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POB(99)14

POST OFFICE BOARD
CHIEF EXECUTIVE'S REPORT : MARCH 1999
(January Results)

KEY POINT SUMMARY

1. ROYAL MAIL

- 1.1 Profit in January was £22m, £8m below budget due to a disappointing income performance in Royal Mail National. Expenditure was £1m below budget, with tight controls on non staff costs more than offsetting a £9m overspend in mail operations.
- 1.2 Volume in Royal Mail National fell by 3.4% compared to the previous year, with falls in both First and Second class traffic. Performance in Streamline was more encouraging, with a growth of 6.2% being 1.8% over budget. International traffic continued its strong recent performance, with growth of 1.8% compared to a budgeted figure of 0.4%.
- 1.3 January's quality of service results were mixed. First class and Mailsort 1 were down on the previous year, whilst Priority services, Presstream and Mailsort 2 & 3 showed year on year improvements. Second class performance of 99.7% remains above the full year target.

2. POST OFFICE COUNTERS LTD (POCL)

- 2.1 POCL showed a loss in January of £3.3m, which is in line with the performance required to achieve their full year profit forecast. Income was just over £2m below budget, whilst both core and development expenditure exceeded budgets as the business began to catch up with previous delays.
- 2.2 Quality of service in the 3 months to January 1999 was 93%, 2% below the full year target. January's result was 94.4% which was encouraging since it showed the effectiveness of our improved planning processes in ensuring that we did not suffer the negative impact on quality previously associated with winter fuel payments.

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4. OVERVIEW OF PERFORMANCE

On the basis of these January results, each business remains on track to meet its year end profit forecast, but with risks outweighing potential opportunities in Royal Mail. Provisional February results suggests that the January trends have continued.

As a result of these pressures, the year end EFL position remains tight, although this will benefit from the settlement with Hewlett Packard and the potential for the publishing industry to 'buy forward' presstream services.

5. OTHER ISSUES

5.1 Shaping for Competitive Success

Managing Directors have been appointed to 11 of the 16 business units that are to be created under Shaping for Competitive Success. A selection process, considering both internal and external candidates, is underway for the International, Network Banking and Logistics & Contract Distribution businesses, whilst appointments to the New Enterprises and Sales & Customer Support units are being held over until further work has been completed on unit design.

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The formal communications cascade of the work to date begins on Friday 19 March at a meeting of our top 70 managers. A presentation on SCS will then be cascaded to our top 3,000 managers within the next two weeks in order to ensure a common level of understanding amongst this group.

5.2 Horizon

Following discussions with ICL, the Treasury has produced a proposal for the continuation of the Horizon project based upon:

- scrapping the Benefit Payment Card, with the Benefits Agency moving directly to the electronic payment of benefits;
- establishment of Post Office 'Benefit Accounts' for those recipients who receive their benefits over the counter, into which the Benefits Agency would transfer money by ACT. These would be simple, credit only accounts which could be accessed at any Post Office using a Smartcard;
- Post Office developing a range of services over time which could be offered via the Smartcard.

Intensive negotiations are now taking place between all the parties, to establish the technical and commercial viability of this proposal. The Treasury are tasked with producing a final report to go to the Prime Minister by the end of April.

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Irrelevant

5.5 Meeting with Stephen Byers

The Chairman and I had an initial meeting with Stephen Byers on Friday 5 March, which covered progress on Horizon and the Government's White Paper on The Post Office on which we will provide an oral update.

5.6 POUNC

In a poorly constructed and argued report, The Post Office Users National Council (POUNC) has responded to our proposed price changes by recommending that the reduction in Second class prices be extended to higher weight items and the proposed price increases for Presstream be delayed for 12 months. These proposals would cost Royal Mail £7m and £5.5m p.a. respectively and are based on POUNC's mistaken assumption that the price changes will result in a £50m p.a. benefit to Royal Mail. We have therefore rejected these proposals. POUNC have also suggested that Royal Mail should make proposals about improving compensation payments around lost mail, an issue which we have indicated a willingness to address outside of the context of this tariff round.

We expect to receive a response from Stephen Byers within the next few days and unofficially, at least, believe that the DTI will support the position we have adopted.

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5.8 Communications Review

The interim report on The Post Office wide review of Communications, requested by the January Board (POB(99)3), is attached as an Annex to this report.

5.9 Princess Royal Distribution Centre

Last May, the Board agreed a strategy for tackling poor productivity and industrial relations at the Princess Royal Distribution Centre at Willesden (PO 98/56), a vital element of Royal Mail's national distribution network. An agreement has now been reached within the cost/benefit profile agreed by the Board which will deliver significant improvements in efficiency, a net saving of £430,000 per annum, an enhanced and more stable earnings package and a series of measurable behavioural standards. The package was accepted in a ballot by 75% of the 90% turnout and will now involve around 100 staff either taking redundancy or transferring to another unit.

5.10 POCL Pay Authority

POCL propose to seek authority from the DTI to reach a pay settlement for 1999/2000 of up to a ceiling of 2% on total pay bill (additional costs of up to £17m p.a.) This is in line with the budget presented by POCL and the Board is asked to note that I have agreed to this approach, subject to the Board's approval of that budget.

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6. CONCLUSION

The Board is invited to:

- note the March Report

- agree that the following, unchanged, profit/loss forecasts will be released to the DTI:

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|------------|------------|-------------|
| Royal Mail | £478m | - no change |
| | Irrelevant | |
| POCL | £ 35m | - no change |

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MARCH 1999

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ANNEX

Re-shaping Communications for the Complete Distribution Company

Interim Summary

- The principle recommendations for the future structure of the communications function, under Shaping for Competitive Success, are detailed below. In addition, over £3m of savings in the communications budgets for 1999/2000 have been identified and agreed by the individual businesses.
- Group communications will adopt a more pro-active, direction setting approach involving:
 - an integrated external relations team;
 - cross functional (press office/corporate relations) teams aligned to each brand and to the corporate mark;
 - a single field media relations structure operating out of seven regional centres;
 - corporate relations management of Westminster, Brussels, Scottish Parliament, Welsh and Northern Irish assemblies;
 - an integrated communications strategy, communicating corporate capability and credibility, whilst reducing the amount of communications about non-core activities currently co-ordinated by Group Centre;
 - building the capacity in the communications policy team to deliver reputation and brand strategy.
- This is likely to be achievable within current Group Centre numbers assuming significant rationalisation to present Country Chairmen support teams.
- With each market unit, there will be a Head of Market Communications responsible for communications direction within the specific market sector and for internal communications - which at market unit level must be based on market performance and characteristics and competitor information.

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- Lead communications accountability for each brand to be assigned to a lead market unit.
- Communications teams in the service delivery units will have a tactical and deployment remit, setting key messages into context for our employees.
- There will be a minimal territorial communications function, reporting to the national communications director, or equivalent. Communication at an Area level (in the 2D service delivery unit) will be by flexible teams rather than a permanent communications structure.
- Throughout the structure, a level of functional accountability - to Group Centre - will be applied in addition to unit accountability, to ensure that consistency and coherence are maintained and to prevent the tribalism that has arisen in the past.
- Implementation of the principles recommended in this summary would suggest a core template (within Group Centre and the new business units) of around 190 posts at a likely staff cost of £8.1 million.
- Post Office Services Group will be asked to assess the viability of adding key functions (regional communications services, public relations and communications consultancy to market units, communications planning support and distribution and fulfilment) to its portfolio to provide cost effective (and flexible) support to the new structure. The net change in its employee base is likely to be an increase of around 25 posts, making 150 posts in total at a likely staff cost of £4.6 million.
- Overall, these recommendations will reduce staff numbers from the present level of 560 to around 340 (including an increased number of freelance and contract staff managed through POSG Communications Services) with a consequential saving in the region of £4.5 million. Such savings would require us to consider compulsory redundancy.
- Implementation needs to be complete before April 2000 to support the post SCS Post Office.