POB(99)1st
PO99/1 to 11

POST OFFICE BOARD

Minutes of the meeting held on 12 January 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
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: Alan Williams, Director Communications and Corporate Relations, for item PO99/6
Norlan McIntyre, Director Year 2000, for item PO99/8

Apologies: Miles Templeman was unable to attend.

MINUTES OF PREVIOUS MEETING

PO99/1

The Board approved the minutes and separate record of proceedings from its meeting of 8 December 1998.

MATTERS ARISING POB(99)1

PO99/2

The Board noted the matters arising from the meeting of 8 December 1998.

CHAIRMAN'S BUSINESS

PO99/3

(i) Since the previous meeting the political scene had changed considerably with the resignation of Peter Mandelson as Secretary of State, the appointment of his successor, Stephen Byers and the appointment of Alan Milburn as Chief Secretary to the Treasury.

(ii) To a considerable extent Peter Mandelson had personally enabled the acquisition of German Parcel (Sapphire (PO98/131) to successfully proceed through Government

GRO

and his influence within the top echelons of Government would be missed. Ian McCartney had not been affected by the new appointments and he could therefore continue to provide a valued and supportive contribution.

(iii) The **Trade and Industry Select Committee** had met on 9th December 1998 and a report of the hearing had now been published. Helpfully, the report set out what the Committee expected the White Paper on The Post Office to cover and this included the key issues that The Post Office itself had identified. It was now unlikely that the White Paper would be published before March.

(iv) The acquisition of **German Parcel** (Sapphire PO98/131) had been successfully concluded and announced publicly on 11 January. The acquisition had taken considerable management time and effort and the Board recognised the work successfully carried out by a number of people and particularly Dom McKenna and his transaction team.

(v) Resultant media coverage had to a great extent concentrated on the price of the acquisition as this had not been declared. This was in line with the approach of competitors who had acquired private companies. The price paid had included a small premium but compared favourably to similar transactions by Deutsche Post etc.

(vi) Media coverage in Germany had been very favourable.

(vii) Final negotiations had resulted in a slight improvement for The Post Office with an NPV increase of £5m. Transaction costs amounted to £10m and in some areas, such as legal work, an improved scale of charges may have been possible. These lessons would be learnt for future acquisitions.

(viii) As a matter of urgency, a Post Completion Audit would be undertaken with any key issues identified and monitored. Performance targets would also need to be considered and introduced. In the longer term the Managing Director of the German Parcel would report to the Managing Director of the proposed new International business unit, but meanwhile he would report to the Chief Executive. His key role in the coming year would be to assimilate the franchise companies.

(ix) The acquisition presented The Post Office with an accounting challenge as not all of the franchisees operated to recognised accountancy standards. Funding and hedging issues had been considered and a note of the key issues was circulated to Members.

(x) The degree to which German Parcel was left to operate independently from The Post Office was important, as was introducing some form of 'transition team' through which appropriate integration with The Post Office could be channelled.

(xi) The impact of competitors responding to the acquisition had been factored into the business case although it was not thought that this would be significant.

(xii) A Ministerial meeting was today being held to consider the future of **Horizon**. It was hoped that the outcome would be announced quickly. Updates on Horizon and German Parcel would be provided to February's meeting.

(xiii) The other major item of Chairman's business was concern over the level of trading; Royal Mail cost over-runs and Parcelforce performance both in profit terms and cash generation. This was discussed in detail under performance matters.

(xiv) (Secretary's note: The remainder of this minute has been circulated to Members on a personal basis)

Action
Secretary

(a) Circulate to Members the Report from the Select Committee held in December 1998.

(b) Include updates on both Sapphire and Horizon for the February Board meeting. Outside this, Stuart Sweetman and John Roberts to feed information on key developments through the Secretary for circulation to Non-Executives.

CHIEF EXECUTIVE'S REPORT POB(99)2

PO99/4

(i) Financial Performance. Counters had performed well over the Christmas period and with profit ahead of budget had now to focus on successfully managing the year end. Parcelforce, together with its main competitors, continued to underperform and the revised full year loss of £20m was not without some serious risk. Royal Mail was also facing its most serious financial predicament for a number of years, with traffic in Royal Mail National down 3.9% on the same period last year. The performance of both Parcelforce and Royal Mail was being taken extremely seriously with a considerable amount of work being undertaken to ensure that Royal Mail and POCL achieved their Government targets and that the EFL was met.

(ii) A 5% overspend on Mails Operations costs in the year to date was the key to Royal Mail's financial difficulties with the business trying to process an increased workload, as a result of a change in the mix of traffic, whilst seeking to maintain customer service. Additionally, savings envisaged from the introduction of automation had not been realised and industrial relations difficulties had restricted the introduction of efficiency projects.

(iii) A number of recovery actions were underway including Divisional performance reviews, the introduction of manpower controls and a weekly review of performance. Further options, including laying off temporary and casual employees, had also been identified but these could both reduce quality of service and increase the possibility of industrial action. The Union was being consulted on these options.

(iv) Royal Mail had agreed a new productivity deal with the CWU Executive. A ballot, combined with the new pay settlement, was due to close on 10 February.

(v) Parcelforce was experiencing revenue reductions in two key sectors - Europe and Customised Solutions where costs remained fixed regardless of volume reductions. Expenditure improvements had been achieved on vehicle costs and 2,700 casual staff had left the company since Christmas. The Activity Based Costing system now operating was providing useful information on market sector profitability and enabled Parcelforce to ensure that new contracts were agreed at acceptable profit margins.

noted further that

(v) It was a matter for Royal Mail, in consultation with the Chief Executive, as to whether service reductions were traded for cost improvements.

(vi) A 5% efficiency improvements through automation could significantly improve Royal Mail's financial position and it was also important that local managers sought opportunities to reduce manpower where automation was deployed. John Lloyd had first hand knowledge of just what could be achieved through efficiency improvements and commended any effort taken to realise improvements within Royal Mail.

Action
Kevin Williams

For February's meeting produce a short paper on Parcelforce's debt recovery programme.

FINANCIAL SUMMARY

PO99/5

(i) Profit for November was:
- Royal Mail £31.7m
- POCL £5.2m
- Parcelforce £(1.8)m
- SSL £0.6m

(ii) Provisional results for December were:
- Royal Mail £28m
- POCL £23m
- Parcelforce £1.4m
- Group £61m

(iii) With the exception of POCL, which outturned £4m above budget, December's provisional results were all below budget.

(iv) In terms of targetry, Royal Mail was forecasting to achieve its ROCE and RUC targets, and POCL its ROT. The Parcelforce ROCE target of (5.3)% had not been officially announced by Government and the business was currently forecasting a full year result of (8.8)%.

(v) Royal Mail's recovery plan aimed to close the £30m profit gap and achieve its budget of £478m through increased National income, reductions in discretionary spend and as a consequence of delays to the introduction of REIMS II. This plan was subject to risk, particularly should discretionary savings not be realised, and in the unlikely event of the implementation date for REIMS II being backdated.

(vi) Parcelforce's assessment of its full year loss was now £(25)m with a best case of £(20)m and worst of £(30)m. Risks still outweighed opportunities by £10m.

(vii) For Counters, opportunities considerably outweighed risk.

(viii) Achievement of the EFL reflected the financial difficulties of Royal Mail and Parcelforce and a shortfall of between £38m and £128m was currently forecast. Recovery action had, however, identified opportunitiies to the tune of £120m.

(ix) Parcelforce continued to bring down the level of outstanding debts with a £17m gap between the 'normal' level of over 30 day debt and that currently recorded; 200 customers accounted for £6.5m and 750 for £12m. The number of staff employed to recover the debts had now trebled. A paper on the recovery programme would be helpful for the Board to consider.

(x) Parcelforce was currently talking to a leading mail order company on a proposal which would result in Parcelforce contracting for the distribution and delivery of all their home shopping items and transfer of their courier arm. It was hoped that Heads of Agreement could be reached by the month end. The contract was valued at £150m over 5 years.

(xi) It remained essential that the Businesses strived to achieve their budgeted targets and this message should continue to be communicated internally. For 1999-00 The Post Office would be arguing for a simple approach to targets with one profit target covering the whole organisation.

(xii) It would be important to review the full year profit/loss targets at next month's meeting and make any appropriate adjustments at that time. Until then it was agreed that Richard Close would report to DTI forecast outturns of £478m for Royal Mail, £(20)m for Parcelforce and £35m for Counters.

COMMUNICATIONS STRATEGY POB(99)3

PO99/6

(i) A key aim of The Post Office's communications strategy was to ensure clarity in communications from the centre across the organisation, through which it would then be possible to link communications activity with strategic commercial direction.

(ii) Group Communications currently comprised National/media relations, Corporate Relations, Community Affairs and sponsorship, Internal Communications Policy and Branding Policy. Additionally, each business had a communications unit which dealt with its own internal communications, marketing communications, and external relations at Regional and local level.

(iii) In total, Communications employed 560 staff with annual staff costs of £17.5m, non-staff costs of £31.6m giving a total budget of just over £50m. This was the equivalent to £250 per employee per annum, compared with a cost of £280 within British Telecom and £375 by National Westminster Bank. The ratio of communications staff to employees was one every 357 employees which was compared with 452 in British Telecom and an industry norm of one every 1,500.

(iv) Employee opinion surveys had generally scored internal communications poorly and in response a number of new initiatives had been introduced. With hindsight the organisation had probably over reacted and there were now too many messages being communicated in an uncoordinated and ineffective way. A review of communications strategy had therefore been initiated which was looking at the communications structure, branding and identity policy, community activities and charitable giving.

(v) The 1998/99 charitable budget was £2m but it was questionable whether full PR value was being gained from this outlay. It was certainly the case with regard to community activities The Post Office did not extract sufficient promotional value for itself. The Executive Committee was due to review The Post Office's charitable policy at its February meeting.

(vi) In reviewing communications it was important to consider the activities of union representatives and in particular the cost of providing facilities time in an overall assessment of communications costs. It was also essential to minimise the number of mixed messages that circulated within the organisation, examples of which could clearly be seen when comparing Courier and Voice the respective employer and union newspapers.

(vii) With the introduction of increased commercial freedoms The Post office as a whole would come under greater scrutiny and may have increased dealing with the City. It would be important to develop any such relationship within the context of an overall communications plan. This was also true of Europe and the opening of an office in Brussels for lobbying was an important first step.

(viii) It was acknowledged that Communications across the organisation employed too many people at too high a cost. It was also clear that the role of the Businesses and Group Centre and channels of communication were confused. The strategy to develop a co-ordinated and simplified approach which gave value for money was therefore supported.

(ix) Phase one of the communications review would be completed in March and the Board would welcome the opportunity to review the outcome of this work in advance of the 1999-00 communications budget being set.

(x) Thanked Alan Williams for his informative paper.

Action
John Roberts

Produce for the March meeting a paper on The Post Office's policy on charitable giving and provide an interim report on a co-ordinated communications review.

PENSIONS **PO99/7**

STRATEGY

(Secretary's note: The minute of this discussion has been circulated to Members on a personal basis)

YEAR 2000 UPDATE
POB(99)4

PO99/8

(i) The key objectives of the Year 2000 project were to prepare The Post Office fully for the Year 2000 and to be seen to be doing so by Government, customers and suppliers, benchmark with the best in the UK and to be helpful to customers/suppliers needing advice or assistance.

(ii) To date progress was generally satisfactory with in particular, Counters' preparations proceeding well. In fact The Post Office was regarded as a benchmark for other organisations. A stretching target to have all critical systems compliant by December 1998 had originally been set and 87 of 122 critical systems had achieved this. The majority of those outstanding were close to completion.

(iii) Work on embedded systems had progressed extremely well and this was no longer an area of concern. Suppliers of critical services could not all confirm that products and services would be compliant, and in some international cases services would be withdrawn rather than risk service problems.

(iv) Main internal risks revolved around the replacement of Parcelforce systems and multiple faults occurring in small systems. Externally, as well as concerns over suppliers, there was real concern that The Post Office would be used as a supplier of last resort which at an already busy period could easily overload the mails network. Contingency arrangements were being developed to address these issues.

(v) Capital spend of £88m was forecast, spread over a three year period. To date 55% of this had been spent.

Noted further that

(vi) Key employees who would have to attend over the Millennium period, and those needed to be on standby, had all been identified and advised. For some key iT personnel it had been necessary to provide a 'golden handcuff' to ensure their expertise remained within the organisation.

(vii) Royal Mail had not yet confirmed what days it would be operational either side of the Millennium and had not therefore commenced any pay negotiations with the Union. The main area of concern was not necessarily agreeing a pay settlement but getting staff to attend.

(viii) Although only 55% of the capital budget had been spent 70% of the critical systems and 80% of embedded had been completed.

(ix) The Board commended the work done by Norlan McIntyre and his team.

Action
Jerry Cope

Provide a quarterly update, on an exception basis, within the Chief Executive's Report.

PROJECTS APPROVED BY MaPEC - Parcel Management System - Phase IV POB(99)5

PO99/9

(i) The Parcel Management System would provide Parcelforce with the capability to track and trace parcels through every stage of the network. In this respect it would bring Parcelforce up to the level of its competitors.

(ii) The project produced recurring savings of £22.9m and a positive NPV over 6 years of £27.6m. Staff savings of 436 were forecast.

(iii) Endorsed MaPEC's approval of expenditure of £40.7m, of which £5.2m in respect of the trunking management strand was given in principle, with full authority to proceed with this strand devolved to Parcelforce.

MaPEC - Lotus Notes 4.5 Migration Programme POB(99)6x

(iv) Endorsed MaPEC's approval for expenditure of £7.9m at outturn prices to achieve migration of the next phase of sites to Lotus Notes 4.5; and

(v) MaPEC's approval in principle for the continuation of the deployment to further sites to complete the migration for The Post Office at a cost estimated at £5.6m, making total costs, including sunk costs, £16m.

MaPEC - Property and Facilities Management Project POB(99)7x	(vi)	The removal of 600 posts budgeted within the paper would be tracked using a system that was to be used in other projects across The Post Office.
	(vii)	Endorsed MaPEC's approval at a total outturn cost of £2.8m capital and £15.6m revenue, and DFEs for: EVRs at £7.5m; relocation £0.75m, and general £0.4m, and in principle authority for up to £15.6m, giving total project costs (inclusive of £7.5m sunk) of £50.2m.
CHAIRMANSHIP OF ROYAL MAIL US INC. POB(99)8x		**PO99/10**
	(i)	Given his wider responsibilities, John Roberts was stepping down as Chairman of Royal Mail US Inc. He was to be replaced by Richard Dykes
	(ii)	Agreed to the appointment of Richard Dykes as an 'A' Director and Chairman of Royal Mail US Inc. with immediate effect, subject to formal confirmation from the Secretary of State.
DATE OF NEXT MEETING		**PO99/11**
		The next meeting was scheduled for 15 February 1999 and Ian McCartney, The Post Office Minister at the DTI would be joining the Board for lunch.