13 May in a limited pilot of 39 branches in Norfolk. It is expected that Jo Swinson will participate in the launch.

Annex A – Speaking notes

	Points to draw from:
2012/13 Business Performance	<ul style="list-style-type: none"> ▪ I'm delighted to note the Post Office's strong financial performance in 2012/13 which included a mix of growing revenues and cutting costs. ▪ It is crucial that this is continued into 2013/14 and I do hope that Post Office Ltd has been ambitious in setting challenging targets for the current financial year.
Post-2015 strategy and funding	<ul style="list-style-type: none"> ▪ It will be vitally important for my officials to be closely involved with the analysis of the plan as the funding for the next SR is agreed. ▪ We are in the process of appointing advisors to provide third party assurance and assessment of the plan. ▪ Key requirements for Government, as shareholder, will be to see the successful completion of the network transformation process, coupled with an achievable growth strategy, while at the same time crucially ensuring a continued positive story to tell about the Post Office.
Mutualisation	<ul style="list-style-type: none"> ▪ Progress towards Mutualisation remains a key objective of this Government. ▪ Mutualisation is closely linked to the successful delivery of POL's commercial strategy to build a sustainable business, in particular Network Transformation. ▪ I would be interested to learn more about the company's plans for wider public engagement in the coming months.

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<p>Network Transformation</p>	<ul style="list-style-type: none"> ▪ Congratulations for achieving 1,450 signed contracts to convert to the new models by end of March 2015. I hope that the Network Transformation team is able to maintain this momentum over the coming year. ▪ I was though slightly disappointed that at the end of the year only 507 branches had been physically converted. ▪ Ensuring that branches move from contract signature to physical conversion in a timely fashion is important for the integrity and reputation of the Network Transformation programme.
<p>Crown Transformation</p>	<ul style="list-style-type: none"> ▪ The ongoing dispute between management and the CWU is obviously an operational matter for the company, but reaching break-even in these branches by March 2015 remains the Government's (as shareholder) primary objective for the Crown network. ▪ I am pleased to note the progress over the last year towards meeting this objective.
<p>Front Office for Government</p>	<ul style="list-style-type: none"> ▪ As you know, Government can not simply award work to the Post Office. I am pleased to note that Post Office Ltd has adopted a much more competitive approach since February 2011, as evidenced by recent contracts wins. ▪ [if pushed on lower transaction values] This is a commercial and economic reality. Government cannot award work without competition. Post Office Ltd has demonstrated it can compete competitively and win contracts from Government, and I encourage the company to build on the positive progress made over the last two years.

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