

In Strictest Confidence

**POB(99)2nd
PO99/12 to 22**

POST OFFICE BOARD

**Minutes of the meeting held on 15 February 1999
at 148 Old Street**

Present

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

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

Others attending: Vanessa Leeson, Director Organisational Capability for PO99/19
Ian McCartney, Minister of State, DTI, Frank Doran, MP, Parliamentary Private Secretary, Martyn Baker, DTI and Geoff Moore, DTI, for PO99/21-22

**MINUTES OF
PREVIOUS MEETING**

PO99/12

The Board approved the minutes and separate record of proceedings from its meeting of 12 January 1999.

**MATTERS ARISING
POB(99)1**

PO99/13

The Board noted the matters arising from the meeting of 12 January 1999

Financial Summary:
Parcelforce/Freemans
(PO99/5(x))

- (i) Discussions with Freemans had not been concluded due to the uncertainty surrounding the parent company Sears. Parcelforce was hopeful of developing similar arrangements with other organisations and had already been approached in this regard.

IAN McCARTNEY MP

PO99/14

- (i) The Chairman would highlight to the Minister the role of the Board and its Committees, seek an update on the

In Strictest Confidence

White paper, which was not now expected until Easter, and outline the role and format of the Strategic Plan.

- (ii) DTI officials had indicated that they would want to see the Strategic Plan in May, a month earlier than scheduled. This would not give the Board sufficient opportunity to input into the Plan and a compromise solution would therefore be sought, possibly through the provision of a draft Plan.

**CHAIRMAN'S
BUSINESS**

PO99/15

- (i) The financial performance of Royal Mail and Parcelforce in December had been disappointing and whilst the early signs were that January had improved, profit and cash management performance needed to be raised in order to meet agreed targets, particularly the EFL.
- (ii) It was important that a change programme be developed to generate, through new processes, reductions in the organisation's cost base. In the Chairman's view given the necessary investment, especially in IT, savings of £0.5bn over 3 years should be possible. Coupled with this was the utilisation of assets to improve the asset turn and hence the ROCE.
- (iii) The current financial difficulties highlighted the need for reductions in the cost base and particularly headcount. There was total executive commitment to achieve this through the COSSP project, which would generate savings of £400m, Shaping for Competitive Success and the new productivity deal in Royal Mail. The need to maintain or improve industrial relations was the only caveat to achieving the proposed performance improvement within a 3 year timescale.
- (iv) Management capability to deliver was a key element to the success of any change programme. Some changes in the senior management team would probably be necessary and the use of talented young internal people as change managers could provide a powerful stimulus.
- (v) An essential element of the Strategic Plan would be discussions on the cost base and how savings could be achieved. The Plan itself would be prepared in the knowledge that the Regulator would use the data as an aid to determining the RPI - x formula.

In Strictest Confidence**CHIEF EXECUTIVE'S
REPORT (POB(99)10**

PO99/16

- (i) Financial Performance. The performance of Royal Mail and Parcelforce continued to be of concern and in discussing the individual Business Plans the Executive were seeking to set tough but realistic targets. For the achievement of targets in 1999-00, it was important that the Businesses entered the new financial year at the appropriate running rate levels.
- (ii) Horizon. Both DSS and Counters had been excluded from recent Treasury discussions with ICL and consequently The Post Office had no reliable information of when or in what form an announcement on the future of the programme would be made. The Board expressed extreme concern over this development.
- (iii) Costs of maintaining the programme were for Counters relatively modest, at least until the system had been successfully installed. Of real concern, particularly to Non-Executive Members, was the exclusion of Counters from discussions and the lack of Executive control that The Post Office now had in the management of the programme. Whilst for contractual reasons, suspending the project was not an option, it was imperative that a decision on the way forward was taken quickly and in consultation with all interested parties. The presence of Ian McCartney at the Board provided an opportunity to clarify his understanding of the situation.
- (iv) Liberalisation. A new draft Directive on postal liberalisation was expected shortly from the European Commission. The position advocated by The Post Office, a gradual and controlled reduction of the monopoly weight and price limits, had appeared to be gaining ground within the Commission. But Commissioner Bangerman, principal sponsor of the new Directive, was pressing for a firm commitment to full liberalisation in 2005 to be included. The Commission were expected to decide on the issue in early March, subject to the agreement of the Parliament and Council of Ministers. The outcome would be relevant to the White Paper.
- (v) Government White Paper. A first draft of the White paper had been made available to The Post Office. Within the paper four key issues had been identified: timing of the monopoly reduction; the level of dividend payment; past surpluses held in the balance sheet (gilts); and the degree of flexibility on borrowing.

In Strictest Confidence

- (vi) With regard to the monopoly, DTI officials were proposing a reduction to 50p with effect from the publication of the White paper. This would be in advance of Europe, and possibly in a different form; it would also be before any of the other commercial benefits announced by the former Secretary of State, Peter Mandelson, could be enjoyed. On the dividend payment of 40% of post tax profits, the Treasury's view was that this be regarded as a 'floor' level with any excess benefit paid direct to Treasury. Additionally, there was a proposal to re-structure the Group balance sheet and strip out the past surpluses held in the form of gilts, which in themselves generated interest of £107m. Treasury were also opposed to The Post Office having the ability to flex the £75m a year that it had been agreed the organisation could borrow, over a five period. DTI had proved reasonably receptive to The Post Office's views.
- (vii) The scope of regulation was an important factor within the White paper and any 'creep' into the competitive areas of Counters and Parcelforce would need to be avoided. As currently envisaged the regulator would not regulate competitors although he could issue licences to operate within the monopoly area. Currently around 50% of turnover would be within the regulated area. Regulation could have a significant impact on the financial performance of the Businesses and explaining the financial impact to a regulator and officials was not always easy. Mike Kinski had experience in this area and was happy to offer any advice or assistance should this be helpful.
- (viii) The style and approach of the person appointed to act as regulator would obviously influence the way in which the interface with The Post Office was managed. Creation of an independent regulator required primary legislation so regulatory powers were expected to be retained by the Secretary of State, the new regulator acting through a Memorandum of Understanding.
- (ix) It would be useful for the Board to understand the key regulatory issues.
- (x) Project Fiona. The Chairman and Chief Executive had held constructive talks with a major express carrier and foreign postal administration over a potential collaboration around a newly developed air hub. Kevin Williams had held follow up talks on how the proposal could be taken forward.
- (xi) Lottery. Ian McCartney was considering the competition

In Strictest Confidence

law implications of The Post Office's extended involvement in the national lottery. The Post Office remained optimistic that a positive outcome would be forthcoming.

Action

Jerry Cope

Bring a high level review of regulation issues to the March Board.

**FINANCIAL
SUMMARY****PO99/17**

- (i) The current full year forecasts were:
- Royal Mail £458m
 - Parcelforce £(20)m
 - Counters £38m
 - SSL £3m
 - Group Centre £94m
- (ii) The current Group Centre forecast was £6m below budget as a result of expenditure on Shaping for Competitive Success and the Trusted Third Party project.
- (iii) Profit for December was:
- Royal Mail £20m
 - Parcelforce £2.7m
 - Counters £24m
 - SSL £0.4m
- Cumulative Group profit stood at £447m against a budget of £473m. December's actual results varied from those provisionally reported last month (PO99/5), but not to any significant extent.
- (iv) Risks continued to outweigh opportunities in Royal Mail with lower mails efficiency, Streamline volumes and risks in the business' emergency plan, together totalling £58m. The emergency plan included ceasing discretionary spend and restrictions on the filling of new and vacant management posts.
- (v) Notwithstanding the action being taken by Royal Mail, staff costs for the fourth quarter of the year were forecast to outturn over budget. Non-staff costs were forecast to outturn under budget and below the 1997-98 outturn.
- (vi) Parcelforce's cumulative performance compared with budget showed income £10.4m below budget and expenditure £7.8m above budget. These poor results made the cumulative loss £20.6m compared with a budgeted loss of £2.4m.

In Strictest Confidence

- (vii) Parcelforce's income performance needed to improve considerably, with the cumulative variance £10.4m below budget and the full year forecast currently £5m below budget.
- (viii) Parcelforce staff costs had now been de-risked.
- (ix) In order to achieve its full year forecast loss, Parcelforce would be reliant on a number of one-off items: the SAP settlement with Hewlett Packard; computer re-lifing; and various income and expenditure adjustments.
- (x) Four issues were likely to be raised by the auditors at the year end: the increased bad debt write-off; potential fixed asset impairment; the Hewlett Packard compensation claim; and re-lifing of computer equipment.
- (xi) Counters performance remained ahead of budget with additional opportunities of £13m against risks of £2m.
- (xii) It would be helpful for the Board to understand the severity of the rest of year task the Businesses faced to achieve their full year targets, compared with that in 1997-98.
- (xiii) The auditors had now agreed the pensions funding assumptions endorsed by the Board in January (PO99/7).
- (xiv) A £20m risk to achieving the EFL target of £310m still existed with at present no obvious means to reduce the shortfall having been identified.
- (xv) The post completion audit statement for German Parcel was expected to be completed by March. For The Post Office report and accounts an estimate of the trading performance would be used. Minimal disclosure of information would be included within the accounts.
- (xvi) It was important that the Board had confidence in the trading performance of the company and that the expected performance was being achieved.

Noted further Richard Dykes's presentation and that
- (xvii) Royal Mail's provisional result in January was encouraging with a favourable variance on core non-staff expenditure. Expenditure in mails operations had, following increases up to period 9, started to move downwards and it was important to ensure that this trend continued through into the next financial year together with the other disciplines the Business had introduced.

In Strictest Confidence

- (xviii) Meetings with the CWU and CMA had been held to explain the financial difficulties Royal Mail faced. Encouragingly, the unions had recognised the severity of the situation and agreed, in principle, to tackle the problem of high overtime levels.
- (xix) Agreement to the introduction of a new performance bonus scheme was expected shortly and this would go some way to generating 'real' savings.

Noted further that

- (xx) With no issues around the achievement of its full year profit target, Counters was focusing its efforts on delivering its change programme and maximising its cash flow. The first conversion since the moratorium was lifted was three months away. The external consultation process had been improved. The CWU had still to comment on their position and the stance they would adopt on new conversions was therefore unknown. DTI had been kept apprised of the situation.
- (xxi) The general trading position across the parcels market had worsened since the turn of the year although Parcelforce's Next Day volumes were still showing healthy year on year increases. International performance remained of concern. Staff numbers were close to budget.
- (xxii) A meeting to conclude the settlement with Hewlett Packard was scheduled for the coming week with a £4m payment the likely outcome.
- (xxiii) It was agreed that Richard Close would report to the DTI forecast outturns of:
 - Royal Mail £478m
 - Parcelforce £(20)m
 - Counters £35m
- (i) For the March Board provide an update on the performance against expectation for German Parcel and the form of management report that would be introduced to monitor performance
- (ii) Circulate information on the financial task that the Businesses faced for the remainder of the 1998-99 financial year, compared with 1997-98.

Action
Richard Close

In Strictest Confidence**PARCELFORCE
DEBT RECOVERY
(POB(99)11)****PO99/18**

- (i) When Parcelforce's SAP R3 finance system had been introduced in February 1998, it became apparent that the system was undersized by a factor of 7. This resulted in a 50% drop in performance and very quickly led to a backlog of 130,000 customer dockets. This was compared with a normal backlog of 5-6,000. Consequently, customer invoices were issued late and customer enquiries increased from 500 a day to 5,000.
- (ii) At one stage debts totalled £98m but this had now been reduced to £67m, with £41m under 30 days old, £11.5m between 31 and 90 days old and £15m over 90 days old. Efforts were concentrated on targeting the 700 customers who accounted for £11m of the over 90 day old debt. 900 customers were now going through a legal process to recover debts, half of whom had debts over 1 year old.
- (iii) In total debts of £1.8m were now over one year old and it was likely that the external auditors would seek to write this off, together with a proportion of the £7.4m debt that was between 181 and 360 days old. Potentially this could give a write off of £4.3m. To counter this Parcelforce was seeking to secure customer documentation that would demonstrate that arrangements to pay were in place.

noted that
- (iv) Considerable resource and effort had gone into debt recovery with over 152 staff employed, excluding agency staff, against the templated 100.
- (v) Whilst some sympathy had to be felt for customers who had been inconvenienced, there was a legitimate point beyond which the withholding of payment was unjustified and strong action had to be taken. Parcelforce had established an escalation process to deal with this.
- (vi) The SAP system was now operating correctly.
- (vii) An independent review of the SAP system had attributed a significant proportion of blame to Hewlett Packard although Parcelforce had contributed to the difficulties by seeking a number of system changes. Legally, it was unlikely that full responsibility could be laid on Hewlett Packard and a settlement of £4m was therefore considered a sensible and reasonable outcome.

In Strictest Confidence

**SHAPING FOR
COMPETITIVE
SUCCESS**

- (viii) Thanked Kevin Williams for his update and the efforts made to recover the debt.

PO99/19

- (i) Shaping for Competitive Success (SCS) was the biggest reorganisation of The Post Office for 10 years. It had been discussed in outline terms at the Board's July Awayday at which time the Board had supported the direction and scope of the review.
- (ii) A number of pressures for change had driven SCS. Internally these included: the manageability of a business the size of Royal Mail, the need to focus more on markets and customers, high unit costs, the slow pace of change and turfism versus flexibility. External reasons for change included: customer demand, the introduction of commercial freedoms, regulation, new technology and greater competition.
- (iii) SCS had to fulfil a number of key criteria:
- support global ambitions;
 - improve employee and industrial relations and competitiveness;
 - allow flexibility for continuing change;
 - measure and reward success;
 - secure long term profitability;
 - be market and customer facing; and
 - above all produce focus on consistent delivery.
- (iv) Nine different markets and the overlaps and boundaries between the businesses had been identified and from this the individual Business Units had been established. Significant changes within these new units included the creation of a stand alone international unit and one unit to manage the top 50 (possibly) business customers.
- (v) Value from SCS would be generated by: contributions from new markets, although the extent of this could not yet be judged; from greater rationalisation of support services that could be shared across the organisation; the reduction of overheads; the development of existing and future core competencies; and increased fluidity of systems infrastructure.
- (vi) One off costs of £50m were forecast with annual savings of between £30 -£40m to be generated.
- (vii) Migration to the new organisation would not take a 'big

In Strictest Confidence

bang' approach but would be phased from April 1999 through to April 2000. Built into the migration would be a 'fire wall' which would provide continuity between managers and the operation of their teams.

- (viii) A number of major issues still needed to be addressed by the Executive Committee including: the organisation of the IS/IT Supply Chain; the role and focus of the currently separate sales functions; and the scope of logistics and contract distribution.
- (ix) Communication was planned in 5 waves, was stakeholder based and for affected employees would be handled on a face to face basis. The CWU, CMA and NFSP were involved in the process and had already voiced concerns over the transfer of HGV drivers from Royal Mail to Parcelforce and the possibility of further outsourcing of services.

Noted that

- (x) SCS was not the only major initiative that would generate savings and improve performance. Initiatives such as the Competitive Overhead Strategic Structure Programme and Finance Excellence Programme were also targeting considerable cost reductions.
- (xi) Primarily the SCS work was being handled in house, supported by advice from consultants from PA, ER Consultants and PricewaterhouseCoopers.
- (xii) Branding of the new organisation had to be linked to a significant external change and as yet nothing specific had been targeted.
- (xiii) The timescale for introducing the organisation was acknowledged as being tight but it would not be allowed to influence the successful implementation of units and if this required a delay then the timescales would be extended.
- (xiv) The cultural changes that would be demanded from the new organisation were considerable and the need for change would be emphasised to all managers having responsibility for units within the new structure. Those people who were unable to change would not be retained.

Thanked John Roberts and Vanessa Leeson for their informative presentation.

In Strictest Confidence

**AUDIT COMMITTEE
REPORT
(POB(99)12x)**

PO99/20

The Board noted the report and that in future internal abbreviations and jargon would be avoided.

IAN McCARTNEY MP

PO99/21

- (i) The Chairman welcomed Ian McCartney, The Post Office Minister at the DTI, and his colleagues to the Board.
- (ii) The Chairman explained the role of the Board and that its key focus was on:
 - strategy;
 - management development and succession planning;
 - business budgets;
 - ensuring that appropriate controls existed;
 - monitoring Business performance against agreed goals;
 - monitoring the health of the Business;
 - reviewing and when necessary approving key projects; and
 - monitoring the management of The Post Office.
- (iii) From a personal perspective the Chairman believed the Board to be well balanced and experienced, independent, empathetic but challenging. However, he did question the extent to which Government and Whitehall acknowledged the value of the Board and was concerned that communication at ministerial level was too infrequent and that the decision making process was slow.
- (iv) Mike Kinski, as Chairman of the Remuneration Committee, welcomed the opportunity to provide the Minister with data on the remuneration of senior executives within comparable external organisations and develop opportunities to provide a less restrictive remuneration package. He also expressed concern, shared by the other non-executives, that the control and direction of the Horizon programme no longer appeared to be held within The Post Office.
- (v) In response, Ian McCartney agreed that the decision making process and communications could also be improved. He stressed the importance of the Strategic Plan and the need for Treasury to be kept 'on side' as the process developed.
- (vi) The Minister would welcome some data from the

In Strictest Confidence

Remuneration Committee and discussions on ways in which improvements could be achieved. With regard to Horizon, the strategic importance of the programme was understood but DTI were also placed in a difficult position having to deal with the political implications for other Government departments. It was hoped that an announcement on a way forward would soon be forthcoming.

- (vii) The White paper was under preparation and the Minister was keen that it be concluded by the end of March. It could not be publicised until the future of Horizon had been determined

It was noted that

- (viii) The new style Strategic Plan would be developed around 5 areas: an overview of the goals and targets; an environmental scan (the hurdles to overcome); the strategic response to overcome these hurdles; capability and deployment and finally the financial and performance projections. The DTI needed information on the key objectives of the Plan in order to input and conclude the White paper. The Post Office would be able to provide this information within the DTI time frame.
- (ix) The Chairman outlined the timetable for the Plan which would be available in mid-June. A key part of the process being the Board discussions on the evening of 7 June and morning of the 8th.
- (x) The Minister saw the role of the Strategic Plan as being critical to The Post Office's relations with its shareholder. He would be looking particularly for rigorous transparency between investment in core and non-core activities. The new style plan was an opportunity to persuade the Treasury to adopt new perspectives.
- (xi) The Minister was happy to look at and seek to resolve discussions around the one year profit target.

The Chairman thanked Ian McCartney and his colleagues for their support.

**DATE OF NEXT
MEETING**

PO99/22

Scheduled for 23 March 1999 at Gatwick Mail Centre.