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POST OFFICE BOARD

Minutes of the meeting held on 14 January 1997, at Post Office Headquarters, London

Present

Sir Michael Heron	Chairman
Mr P Allen	
Mr R C Close	Managing Director Finance
Mr J E Cope	Managing Director Strategy & Personnel
Dr D Grieves	
Sir Christopher Harding	
Mr A J Roberts	Chief Executive
Mr R G Osmond	Secretary
Mr S Childes	)Notes
Mr S Hill	)

Others Attending: Mr K Williams, Managing Director Parcelforce, for item PO97/7.
Mr S Sweetman, Managing Director Counters, for item PO97/9 and PO97/10.

SIR MICHAEL HERON

PO97/1

The Board CONGRATULATED Sir Michael Heron on his re-appointment as Chairman of The Post Office

MINUTES OF PREVIOUS MEETING

PO97/2

The Board APPROVED the minutes and separate record of proceedings of the meeting held on 10 December 1996

MATTERS ARISING POB(97)1

PO97/3

The Board noted the matters arising from the meeting held on 10 December 1996

CHIEF EXECUTIVE'S REPORT POB(97)2

PO97/4

The Board noted Mr Roberts' report and the presentation by Mr Close, the main points from which were that

GRO

(i) cumulative Group profit stood at £381m against a budgeted figure of £324m. This mainly resulted from the over-achievement in Royal Mail which was cumulatively £77m ahead of budget, and stood at £356m;

(ii) in terms of volume Streamline was now in line with the full year forecast. This took account of the large one-off postings by those Building Societies changing their status during the coming year. The full year forecast of 1.8% growth for National traffic was subject to some downside risk, which in financial terms equated to £10m;

(iii) to achieve the full year profit target of £532m Royal Mail was budgeted to achieve a profit of £204m between December and March. However, achievement of the final outturn would be adversely affected by factors which had emerged during the year, including £20m originally assumed from a General Election before April 1997, £23m as a result of lower efficiency following the non-implementation of the Employee Agenda and £10m from the net effect of a year end review of Employee Agenda provisions. In total this left a profit gap of £17m, which on the evidence of December's provisional results, which showed budgeted profit being exceeded by £14m, had already been substantially reduced;

(iv) a £20m opportunity still existed if a General Election took place before the end of March, with a £5m opportunity should it occur during April. A £10m risk, as mentioned in (ii) above, existed with National traffic;

(v) November had been a disappointing month for Parcelforce with income £1.9m below OPB and expenditure £1.6m above, culminating in a profit of £0.6m, £3.5m below budget. The main cause of this under achievement was staff expenditure, cumulatively £14.5m above budget. Together with a £3m adverse change on the previous forecast for non-staff operational costs (including road transport costs and increases in compensation) the business was now forecasting a full year loss of £8m. The latest income and staff cost projections were in line with this revised forecast;

(vi) in assessing income performance against OPB it was clear that volumes had suffered considerably from the Royal Mail strikes and whilst difficult to quantify precisely, a figure of £7m was not unrealistic. For the remainder of the year the business was forecasting volumes ahead of OPB, which mirrored the levels achieved in 1995/96;

(vii) risks and opportunities were evenly balanced at £3m

noted in discussion that

(viii) the importance of achieving the revised target of (£8m) had been stressed to Kevin Williams, Parcelforce's Managing Director, and he and his team would be striving hard to seek opportunities for improving performance over the remaining quarter. It was particularly important that having shed 2,000 staff since Christmas the Business did not allow numbers to drift upwards again and that for the 1997/98 baseline the Business used realistic figures, even if this required changes to the OPB;

(ix) notwithstanding the impact on Parcelforce's income of Royal Mail's industrial action the Business had failed to manage its costs sufficiently well and Members wished to establish, possibly through a stock audit of manpower at the year end, why staff costs were now expected to outturn £22.5m above budget. Members accepted that fundamental changes were needed to the Business in order to secure its long term viability and that it was in particular necessary to seek structural changes both in the market in which Parcelforce operated and in the way its network was organised. This was an issue for the Board to consider further after the General Election. It was clear that progress could be made meanwhile by improving the relative efficiency of the nine geographical divisions and work on this was already under way

noted further that

(x) Counters' profit forecast of £40m had been revised to £34m mainly the result of the expected £10m benefit from Girobank, under the usable cash credit agreement, now being estimated at only £4m. November's result, a £3.3m loss compared with a budgeted profit of £3.3m, reflected the reversal of the accrual made for Girobank and therefore the underlying position was not a poor as at first appeared;

(xi) an analysis of Counters' income performance showed that in the majority of areas performance was below budget. A comparison with the previous year was not yet available but would be provided when the Board reviewed the performance of POCL's new products at its February meeting. Future reports would show a year on year comparison of performance;

(xii) interest was an extremely important element of Counters' financial performance, accounting for £21m of the original £40m profit target and £15m of the revised £34m target. Interest performance over the course of the year was below budget, caused in particular by poor management of stock, leading to an over supply of Littlewoods scratchcards and foreign currency. Changes to client funding, (the money due to clients, on which Counters gained interest) had also reduced interest levels and was vulnerable to further erosion as automation was introduced, enabling real time reconciliation of funds;

(xiii) provisional results for December indicated that Counters had produced a strong retail performance to offset lower than budgeted client income. Interest continued to run below budget

<u>noted</u> in discussion that

(xiv) given the significance of interest the business had been asked by POEC, at its meeting on 7 January, to review its monitoring and control processes to ensure that an optimum performance was realised

<u>noted</u> further that

(xv) SSL continued to perform well with its current profit forecast £1.25m over budget at £8.475m;

(xvi) the current EFL position would result in a manageable surplus of £10m

<u>noted</u> further Mr Roberts' report and in particular that

(xvii) the productivity and flexibility dispute at Willesden appeared to be moving towards a negotiated settlement with a proposed agreement, which Mr Roberts intended to review personally, to be put to local ballot. A full review of the difficulties and the background to them would be carried out by a senior manager from outside Royal Mail. Royal Mail's quality continued to under-perform and the cumulative first class quality of service target was likely to outturn at or around 90%. The business had been targetted to achieve an exit rate of 92.5% by the end of the financial year;

(xviii) Christmas had generally been successful with 2 billion items handled, 2 million more than in 1995. Productivity improvements had been made with hours 0.1% down against plan. Quality had been slightly disappointing with a first class result of 56.7% less than the 60% that had been expected. Performance had not been helped by many customers posting late and for 1997 Royal Mail would issue a 'Post early' message in November and again early in December. All 'in time' mail had nevertheless been cleared before Christmas, including mail from abroad;

(xix) industrial relations were currently stable with the two working parties on delivery and working practicies now under way;

(xx) discussions with AEG (PO96/122) had now been concluded with Royal Mail making an advance payment of £52m, against which they had secured a favourable back to back deal, providing for the money to be repaid if the commissioning work did not prove successful. An additional £15m had also been paid against which Royal Mail had gained significant benefits, which had been independently validated by Coopers and Lybrand;

(xxi) consideration had been given to announcing a price freeze on first and second class rates until at least March 1998, a proposal that Members fully supported. Mr Roberts would announce the price restraint as part of a press briefing later this month;

(xxii) a formal notice had been served on The Post Office under the terms of the Welsh Language Act, which required The Post Office to draw up a Scheme setting out how parity of status would be given to the Welsh and English languages within Wales. Implementation was compulsory and likely to cost £5.5m over three years. The Scheme would come to the Board for formal clearance by March;

<u>AGREED</u> that

(xxiii) the following profit/loss forecasts be released to the DTI: Royal Mail £510m, POCL £34m and Parcelforce (£8m)

SENIOR MANAGEMENT REWARD STRATEGY POB(97)5

PO97/5

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

KING EDWARD BUILDING UPDATE POB(97)3

PO97/6

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

PARCELFORCE SORT CENTRE REVIEW POB(97)4

PO97/7

The Board noted Mr Roberts' report and presentation, the main points from which were that

(i) following the Board's earlier endorsement of Parcelforce's Sort Centre Review (PO95/130) a formal case had been submitted to MaPEC for authorisation. In the light of MaPEC's deliberations,the Board was now being invited to confirm its continued support for the project, to endorse MaPEC's authorisation and agree that the project would be funded by The Post Office;

(ii) in considering the project it was crucial for the Board to be supportive of the Post Office's intention to remain a major commercial player in the three dimensional objects business, and not simply a carrier of last resort fullfilling the Universal Service Obligation;

(iii) several factors were necessary to commercial success: it was necessary to operate a separate network from that used for letters, to adopt the industry benchmark of utilising a single hub and to secure real cost reduction and transport cost optimisation;

(iv) regardless of the eventual location of this work and the organisation of it, a hub was necesary to the distinctive organisation and branding of the three dimensional business, but joint use of the hub by Royal Mail was also envisaged;

(v) the project had been approved financially by MaPEC and provided an NPV of £116m over six years. The market risk had been carefully assessed and an IR strategy that sought to gain real commitment from the union was being developed noted in discussion that

(vi) discussions with National Officers from both the CWU and CMA had been held and the significance of the project to the long term viability of the business appeared to have been acknowledged. Whilst industrial relations difficulties could not be eliminated entirely, a careful selection process for staff was planned, using the model successful deployed by Toyota;

(vii) Members were in agreement that the Post Office could and should not withdraw from the three dimensional objects market and that therefore the most appropriate commercial method for handling this traffic should be adopted. In market terms the project provided for all style of packages to be handled and introduced 100% automatic revenue protection. The business was also confident of the base numbers on which cost reduction had been set, as these had been thoroughly prepared by external industrial engineers and Coopers and Lybrand;

(viii) the appointment of senior staff to manage the operation was crucial and Parcelforce believed that appropriate internal candidates existed. The business was also very much aware of the need to have good, experienced front-line staff in post;

(ix) some Members were surprised that the business was not seeking more substantial manpower reductions, although it was acknowledged that given the increase in delivery projections it would be necessary to at least maintain the number of drivers to operationally handle this traffic. Nevertheless, 350 staff would be shed with Royal Mail taking a number of these against existing vacancies. Members thought it important to ensure that Royal Mail was formally committed to absorbing surplus staff, in order to avoid difficulties as the project progressed;

(x) it was important to ensure union commitment to the project and Members felt strongly that a condition of the Board, endorsing the project should be that a Heads of Agreement document be signed by the unions, and the Chief Executive should be satisfied about progress towards this end before contracts for the building were signed;

(xi) it was important for the Board to be aware that the balance sheet on the Parcelforce profit and loss account, within the Report & Accounts, would be increasingly insolvent as a result of the Post Office funding the project, and that this could result in competitors' once again claiming that Parcelforce was receiving unfair financial support, although doubts about improper state aid had been resolved following advice from Slaughter and May. Following the General Election the Board would want press Government on the future of Parcelforce and this would address the issues likely to be raised by competitors

in conclusion the Board

(xii) CONFIRMED its continued support for the Sort Centre Network Strategy and ENDORSED MaPEC's authorisation of the project subject to the caveat in paragraph (x) above, and formally AGREED funding by The Post Office

SSL PERFORMANCE BONUS SCHEME POB(97)8

PO97/8

The Board noted the report by Mr Cope and in particular that

(i) it was intended to introduce the framework of the success sharing scheme from 1 April 1997;

(ii) in Mr Cope's view it was not necessary to inform the DTI

welcomed the introduction of this initiative

COUNTERS' AUTOMATION (HORIZON) PROGRESS UPDATE POB(97)6

PO97/9

The Board noted Mr Roberts' report and Mr Sweetman's verbal presentation, the main points from which were that

(i) since the Board's previous update (PO96/90) the Counters Automation project, now known as 'Horizon', had been considered by MaPEC, which had agreed changes to the original financial projections. The need to revise costs had emerged following work carried out together with ICL Pathway and the Benefits Agency on the logistical deployment of the project into Counters' outlets, and in total amounted to an additional £26.4m;

(ii) as a result of POCL working closely with ICL and the Benefits Agency it had become clear that the cost and level of training and support originally forecast had been under estimated. POCL was determined that training and the appropriate level of support provided to subpostmasters should not be compromised and had therefore increased the level of investment within this area. The business would provide an additional 250 people to train and support subpostmasters, including covering vacancies that arose in offices when staff where being trained;

(iii) a potential six month delay had been identified in the work being carried out by the Benefits Agency on Customer Accounting and Payment Systems. In addition, the programme of testing, which POCL thought inadequte and had already been discussing with ICL Pathway, might also be delayed. Nevertheless the business remained firm in its belief that testing should not be compromised for speed. POCL's own work programme was on target

<u>noted</u> in discussion that

(iv) although no other clients had yet definitley committed to use the system, the business was actively pursuing contracts and was happy with progress being made with Girobank, Royal Mail and National Savings though there remained a degree of risk. Progress on securing clients was not behind schedule;

(v) since the major industrial relations dispute in POCL in the 1980's, the business had suffered little distruption and although the CWU still had to be taken through the changes in working practices that would result with the introduction of automation, the risk of strike action was not considered to be high;

(vi) a risk still existed with the recoverability of VAT on the contracts and Ernst & Young, on POCL's behalf, were working closely with H M Customs to try and ensure a favourable outcome

<u>Thanked</u> Mr Sweetman for his report

PROJECTS APPROVED BY MaPEC REQUIRING ENDORSEMENT BY THE BOARD: BA/POCL (HORIZON) POB(97)7

PO97/10

The Board noted Mr Close's report

ENDORSED

(i) MaPEC's approval of increased project costs of £26.4m, including a ring-fenced £4.1m DFE for training attendance allowances for subpostmasters, to £42.2m inclusive of sunk costs of £8.1m

AUDIT COMMITTEE REPORT POB(97)9x

PO97/11

The Board noted Mr Allen's report and in particular that

(i) concerns still remained over compliance with Competition Law in Quadrant, POSG and Communications Services. Further work by Internal Audit was in hand;

(ii) the Committee had welcomed the action being taken to rectify problems previously identified in POCL Cash Centres and with Royal Mail Meter management

TRUSTEESHIP OF POSSS/POPS/ SPOPS POB(97)10x

PO97/12

The Board noted the paper by Mr Cope

AGREED that Kevin Shaw be appointed as a Trustee of POSSS, POPS/SPOPS for a three year period until 1 January 2000

DATE OF NEXT MEETING

PO97/13

The Board noted that its next meeting was scheduled for 11 February 1997, at 148 Old Street