

## OFFICIAL – COMMERCIALY SENSITIVE

**To:** Secretary of State and Jenny Willott

**From:** Peter Batten GRO

**Date:** 04 March 2014

**Subject:** Briefing for meeting with Post Office Ltd Chair and CEO

**Purpose:** You are both meeting the Chairman and Chief Executive of Post Office Ltd (POL) for them to update you on progress to deliver the strategic plan that was agreed last year, and to raise any other current issues.

**Attendees:** Alice Perkins (Chairman, Post Office Ltd); Paula Vennells (Chief Executive, Post Office Ltd); Richard Callard (Shareholder Executive)

**Timing:** Scheduled for Wednesday 5 March, between 13:15 and 14:00 in your BIS office.

**Background and progress made:**

1. Since 2010, HMG has committed nearly £2bn to support POL in maintaining and modernising the post office network. £1.34bn was announced in 2010, and covers the period to 2015. Following last year's agreement with POL's strategic plan, HMG is providing a further £640m funding for the period April 2015 to March 2018 to enable a network of at least 11,500 branches to be maintained.

Network Transformation

2. These commitments are allocated to fund: (i) the transformation and modernisation of the post office network (e.g. through the Network Transformation (NT) programme and investment in IT and commercial infrastructures); and (ii) continuity of service provision across the network while the transformation and modernisation initiatives are delivered.
3. £20m of the most recent £640m commitment will be allocated to setting up an investment fund for Community post offices – this makes Government support available to these branches for the first time and is important for a population of post offices that are typically the last shop in their area.
4. The £640m funding enabled POL to introduce changes to NT which address weaknesses identified during the first 12 months of the strategy's implementation. Since November 2013 POL has written to all subpostmasters, explaining what the changes mean to them and the options they now have available, and to date subpostmasters have also completed a retail survey that has pooled a significant amount of management information (e.g. on opening hours and retail sales) that will help POL to plan the implementation of NT more effectively. Importantly these changes were developed with and have the support of the National Federation of Subpostmasters (NFSP) – this was not the case with the "old" version of NT.
5. NT is central to POL's strategic ambitions. It reduces and makes more flexible POL's high fixed cost base, making the company more financially sustainable. It improves branch environments and extends opening hours, helping post offices to retain and

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win customers and clients. Critically it also makes the post office network as a whole more sustainable and stable (e.g. because individual branches themselves are more viable) which reduces the need for taxpayer subsidy. Together the benefits of NT help to create a business that could, subject to stakeholder support, be mutualised.

6. As of 28 February, POL had secured contracts to convert 2,906 branches (35% of the convertible network) to the new NT operating models, and 1,754 branches have converted (21% of the convertible network).

#### Relationship with the NFSP

7. POL's relationship with the NFSP (which represents the vast majority of subpostmasters) has improved significantly over the last year. This is in part due to your request that POL works with the NFSP on the proposed changes to NT, but also due to closer engagement between POL and the NFSP on other business-as-usual matters. This brings considerable benefits, including helping POL to implement changes to NT and in relation to more productive day-to-day interactions.
8. As a result of NT the NFSP is currently facing up to the challenge presented by a network with fewer standalone subpostmasters and therefore a smaller membership and less influence (e.g. NT will see more post offices operated by existing retailers who are less likely to sign up to membership). POL recognises this however it also accepts that there is a long term role for a body that represents people that deliver post office services. It is therefore working with the NFSP to see if the NFSP has a role to play in this future and how a relationship between two closely aligned organisations might work (e.g. with the NFSP as a trade association).

#### Mutualisation

9. POL has made steady progress towards mutualisation over the past 18 months since BIS published its response to the public consultation on POL's mutualisation. This has included convening a Stakeholder Forum to develop a "public purpose" of the post office – this is a "purpose" around which a mutual can be built and is a key milestone on the road to mutualisation.
10. POL is planning to publish this "public purpose" soon, alongside a list of other milestones that mark a path to mutualisation. This approach was agreed between POL and Jo Swinson in November when the new funding was announced and this is an important opportunity for POL to signal what has been achieved to date and the steps it will be taking in the future.
11. It has been envisaged that this would be published in March / April and your strong encouragement for POL to continue to work to this timescale is important. This is an important signal to stakeholders – many of whom have questioned POL's commitment that POL will continue to make progress towards mutualisation. In addition, this timing would be aligned to Jo Swinson's statement in the House of Commons on 27<sup>th</sup> November which stated:

*"Creating a financially sustainable network will be key to delivering a Post Office that can be mutualised. Significant progress has been made by the Post Office and its stakeholders already, and that will be boosted by the Government's funding commitments today. The Post Office will shortly publish further details of the steps it is taking to build a mutual future."*

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**Issues POL may raise:**

12. In addition to updating you on their recent progress, Alice and Paula may choose to raise the following topics, which are all subject to continuous and ongoing engagement between the ShEx team and POL.

Revenue from Government services

13. You and Jenny continue to act as champions for POL across Whitehall, but Paula may flag a risk to delivery of POL's strategic plan if certain existing Government contracts are renewed on weakened terms (e.g. POCA with DWP) or if opportunities that have been identified are delayed (e.g. ID assurance and assisted digital with Cabinet Office). You can assure POL that you continue to support their ambitions to be the front office of government, but that they must continue to show they represent value for money for the taxpayer by engaging commercially with Departments.

Revenue from mails

14. Mails revenues will be lower in 2013/14 compared to 2012/13, and POL may seek to provide an explanation by suggesting that the fall is a result of poor pricing policy by Royal Mail. It would be helpful for you instead to draw attention to the need for POL to prepare fully for the mid-term review of POL's contract with Royal Mail, which will take place in 2016/17 – e.g. by being innovative and customer oriented and by making sure POL delivers the transformation of the post office network. It is possible that Royal Mail might seek to renegotiate some contractual terms in 2016/17, which could have a material impact on POL's financial performance.

The integrity of POL's 'Horizon' accounting software

15. All in-branch transactions performed by subpostmasters and POL staff are recorded by POL's accounting software, known as 'Horizon'. Shortly after joining POL and in response to low-level but persistent grumblings by a small number of former subpostmasters, Alice commissioned a review of the integrity of the Horizon system. An independent report, published in July 2013 found there were "no systemic" issues with the software, but made recommendations about POL's processes for handling financial irregularities in subpostmaster accounts.
16. Following the report, POL has worked with a group representing the former subpostmasters and the report's author (a small firm of forensic accountants called Second Sight) to establish a working group under an independent Chair that has set up a mediation process for former subpostmasters who feel wronged by the Horizon system. The working group has received 147 submissions, but has not yet agreed its terms of reference. POL may choose to raise this with you; however you should avoid being drawn on the matter at this stage as HMG involvement risks the independence of the working group, and involves Ministers in an operational matter. Further specific advice will be submitted to you shortly.

Business transformation

17. As part of its strategic plan POL will be undertaking a review of its business model to ensure that it has the right structure to deliver its strategy effectively. Given the marked change in POL's business and its network over the last 25 years this is likely to lead to a number of recommendations suggesting a restructuring of a variety of business processes (e.g. supply chain, finance function, IT delivery, network

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management) – together these will not only help to reduce costs but they will also make sure that POL is structured for a growing future. It is important that POL takes the right decisions following this review, and to meet its targets some of these decisions are likely to be difficult to make (e.g. challenging long established business practices). All options are currently being considered and you should encourage Alice and Paula to wait for the review to end, and then to consider the commercial, strategic and political costs and benefits of each option. It would also be recommended for them to engage with the ShEx team to ensure plans are deliverable and assessable.

**Copied to:** Perm Sec MPST; Spad MPST; ShEx Post Office team; Anthony Odgers

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**Speaking Notes / Questions to ask:**

	<b>Points to draw from:</b>
<b>Funding</b>	<ul style="list-style-type: none"> <li>• Securing £640m funding for the period 2015 to 2018 was a major achievement. This is a sign of this Government’s commitment to the Post Office</li> <li>• In turn, it is absolutely vital for the Post Office to deliver on the agreed strategic plan, including delivering Network Transformation to time and budget.</li> </ul>
<b>Network Transformation</b>	<ul style="list-style-type: none"> <li>• I was very pleased to see the NFSP supporting the reforms of the Network Transformation programme. I hope that this heralds a new and productive period in your important relationship with the NFSP and subpostmasters.</li> <li>• Recent progress under the Network Transformation programme has been encouraging; can you assure me that lessons are being learned that will ensure the rate of branch openings will be improved?</li> </ul>
<b>Mutualisation</b>	<ul style="list-style-type: none"> <li>• This is an area that is very important to me and my Ministerial colleagues. Jo Swinson announced last year that you would publish an update on mutualisation shortly. I am looking forward to this in the coming weeks.</li> <li>• What do you see as the key steps towards mutualisation over the next twelve months, and in the longer term?</li> </ul>
<b><u>[If raised]</u> Government Services Revenues</b>	<ul style="list-style-type: none"> <li>• I continue to lend my support to the Post Office’s ambitions to become a Front Office for Government. However, in the context of continued budgetary restraint, it is incumbent on the Post Office to demonstrate that it is delivering value-for-money for the taxpayer.</li> <li>• Jenny and I continue to act as the Post Office’s “cheerleaders” across wider Government, but it is crucial that the Post Office starts thinking of the Government as a customer.</li> </ul>
<b><u>[If raised]</u> Mails revenues</b>	<ul style="list-style-type: none"> <li>• The Post Office is an independent business that has a commercial agreement with the Royal Mail. The Government cannot be involved in commercial matters, and it is your responsibility to negotiate effectively and in your company’s best interests.</li> <li>• As a regular shareholder, the Government has no special influence over the Royal Mail.</li> </ul>

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<p><b><u>[If raised]</u></b> <b>Horizon accounting software</b></p>	<ul style="list-style-type: none"><li>• I understand that you have established a Working Group with an independent Chairman. I am conscious that this working group must be seen to be independent, and cannot comment at this stage.</li></ul>
<p><b><u>[If raised]</u></b> <b>Business Trans- formation</b></p>	<ul style="list-style-type: none"><li>• I understand the importance of transforming and modernising the business. I would urge you to consider the range of skills required to deliver the necessary changes.</li><li>• And to work closely with my officials to ensure that all options are appropriately assessed, and are deliverable from a commercial, strategic, and political perspective.</li></ul>