



DEPARTMENT OF TRADE AND INDUSTRY

The Future of Postal Services

A Consultative Document

*Presented to Parliament by the President of the Board of Trade
by Command of Her Majesty
June 1994*



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CHAPTER 1

INTRODUCTION

1 This Green Paper invites views on the future of postal services. It explains the present structure of the Post Office and the possible options for the future. It indicates the Government's current thinking on these options.

2 The Post Office has for centuries made a vital contribution to our national life. Both individuals and businesses rely on it for a wide range of services. It delivers over 60 million letters and three quarters of a million parcels every working day; and post offices serve some 28 million customers every week. The Post Office is one of the nation's unifying forces and delivers daily services to the remotest of locations, helping to keep those communities alive. British industry and commerce also depends on good communications, as the Government's White Paper on "Competitiveness : Helping Business to Win" (Cm 2563) recognised.

3 The Government is committed to the maintenance of these services. That is why the Government has emphasised the importance of service standards under the Citizen's Charter, and made clear in its Manifesto its commitment to:

- a nationwide letter and parcel service, with daily delivery to every address in the country;
- a uniform and affordable structure of prices, under which it will cost the public the same to post a letter no matter where it is posted or to where it is sent, throughout the United Kingdom;
- a nationwide network of post offices.

At the same time the Government undertook to introduce measures which would bring more choice and competition into the postal market.

4 In order to decide how best to meet these commitments the Government has been considering the future structure and organisation of the Post Office, whose status as a nationalised industry dates from 1969. Since then the commercial environment has changed radically. The rate of change will accelerate still further in future years and it is essential that the Post Office is not left behind if it is to respond to competition and to continue to meet its customers' needs. The all-party House of Commons Trade and Industry Select Committee, in their recent report "The Future of the Post Office" (HC 207, published on 24 March 1994) accepted this argument. The Government agrees with the Committee that "the Post Office cannot be retained in its present form".

5 The Post Office consists of three main businesses: Post Office Counters, Royal Mail and Parcelforce. *Post Office Counters* runs the network of almost 20,000 post offices. It is already a successful partnership between the public and private sectors. A very high proportion of post offices - over 95% - are run as private businesses, while the hub of the network, Post Office Counters Ltd, is in the public sector, negotiating and co-ordinating the contracts on which the network depends. The Government has concluded that the current arrangements for the network should remain essentially unchanged, though there is considerable scope for modernising its operating methods and expanding the range of its activities. This is set out in detail in Chapter 4.

6 *Royal Mail* has been a highly successful business in recent years. From declining volumes and heavy losses in the 1970s it has produced record profits, dramatically improved quality of service and higher volumes. Nevertheless it has been losing its share in a rapidly changing and increasingly competitive communications market. *Parcelforce*, in contrast, has made losses in recent years, faced with the recession and overcapacity in the parcels market.

7 Technology is transforming the market place of both companies. It is allowing postal operators to improve standards and speed of service in traditional areas of business. It is also turning postal communication into an increasingly international business, with different national post offices competing to be the point of posting for bulk mail. More fundamentally, postal services are facing increasing competition from other forms of communication like fax and electronic mail.

8 Customers stand to gain greatly from these developments. Both the range of services and their speed, quality and cost should improve. Greater competition is the best way of ensuring that the benefits of modern technology are fully realised and the Government remains committed to introducing more competition into the UK market.

9 But *Royal Mail* and *Parcelforce* also need the freedom to respond effectively and flexibly to this changing market place. They need access to capital to invest in new technology and the freedom to compete against private sector operators in supplying new and better services to customers. Other countries are giving their Post Offices more freedom to compete in this new market. The Dutch, for example, are selling a large shareholding in the company which runs their postal service. They have ambitions to be one of the leading postal administrations in the world. Our Post Office is already among the best in Europe. Given the freedom to compete, it could be a world leader.

10 The Government wants to find a way forward which will secure basic postal services across the country, maximise the benefits to customers from increasing competition and greater efficiency, and enable *Royal Mail* and *Parcelforce* to compete effectively in a changing commercial environment. A number of options are discussed in Chapter 5.

11 The Government's provisional conclusion is that the best way of meeting all its objectives is to allow *Royal Mail* and *Parcelforce* to operate as a private company owned by the public and employees, with the Government retaining 49% of the shares. The public services would not be put at risk by such proposals. The Government's commitment to the universal service and uniform tariff would be written into legislation, and a strong and independent regulator would be appointed to enforce standards of service under the Citizen's Charter. The regulator would advise on the progressive introduction of more competition, so long as this was consistent with the maintenance of the basic services.

12 Regulation and competition are discussed in more detail in Chapters 6 and 7. Chapter 8 covers the issue of consumer representation in postal services. Chapter 9 discusses implications of change for the Post Office's employees, together with the sub-postmasters and sub-postmistresses. The Government recognises that the Post Office is almost unique in British life in the level of daily contact between its employees and the public. While the Post Office will increasingly have to invest in automation in the interests of efficiency, postal services are bound to remain a major source of employment.

13 Chapter 10 covers the VAT treatment of postal services, making clear that there is no possibility of VAT on stamps for letters or parcels. Chapter 11 sets out the position on the Royal connections which the Post Office has traditionally enjoyed.

14 Some of the options for change outlined in this paper would require legislation. Before taking final decisions the Government wishes to hear the views of interested parties. An address for responses is given in Chapter 12.

CHAPTER 2

CURRENT STRUCTURE OF THE POST OFFICE

1 The Post Office has undergone many changes over its long history. While its origins can be traced back to the seventeenth century, it was established in a form we would recognise only in 1840. In 1969 the Post Office ceased to be a department of Government and became a public corporation. The telecommunications business - now BT - was separated in 1981, and Girobank was sold in 1990.

2 The Post Office consists of three main businesses: Post Office Counters, Royal Mail and Parcelforce. Royal Mail and Parcelforce are separate operating divisions of the Post Office, while Post Office Counters is a wholly owned subsidiary. There are important links between them: Royal Mail and Parcelforce sell stamps and other products and services through Post Office Counters, and Parcelforce uses Royal Mail to collect and deliver parcels in remoter areas. All these arrangements are the subject of contracts between the businesses drawn up on an arms-length basis. All three produce their own separate audited accounts. Details of each business are given below.

3 The Post Office itself is set up under statute with a Board appointed by the Government. It is required by legislation to meet all reasonable demands for letter services. It carries out many other tasks which are not required by statute, but with which it is traditionally associated, such as the nationwide parcels service provided by Parcelforce and the payment of social security benefits at post offices.

4 Key facts on each of the three main Post Office businesses are as follows:

Post Office Counters represents 20% of Post Office turnover - around £1bn. It runs the network of nearly 20,000 post offices, of which nearly 19,000 are sub-post offices owned and managed by private individuals or companies on an agency basis. The rest are directly run by Post Office Counters, which has about 15,000 staff. It provides services for many clients¹ besides Royal Mail and Parcelforce, including the Benefits Agency, Girobank, the Driving and Vehicle Licence Agency, the Department for National Savings and a number of utility companies. Of these, much the most important is the Benefits Agency which accounts for about one third of its income. About 25% of its income comes from Royal Mail and Parcelforce.

Royal Mail represents around 70% of total Post Office turnover - over £4bn. It employs 165,000 people. Most of these are front-line postmen and women providing a daily delivery service to 23.4 million addresses. Together they deal with over 60 million items of mail per day, collected from 100,000 street postboxes as well as from post offices and directly from many organisations. Royal Mail has a statutory monopoly on letters delivered for less than £1 (though the Government is committed to reducing this figure - see Chapter 7).

Parcelforce represents around 10% of Post Office turnover - around £500m. It employs 13,000 staff and deals with three quarters of a million parcels per day. It

¹Post Office Counters effectively provides a retail outlet for a range of Government bodies, and ex-Government bodies, to provide services to the public. These are generally called "clients" of Post Office Counters, to distinguish them from "customers", namely members of the public who receive or buy those services in post offices. It is generally the clients of the business, rather than the customers, who provide the income of Post Office Counters Limited.

offers an individual parcels service to customers at post offices, delivering anywhere in the country for a uniform tariff. Its main business activity, however, is to provide a collection and delivery service for larger customers on a contract basis for which it competes with many other businesses in the private sector. For reasons of efficiency it subcontracts some of its services to Royal Mail.

5 A fourth trading business, *Subscription Services Ltd (SSL)*, provides licensing and subscription management services, principally for the BBC. It employs around 1,400 people and has a turnover of over £50m².

6 Although the Post Office is accountable to Ministers, it has been the policy of successive Governments to leave operational matters to the Post Office Board. It is the Post Office, therefore, and not the Government, which decides on such matters as the number of deliveries a day and the location of post offices. The Government's role is confined to various financial controls and agreeing the strategic direction of the organisation. These are looked at in turn.

7 As regards financial controls,

- the Post Office is set each year an External Finance Limit (EFL), for the following three years. This is similar in some ways to the dividend that would be paid by a private sector company to its shareholders. In practice the Post Office does not pay a cash dividend but the EFL requires it to purchase public sector securities, thus making a positive contribution to Government finances.
- in setting the EFL the Government takes account of the Post Office's need to finance investment. The Post Office is given an annual capital expenditure limit. It is also required to submit capital projects with an overall cost of over £20m to the Government for specific approval.
- the Post Office is set, on a three year basis, a *profit* target (expressed as a return on capital employed), and an *efficiency* target (real unit cost reduction) for the Royal Mail and Post Office Counters.

8 This financial framework is intended to create broadly the incentives and pressures on management which they would face from private sector shareholders. But the controls differ from a private sector approach in the following respects:

- because of the needs of overall budgetary management, the EFL is set a year in advance and is cash rather than profit related. A private sector company would decide on the level of its dividend retrospectively. The EFL is set by the Government, whereas private sector dividends are determined by the company's directors;
- the Post Office is not allowed to borrow on capital markets. Like other nationalised industries it has to rely on the Treasury for external funding except in the limited circumstances where it can take advantage of the Private Finance Initiative;
- through the setting of the EFL and the capital expenditure limit, the Post Office effectively competes against other candidates for public expenditure in the annual public expenditure survey.

9 As regards strategic direction, the Government requires the Post Office to produce a corporate plan annually setting out its proposed strategy for the next five years.

²This paper does not consider further the future of SSL, nor of other Post Office activities which are not part of Post Office Counters, Royal Mail or Parcelforce. Detailed consideration of them will depend on the decisions reached on the three main businesses.

In this context:

- the Government has been reluctant to see the Post Office develop new services or products that go substantively beyond its existing activities;
- the Government has specifically been opposed to permitting joint ventures or allowing the Post Office to make acquisitions of companies.

10 All nationalised industries are subject to similar restrictions. Their purpose is to protect the interests of taxpayers, who stand behind all public sector concerns, and to avoid unfair competition with the private sector. The scope for relaxing these restrictions in the case of the Post Office without breaching these principles is discussed in Chapters 4 & 5. The next chapter, however, discusses the developing commercial pressures on the business as it approaches the end of the century.

CHAPTER 3

THE CASE FOR CHANGE

1 Under the arrangements described in Chapter 2 of this paper, the Post Office has been successful, improving its overall profitability, while offering its customers significant improvements in service quality. Each of the main Post Office businesses now faces substantial change over the next decade and beyond, which will present both threats and opportunities. All three must change if they are to survive the threats and make the most of their opportunities.

Post Office Counters

2 Post Office Counters Limited has been consistently profitable since its creation as a separate organisation in 1986. It has also managed to increase its turnover year by year. It remains the largest retail chain in the UK, maintaining a presence in many small towns and villages from which banks, for example, are beginning to withdraw. It is recognised as providing a very personal and popular service to the public.

3 Changing social habits and new technology are challenging the traditional business of the post office network. In recent years, there has been a general move in UK shopping habits away from smaller retail outlets towards larger retail stores, notably supermarkets. Sub-post office status helps many village shops to survive by providing a secure level of income and encouraging people into them. Post Office Counters seek to maintain a presence, wherever possible, for example through the Community Office programme which allows post offices to remain open, offering a more limited range of services, with restricted hours. But, even with this help, a number of small post offices close every year because no one can be found to run them as a going concern.

4 Most services available in post offices are now available elsewhere. Pensioners, for example, now have the opportunity to have their pensions paid direct into their bank or building society accounts and approximately 40% of new pensioners are electing to do so. It is now possible to buy a television licence or pay bills by post or by direct debit, as well as at post offices. Stamps are available at a wide range of outlets. The Government welcomes this diversity of choice for customers but recognises that, as a result, post offices are seeing a decline in their market share of such traditional business.

5 Both these changes offer opportunities too as other organisations like banks withdraw from smaller towns and villages. The ability of the network to provide services in 20,000 different locations allows it to reach more members of the public than any other organisation. Given freedom to do so, Post Office Counters could offer a wider range of services, reducing its current heavy reliance on a limited number of clients. New technology also offers the chance to automate many transactions, which would be both cheaper and able to offer better and quicker management information, benefiting both Post Office Counters and its clients. Automation should also make benefit payment significantly less susceptible to fraud.

6 The Government believes that the network of post offices can not only survive but also prosper. To do so, it needs to be able to respond to the decline of its traditional business by modernising and diversifying. The next chapter discusses the Government's proposed way forward.

Royal Mail and Parcelforce

7 Royal Mail has been consistently profitable for many years. It currently provides by far the largest contribution to the Post Office's overall profits. Parcelforce, in contrast, has been operating in a parcels market which has had acknowledged overcapacity in the recent recession and has been loss-making.

8 In Royal Mail's case, it is important to recognise that the letters market is not self-contained but part of a wider communications market. Both businesses and individuals have an ever increasing number of ways of sending messages, such as telephone, fax and electronic mail. Firms can now order and pay for goods electronically, home banking is a reality and home shopping is in prospect. Direct mail is competing with television, radio and press advertising.

9 These changes are posing an increasing threat to Royal Mail's traditional business. Royal Mail has a monopoly over all mail delivered for less than £1 per item. But even with this protection, commercial pressures are making themselves felt:

- Royal Mail's market share in the wider communication market is estimated at only some 14 to 16%. Competition in that market is fierce. The Electronic Data Interchange (EDI) market is growing by about 20% a year and the fax market by 30% a year. There is evidence that the practice of "confirming" a fax by sending a hard copy in the post is declining. There is also some threat to the "core" letter service between individuals - already no more than 10% of Royal Mail turnover - with mail posted through pillar-boxes showing signs of decline. Both businesses and individuals have a wide range of alternatives to written communication, sent through the post;
- there is also increasing competition for letter traffic. Letters costing more than £1 can be delivered by a wide range of local, national or international private sector courier companies. The real value of the £1 limit has been reduced significantly since its introduction in 1981. If mail for UK companies is printed overseas and posted into the UK, that provides lower revenue for Royal Mail than if the letter is posted in the UK. The Government is committed to lowering the monopoly further to allow other operators to develop new services, consistent with ensuring that Royal Mail can deliver its universal service at a uniform and affordable tariff. This can only be good for Royal Mail's customers, but the business needs to have the flexibility to respond to such competition.

10 Developments in the market place also offer opportunities which Royal Mail should be well placed to seize:

- many companies are already looking to integrate their marketing, including direct marketing, on a Europe-wide basis. An American company looking to market a new product in Europe is likely to prefer to deal with a single marketing and mailing operator rather than deal direct with different companies in different countries. If Royal Mail could offer a combined marketing, printing and posting operation for mail to be sent to customers throughout Europe then this would give them clear new opportunities - and bring business to the UK economy as a whole. Other countries are already doing this;
- businesses are increasingly concentrating on their key activities and looking to contract out their ancillary services. If Royal Mail can offer value-added services, such as mailroom services, printing and marketing support as well as sending of mail, then they will find new sources of revenue and their customers will be more likely to use printed distribution for their communication needs;

- the EC Green Paper on postal services has opened up the clear prospect of a more competitive letters market throughout the European Union. The UK is at the forefront in supporting this liberalisation. Royal Mail is well placed to take advantage of it.

11 *Parcelforce* is, of course, not protected by a monopoly. While it is the only parcels service available at post offices, this represents only about 6% of its volume and, for the most part, *Parcelforce* is competing directly with the private sector. It faces growing competition from:

- a marked growth of competitors in the UK market, particularly from small independent businesses;
- increasing demands by its business customers, for an ever faster and ever more reliable parcels service. Most of *Parcelforce*'s competitors have invested heavily in this area of the market, notably in "track and trace" facilities which enable customers to be given much better information on whether and when their parcels are delivered;
- growing international competition. In the absence of a monopoly, there are no constraints on other companies delivering parcels and related services within the UK. In particular, the postal administrations of Germany, France, the Netherlands, Sweden and Canada have joined forces in a joint venture with TNT to bring together their international time-sensitive delivery services.

12 While both Royal Mail and *Parcelforce* have taken many steps to respond to the new business environment, there are many limitations on their ability to do so within the constraints of nationalised industry status. The Post Office Board has made very clear that the long term future of both businesses - and thus their ability to maintain the vital public services which they carry out - require them to be able to respond with a higher level of commercial flexibility and freedom than is permitted to them while they remain under the current public sector control regime.

13 The Trade and Industry Select Committee in its recent report accepted this argument and argued that

"the traditional Treasury restraint on its activities [is] having a detrimental impact on the Post Office's ability to act as a commercial organisation, to deliver an ever higher quality of service to its customers and to meet the challenges and opportunities of international competition. As competition increases both at home and abroad in existing and revolutionary forms, its prospects can only worsen".

14 The Government believes that increased competition benefits consumers and strengthens the UK economy. Time and time again, competition has been shown to stimulate innovation and greater efficiency. But the Government also accepts that Post Office Counters, Royal Mail and *Parcelforce* need greater commercial freedom if they are to respond effectively to the challenges they face. It therefore takes the view that it is in the interests of consumers and the wider economy that these businesses should be allowed to change, so that they can flourish in a more competitive environment.

CHAPTER 4

THE NETWORK OF POST OFFICES

1 The previous chapter explained the need to improve the commercial outlook for Post Office Counters and the network of 20,000 post offices. This chapter sets out the Government's proposals for responding to the commercial pressures on the business.

Structure of the business

2 The network of post offices represents a partnership between the public and private sectors. Post Office Counters, the public sector core of the business, sits at the hub of the network, negotiating and coordinating the contracts with Government bodies and other clients on which the network depends. It provides the infrastructure which supports the individual post offices and ensures that all of them provide services to a high standard, building on the reputation of the business for security and efficiency. It also runs some 800 of the larger offices - known as "Crown" offices - direct, though the Post Office has been converting these to agency status in the interests of efficiency and customer service. Even including the staff employed in these offices, the Counters business is relatively small, employing just 15,000 of the 200,000 staff of the Post Office.

3 The network of sub-post offices provides a strong injection of private sector involvement - and capital - into the business. It provides direct employment for 19,000 sub-postmasters and their support staff. The combined investment of the sub-postmasters in the post office network has been estimated as more than £1bn, well in excess of the public sector investment in the business. This combination of public and private interests is mirrored at the level of the individual office. The great majority of the 19,000 sub-post offices run an independent business alongside the post office, and the two businesses are often mutually self supporting, with the "private" side of the shop, supporting the "public" services of the post office and vice versa.

4 During the course of the Post Office Review, the Government considered whether there was a case for changing this structure. It considered, for example, whether there was a case for privatising Post Office Counters in order to inject further private sector capital into the business. The Government has concluded, however, that such radical changes are unnecessary. The existing public and private partnership is the network's strength, allowing national provision for the size and activities of the network, coupled with local private sector provision for the delivery of services. The National Federation of Sub-Postmasters has made clear that the key issue for the sub-postmasters is not the ownership of Post Office Counters, but improving the commercial prospects of the network.

5 The Government agrees that changes in the structure of the post office network would not help the business respond to the commercial pressures it faces. The previous chapter made clear that the immediate needs of the network are twofold: first, to increase the level of services it provides, to offset the potential long term decline in its existing business; and second, to modernise itself so that it can provide a more competitive service to those wishing to make use of its unique ability to reach throughout the country from cities to villages and hamlets. These needs, and how they can be met, are discussed in the remaining three sections of this chapter.

Freedom to take on new business

6 The previous chapter set out the extent to which developments in consumer choice are changing the existing business of the network of post offices. Overall, 90% of volume derives from eight clients, each one of which offers alternative outlets for at least some of its services. The profitability both of Post Office Counters and the individual sub-post offices is highly sensitive to the volume of work carried out on behalf of this limited range of clients. Losses in turnover can seldom be offset by a parallel reduction in costs.

7 The Government recognises the risk that, if the traditional business of the network declines, the ability to sustain the nationwide network will also be called into question unless there are corresponding opportunities for the business to expand. It has decided, therefore, to allow Post Office Counters greater commercial freedom in the future to provide services to new private sector clients.

8 The business has already been seeking to develop new areas of business, within the framework of its existing activities and powers. It has, for example, recently agreed with British Gas that consumers will, in future, be able to pay their gas bills at post offices free of charge; it is currently trialling the provision of bureau de change facilities in post offices; and it is optimistic that post offices will play a considerable role in the selling of tickets for the national lottery. But the Government has not generally allowed the business to seek new opportunities from new private sector clients. This has been a significant constraint on the ability of the business to develop new services and make the best use of the network of post offices. Post Office Counters and the National Federation of Sub-Postmasters have argued that consumers would now welcome the opportunity to obtain a wider range of services from post offices, particularly given the geographical range of the network.

9 The Government accepts this argument. It believes that Post Office Counters should seek to develop new services by building on its existing activities. The business has considerable strengths in the size and range of its network and its ability to carry out both simple and complex transactions to high standards of reliability and integrity. By offering these facilities to a wider range of clients, the business should be able to increase its turnover, without undermining the traditional strengths of the network and without changing the fundamental nature of the business.

10 The Government has therefore agreed a set of Guidelines setting out a framework under which Post Office Counters will in future be allowed to develop new business. The Guidelines, set out at the end of this chapter, are designed to ensure that proper account is taken of the need for fair competition with the private sector. They provide a clear framework under which the management of Counters can plan for the future.

11 It will, of course, be for the business to develop these new opportunities as best it can. For example, the management of Post Office Counters is keen to build on the network's expertise in the cross-counter bill payment market by extending its client base to take in a wider range of private sector partners. It also sees opportunities to enhance services in the communications market, building on existing links with Royal Mail and the telecommunications companies.

Automation

12 The Government also recognises that, to survive, the network must be able to handle present and future business in a cost effective and efficient way. This is the best way of securing the future both for the sub-postmasters and employees of Post Office Counters. Automating many of the post office clerical routines, which underpin the network, will provide the network with a modern and efficient platform on which to

develop its business into the next century. Automating benefit payments will require investment of at least £130 million, and the Government intends that it should be brought rapidly to fruition. The Government's preferred course would be to see this project developed, managed and financed by the private sector. A number of possible options are now under consideration.

13 The largest client of the network is the Benefits Agency. The Government confirmed last year that it intended to continue to allow all benefits to be paid at post offices, while continuing to expand the availability of alternative methods of payment to widen choice for the public. The Government recognises, however, that the existing system of paper-dominated procedures for the payment of benefits at post offices is outdated, expensive and prone to fraud. The Benefits Agency is, therefore, an active partner in the automation project, which it expects to lead to reduced costs, both in terms of administration and fraud savings.

Links with the Royal Mail and Parcelforce

14 Although the Government is not proposing any change to the present status of Post Office Counters, some of the options in the next chapter envisage a change of ownership for Royal Mail and Parcelforce. This therefore raises the question as to whether there is any commercial need for Post Office Counters to remain under common ownership with the other two businesses.

15 The Government has concluded that there is no such overriding need for the two businesses to be under common ownership. There are important trading links between them but these are based on arms length negotiation and pricing. There is no cross-subsidy. Moreover, the businesses are in two fundamentally different markets. Royal Mail and Parcelforce are essentially communications and distribution businesses, increasingly operating in international markets. Post Office Counters, in contrast, is a unique retail business, with a network of 20,000 outlets representing the largest chain of shops in Europe.

16 Both Royal Mail and Parcelforce are, of course, very important clients of Post Office Counters. The Government also believes that the public would wish the full range of Royal Mail and Parcelforce services to continue to be available at post offices. It will, therefore, ensure that, whatever option it chooses for the future of Royal Mail and Parcelforce, both businesses will be required to maintain their services through the full network of post offices. But this can be done through regulation. There is no need for the businesses to be under common ownership.

Summary

17 This chapter has described the unique nature of the Post Office Counters business and the nationwide network of post offices. The Government believes this structure has great strengths and has no proposals to change it, although it expects the Crown Office conversion programme to continue. It wishes to ensure the long term prosperity of the network by allowing it greater freedom to develop new services and modernise its operations. It will also ensure that the future arrangements for Royal Mail and Parcelforce maintain the important trading links between the three companies.

COMMERCIAL ACTIVITY BY POST OFFICE COUNTERS: PROPOSED GUIDELINES FOR NEW BUSINESS

1 Through the network of 20,000 post offices and the infrastructure that supports them, Post Office Counters has a unique potential to offer services to its customers throughout the country. The Guidelines set out in this note are intended to ensure that the fullest use is made of this potential, both securing wider economic benefits and improving the finances of the business, to the benefit of existing and new clients and of sub-postmasters. They are intended to give a predictable and stable framework within which Post Office Counters can plan for the future.

2 Post Office Counters' programme for new business will be monitored by Government through the corporate plan process. In a number of cases Post Office Counters will be able to develop new opportunities within existing powers. In other cases current legislation requires the formal agreement of Ministers to specific proposals. In all cases, particular attention will be given to the need to avoid unfair competition through cross-subsidy.

3 Under these Guidelines the Government has agreed that Post Office Counters may seek to take on new clients where any of the following applies:

- i. potential clients are themselves seeking to transfer part of their own activities to Post Office Counters for efficiency and other reasons. Any displacement of private sector activity would in these circumstances be voluntary;
- ii. Post Office Counters can offer a quality or type of service which cannot be matched by other suppliers. This could happen, for example, when clients are seeking services which require the ability to carry out large numbers of transactions with a high level of security, record keeping and reconciliation;
- iii. the proposed activity would help create a new market for services which had previously not been available to the public (eg the sale of lottery tickets), or would help to foster the development of a recently created market;
- iv. the entry of Post Office Counters is likely to lead to significant growth of existing markets, rather than to the displacement of existing activity. This is most likely to happen by widening consumer choice through the provision of the relevant service at a significantly wider range of outlets, including those in remote or rural areas not served by other providers;
- v. notwithstanding low growth in the relevant market, the entry of Post Office Counters is unlikely to have a significant impact on existing private sector companies because the market is already diversified.

4 In addition, the Government will require proposals to take account of:

- i. *factors specific to Post Office Counters' business*, including the impact on its discharge of existing functions and the compatibility of new proposals with its core business activities; how far it will be increasing utilisation of existing capacity; the effect of any expenditure on new investment on its overall return; and the need for revenue from a new service to meet the incremental costs of its provision, including administrative expenses;
- ii. *wider economic market and competition issues*, including whether the relevant market is already well served by the private sector; whether Post Office Counters' involvement would give it disproportionate market power; and the need to ensure that services provided on behalf of third parties, while delivered to high standards of quality, integrity and reliability, are not perceived to be underwritten by Government.

CHAPTER 5

ROYAL MAIL AND PARCELFORCE: POSSIBLE WAYS FORWARD

1 This chapter considers the options for allowing Royal Mail and Parcelforce to respond to the challenges discussed in Chapter 3. The Government accepts that, in order to do so, Royal Mail needs greater commercial flexibility than is available to it at present. It needs to modernise its business, through greater investment; to offer new services to meet the changing needs of its customers; and to make strategic alliances, including joint ventures, to respond to the increasing competition at home and abroad. The Chairman of the all-party House of Commons Trade and Industry Select Committee has said that the Committee “strongly believes that the status quo cannot prevail”. The Government shares this view.

2 Given greater commercial freedom to respond to the challenges of increased competitive pressure, Royal Mail should be able to improve its efficiency still further. The Government believes there will be scope for introducing more competition and choice for customers in postal services, while maintaining the universal services at a uniform and affordable tariff, to which it is firmly committed.

The future of Royal Mail

3 The Government considered, in the early stages of the Post Office Review, a variety of radical options under which Royal Mail would be split into regional businesses, allowing for local monopolies and some “cross-border” competition. Thought was also given to the possibility of splitting the business according to its different functions, namely the collection of letters, sorting, distribution and final delivery. Discussions both with Royal Mail and other experts in the mail industry made clear, however, that any break up solution would be likely to lead to a marked deterioration in the quality of service. They would make it more difficult for Royal Mail to compete effectively in international markets. These options were therefore rejected.

4 The options the Government is still considering are threefold. They are as follows.

(1) Commercial freedom within the public sector

5 The Government has considered whether Royal Mail could be retained in the public sector as part of the Post Office, and given the commercial freedom it is seeking without a change of status. This would mean changes to the standard control regime for nationalised industries, as outlined in Chapter 2. These controls reflect the fact that the risks assumed by nationalised industries are ultimately underwritten by the taxpayer. In particular, Government controls over borrowing by public corporations (all of which, by definition, falls within the public sector borrowing requirement (PSBR)) provide a discipline over all funds which are raised with the backing of the taxpayer and for which the Government is ultimately accountable. Without such controls, nationalised industries would have a clear advantage over commercial rivals, both in competing for business and raising new funds on capital markets. Public sector controls are designed to prevent public corporations from exploiting this privileged position.

6 The Government has considered how far it could amend the existing regime, by the relaxation of certain specific financial controls. For example:

- the Post Office could be freed from its overall capital expenditure limit. This would allow the business greater freedom to reinvest retained profits. The Government could also relax scrutiny of specific projects;
- greater flexibility in the EFL arrangements, with the EFL effectively set as a dividend in relation to prospective profitability;
- the Government could replace the existing efficiency target for Royal Mail with direct control over prices, perhaps incorporating a tariff formula such as those imposed on privatised industries.

7 There is also some scope for giving public bodies a degree of commercial flexibility within the framework of existing controls, for example joint venture projects under the Private Finance Initiative (PFI). The essence of the PFI, however, is that it provides for the private sector to take forward desirable projects in partnership with the public sector, but with the private sector partner taking on overall management control and the majority of the risk and receiving commensurate rewards. It is, therefore, of limited value to Royal Mail, which wishes to extend the scope and operations of its *own* business, in response to new competitive pressures, and which wishes to ensure that the additional activity generates additional benefits for Royal Mail itself.

8 Given the nature and extent of the commercial activities in which Royal Mail plans to engage, the Government sees serious difficulties in freeing it from *all* controls as long as it remains in the public sector. Such an approach would be inconsistent with the Government maintaining strict control over public finances. So long as Royal Mail remains in the public sector, the business would be effectively protected from failure, as any commercial losses would be funded by the taxpayer. This would give it a clear and unjustified advantage in new activities since potential lenders or joint venture partners would perceive it as a low risk proposition with the taxpayer standing behind it, whatever their assessment of the commercial realities. At the same time, the taxpayer would be investing in activities going well beyond Royal Mail's existing services, preempting decisions on alternative uses of those resources in areas such as health and education. Competitors would be understandably concerned that Royal Mail, in developing new commercial opportunities, should be regulated to ensure it was competing fairly. It is questionable, however, whether such competitors would have confidence in the Government's ability to ensure independent regulation of the business, while it remained in public ownership.

9 The relaxations discussed in paragraph 6, together with use of joint ventures under the PFI, would be of some value to Royal Mail. They would also place it in a very favourable position compared to other public sector bodies and nationalised industries. But the key question is whether such changes would give Royal Mail enough commercial freedom to respond flexibly to changing market conditions. Unlike Post Office Counters, Royal Mail has ambitions to become a major international competitor in the communications industry. It has significant market power and the commercial expansion it seeks will bring it into direct competition with a wide range of private sector businesses, requiring additional capital. Above all, it is more likely to be successful and efficient if it is responsible for taking its own decisions, according to commercial criteria, within a clearly defined framework of independent regulation.

10 The Government has provisionally concluded that the changes that would be possible within the public sector would fall short of the commercial needs of Royal Mail. Given the speed with which the communications industry is changing, and is

likely to continue to change over the next decade, the clear risk is that the public sector option would condemn the business to slow decline.

(2) A 100% share sale

11 The Government has considered the option of a 100% sale of Royal Mail via a Stock Exchange flotation, whether in one or more stages. This would involve the transfer of Royal Mail's business to a public limited company, with a public offer of the total share capital and no residual Government shareholding. All the shares would be offered to the public, employees, sub-postmasters and financial institutions.

12 The Government interest would be limited to the retention of a special share which the Government would hold in view of the business's strategic importance. This would ensure that no single shareholder, or shareholders acting in concert, could acquire more than 15% of the equity without the Government's agreement. Consideration would also be given as to whether the special share should cover any other issues.

13 Under this option, the Government would create a comprehensive regulatory regime guaranteeing the universal service and uniform tariff structure. This is discussed in full in Chapter 6 of this paper, with the regulator also having responsibility for competition issues as set out in Chapter 7.

14 This option has much to recommend it. The maintenance and enhancement of the basic public services could be assured by independent regulation. Within that framework, Royal Mail would be able to:

- plan, invest and run its affairs on a commercial basis;
- forge new alliances, including joint ventures, in the UK and overseas;
- gain access to private sector capital free from public sector controls;
- benefit from sharper commercial disciplines thereby improving its efficiency and responsiveness to its customers.

15 This option would maximise the shares available to the public. It would follow the well established patterns of earlier privatisations, as a result of which companies like BT, British Gas, British Airways and BAA are now fully established, highly competitive companies in the private sector with no residual Government interest. The Government set out in the recent White Paper on "Competitiveness: Helping Business to Win" (Cm 2563) how the privatisation programme had brought substantial benefits for consumers and how the lower prices, greater innovation and higher levels of service provided by the privatised companies are helping to raise the competitiveness of other UK companies.

16 The Government recognises, however, that many people would prefer a closer link between the Government and Royal Mail than this option would provide. The desire to see such a link reflects the important role which Royal Mail plays in our national life. The Government has therefore looked for ways to meet this concern while also responding to Royal Mail's commercial needs.

(3) Joint ownership by Government, the public and employees

17 This option would involve a new partnership under which the public, the employees, the sub-postmasters and the Government would each hold significant shareholdings in the business. The Government would particularly hope that those directly involved in the business would wish to invest in it and intends to offer shares on a preferential basis accordingly. The Government sees scope for a significant proportion of the shares to be held by employees and sub-postmasters - perhaps around 10% - and would consider how best to achieve this.

18 Under this option, the Government would intend to retain its shareholding indefinitely. Indeed, it would ensure that the legislation needed for this option would require Parliamentary approval before any sale of its remaining shares. The retention of this Government shareholding would be a clear indication of the Government's continued commitment to the vital public services Royal Mail provides. It would also allow the Government and the taxpayer to share in the company's future success through its shareholding. The requirement for Parliamentary approval before any subsequent sale would reinforce the provisions of the special share, which the Government would also retain in the same way as under the previous option (para 12 above).

19 In terms of the structure of the company and regulation this option would follow the lines of the previous one. The significant difference, however, is that the Government would retain a substantial stake in Royal Mail.

20 The Government is attracted to this option, and has considered what would be the appropriate level of its retained stake were it to proceed. But for it to meet Royal Mail's needs, it is essential that the retained Government shareholding should *not* leave the Government in control of the business. If the Government were to retain a majority shareholding, it would still be in control, Royal Mail's borrowings would continue to count against the PSBR and the taxpayer would effectively be underwriting the business. All the difficulties set out in option (1) above would still apply.

21 For Royal Mail to be allowed to operate as a private sector company, the Government must sell a majority of the shares. As long as the Government is only a minority shareholder, the business would be classified to the private sector, and would be free from public sector controls³. The Government would propose to retain 49% of the shares in the company though not intend to use its rights as an ordinary shareholder

³ During the course of the review it has been argued that Royal Mail could be classified to the private sector even if the majority of the shares were owned by the Government. This is not the case. Sector classification in the UK accounts is determined in accordance with standards contained in the System of National Accounts (SNA), in order to maintain the integrity of the accounts. The SNA is issued jointly by five international organisations (CEC, IMF, OECD, UN and World Bank). A revised version was published at the end of 1993.

In the present context the following extracts from the SNA are relevant:

“Ownership and control of corporations

....

4.30 As explained later in this Chapter, the sub-sectors of the System require private corporations to be separated from public corporations subject to control by Government units, Owning more than half the shares of a corporation is evidently a sufficient, but not a necessary, condition for control. Nevertheless, because it may be difficult to identify those corporations in which control is exercised by a minority of shareholders, it is recommended that, in practice, corporations subject to public control should be confined to those in which governments own a majority of the shares. This recommendation is intended only as a practical guideline, however, to which exceptions can be admitted if there is other evidence of control.

....

Public non-financial corporations

....

4.72 The Government may secure control over a corporation:

- (a) By owning more than half the voting shares or otherwise controlling more than half the shareholders' voting power; or
- (b) As a result of special legislation, decree or regulation which empowers the Government to determine corporate policy or to appoint the directors.

4.73 In order to control more than half the shareholders' voting power, a government unit need not own any of the voting shares itself. For example, a public corporation could be a subsidiary of another public corporation in which the government owns a majority of the voting shares”

The Central Statistical Office, which is responsible for determining sector classification, believes that Royal Mail must be classified to the public sector as long as the Government owns a majority of the shares. Past decisions would not provide a basis for departing from current standards.

to intervene in the commercial decisions of the company. In particular, it would not expect to vote its shareholdings on resolutions moved at General Meetings of the company although it would retain the power to do so.

22 This approach, with the Government's retained stake of 49%, is *the Government's preferred option*. It would give Royal Mail all the commercial freedoms it needs to respond to increasing competition. It would benefit the consumer, by allowing the new company to develop new services and it would fully protect the essential public services provided by Royal Mail, through the arrangements set out in the next chapter.

The future of Parcelforce

23 The Government announced in July 1992 its intention to sell Parcelforce. This reflected the fact that, while Parcelforce provides a vital social function in delivering parcels, handed in by the public at post offices, to every household in the country, the business's main activities are in the commercial parcels market. There is no monopoly in this wider market and no public interest in the Government being an active participant in it. In announcing its intention to sell the business, the Government made clear that a universal parcel service at a uniform and affordable tariff would continue.

24 During the course of the wider Post Office Review, the Government has considered the option of selling shares in a joint Royal Mail and Parcelforce operation. As already indicated, Royal Mail wish to become a major player in the international communications market. In this market customers will expect them to provide a full range of services, including parcels. The management of the Post Office have made clear that they see parcels as an important strategic market for the future.

25 For the Government to attempt to sell Parcelforce separately would, therefore, run counter to the thrust of giving Royal Mail greater commercial freedom through the options outlined above. It is likely that any purchaser of Parcelforce would require an agreement, as part of the sale process, that Royal Mail would not develop a competing parcels service of its own. Alternatively, if there were no such restriction, Royal Mail would wish to develop a new parcels business, at a time when analysts of the parcels industry recognise that there is adequate and arguably excess capacity in the UK parcels market. Neither would be attractive.

26 The Government has therefore decided that the future of the two businesses lies together. This would allow the key social services provided by Parcelforce, namely the public parcels service at post offices, to be subject to the same regulatory control as would be proposed for Royal Mail under the Government's preferred option.

27 The Government acknowledges the concern expressed by other participants in the parcels industry that there should be no cross-subsidies between the regulated mail and parcels services and the fully competitive commercial parcels sector. It also accepts that the recent commercial history of Parcelforce, which has been trading at a loss in recent years, is unsatisfactory. The regulatory system proposed would seek to ensure that the accounts of the combined business were sufficiently transparent to allow the regulator to prevent any cross-subsidy.

Summary

28 This chapter has set out the possible options for the future of Royal Mail and Parcelforce. Subject to consultation on the Green Paper, the Government's preferred way forward is the sale of 51% of the shares in a combined Royal Mail and Parcelforce sale as set out above. Such an approach would give the business the commercial freedoms it needs, while safeguarding the interests of consumers in essential public

services. The Government believes that it would also permit the progressive introduction of more competition in postal services. In the next three chapters, this paper sets out what would be required in terms of regulation, competition and consumer representation to deliver these objectives.

CHAPTER 6

REGULATION OF THE POSTAL SECTOR

1 The Government is committed to ensuring that Royal Mail will continue to provide important and socially necessary services – even where it may not be profitable to do so. The Government will, in particular, protect the services which are vital to rural communities. If the Government were to pursue an option involving the sale of shares, the legislation that would be necessary would set up a regulatory system to ensure this. This Chapter sets out how such a regulatory system would operate. It assumes that the new company, including both the current Royal Mail and Parcelforce, would be known as Royal Mail.

2 At the centre of the system would be the Director General for Postal Services (“the regulator”). Both the Secretary of State and the regulator would be under a statutory obligation to ensure that the public are provided with universal letters and parcels services. They would achieve this by being given powers to appoint Royal Mail to be the universal service provider. The Government would expect to make the initial appointment itself, with the regulator being responsible thereafter for monitoring the Royal Mail’s performance and ensuring it maintained its obligations. The regulator would also ensure, under the Citizen’s Charter, that standards of service continue to be maintained and improved.

3 The regulator would be appointed by Ministers, but would have independent powers which he or she could exercise without reference to the Government. It would be a legal requirement on Royal Mail to provide universal services, and on the regulator to ensure that they do so. This is a greater degree of legal protection for customers than exists at present.

4 The legislation would in particular place on Royal Mail an obligation to provide letters and parcels services throughout the country within a uniform and affordable tariff structure. Under this structure, it would continue to cost the same amount to send a letter or parcel between Land’s End and John O’Groats as between neighbouring streets. Royal Mail would also be legally obliged to maintain a wide network of collection points at which letters can be posted, including both post offices and letter boxes. Similarly, it would have to collect parcels from every post office.

5 The tariffs for both first and second class post would be controlled by a price-capping formula. The Government expects, through these arrangements, to ensure that prices continue to decline in real terms as they have in recent years, reflecting increased efficiency. The Government rejects, in particular, the argument that prices would need to rise “to fund dividends”. The Post Office has in practice been paying substantial sums to the Exchequer for some years through the EFL arrangements, discussed in Chapter 2. Indeed the Post Office has argued that recent EFLs have been significantly higher than a private sector company would expect to pay in dividends. As explained in Chapter 10, there would be no VAT on stamps.

6 There are other services which the regulatory system would impose on Royal Mail. It would also be *required* to provide:

- a free service for blind people as at present;

- recorded delivery and registered post for important and valuable items;
- satisfactory arrangements, free of additional charge, for redelivering mail sent to the wrong address and forwarded on;
- a comprehensive "difficult address" service, so that efforts are made to deliver mail where the address given is non-existent, wrong or incomplete;
- a full range of international services;
- delivery and return of the writ for Parliamentary elections.

7 Past experience has shown that regulatory systems can make sure that such services are delivered by private sector firms. BT, for example, is obliged to provide telephone lines and callboxes throughout the country. There are now 122,000 BT callboxes in the country compared to 86,000 in 1987 - an increase of over 40%. There has been a significant improvement in the reliability of phone boxes so that 95.7% are now working compared to 75% in 1987. Many are not profitable for BT to operate, but they are legally required to keep them going. At the same time BT's prices overall have fallen by around 35% in real terms since privatisation.

8 As well as ensuring that certain services are provided, the regulator would, in line with the Citizen's Charter, set standards for their delivery. For example, the standard for the proportion of first class letters to arrive at their destination in the next working day, currently agreed between the Post Office Users National Council (POUNC) and the Post Office, will be set by the regulator. He or she will be able to ensure that Charter principles are implemented; in particular that a proper complaints procedure is put in place, and that compensation levels are determined if mail is lost or if other specified service levels are not met.

9 Finally, mention should be made of a number of other specific services:

- It has been argued that, if it were not within the public sector, Royal Mail would no longer be required to carry out a second daily delivery of mail. There is, however, no such requirement at present. The provision of a second delivery is not one of Royal Mail's social commitments but entirely an operational matter decided by Royal Mail at a local level. Nearly one area in six receives no second delivery, so its provision is by no means universal. Royal Mail expects the second delivery to continue in the vast majority of places. A key Government concern, however, is to ensure that an ever higher percentage of first class mail is delivered the day after posting. It will expect the regulator, therefore, to set Royal Mail tough targets for the delivery of mail, including for the time of delivery. Provided those targets are met, Royal Mail will have the operational responsibility to decide how best to achieve this. Through the operational oversight of the regulator, customers will be better protected in this key area than at present.
- It has been argued that, under the preferred option, Royal Mail would no longer maintain the post bus network which provides an important service in rural areas. It is not generally understood, however, that post buses are only provided at present when they make a positive contribution to Royal Mail's finances. Where they are directly subsidised, they are subsidised not by Royal Mail but by the relevant local authority. The Government sees no reason, therefore, why any of its proposals in this paper should have any impact upon the provision of post buses.
- HM Forces, serving overseas, are currently able to send and receive mail at UK inland rates. This does not involve any Royal Mail subsidy, however, as the movement of mail to bases overseas is both the responsibility, and at the

expense of HM Forces. Again, this would be unaffected by the Government's proposals.

- It is the general practice in the UK for letters to be delivered through the front door rather than to the "garden gate". This is not a legal obligation, however, and there are numerous cases, notably in blocks of flats, where the postman is not given access to the front door of each household. Royal Mail has no plans to change the current arrangements. But under the regulatory system proposed, it would be for the regulator to monitor. This, again, is a better system of protection for the public than exists at present.
- Lastly, it has even been suggested that Royal Mail would no longer provide a free service of replying to letters sent to "Father Christmas". The Government doubts that such a service - the cost of which is minute, given the size of the business - should be the subject of legislative or regulatory underpinning. The Post Office Board have made clear, however, that the service fully justifies itself commercially in terms of goodwill. They have no plans to remove it. The Government welcomes this commitment to a traditional customer service.

10 Although the key obligations on Royal Mail would be set out in the legislation, many of the precise details would be set out in a separate legal document, initially agreed with the Government and then enforced by the regulator. It would be open to Royal Mail and Parcelforce to discuss with the regulator the precise terms of this and of the obligations it imposes. It needs to be recognised, of course, that such obligations are effectively funded by other mail users, some of whom may prefer fewer social obligations and lower national tariffs. But the regulator would only be able to agree to any changes if he or she were satisfied that the universal service and uniform tariff would continue to be provided, as set out on the face of the primary legislation.

11 The regulator's primary duties will be to ensure the provision of basic services supplied by Royal Mail and to ensure that its continuing letters monopoly is not abused. Consistent with this, he or she will also have a duty to promote competition in the industry to the greatest extent possible. The Government sees no reason why the arrangements it is proposing should put any new burdens on private sector businesses in the postal sector, which currently operate satisfactorily in a largely unregulated environment and will continue to do so. The next chapter explains how the Government would propose to introduce greater competition alongside a private sector Royal Mail.

CHAPTER 7

COMPETITION IN THE POSTAL SECTOR

1 The Government believes strongly in the benefits of competition and free markets. Competition forces companies to innovate and invest in new services. It encourages companies to ensure they provide services that meet the needs of their customers and obliges them to control their costs, so that their products provide real value for customers. Constraints on competition are seldom in the interest of consumers.

2 In the case of postal services, the Government's commitment to maintain the universal service and uniform tariff structure will set limits on the level of competition in the market that is possible or desirable in practice. The cost of delivering letters varies considerably according to the location of the address to which they are being delivered. The cost of delivering a letter from Land's End to John O'Groats, for example, is many times more than the current cost of a first class stamp. It can only be delivered for that price if many other letters are delivered at a cost less than a first class stamp. Royal Mail thus averages out the total costs of running the network over all letters posted. If it had no monopoly, other carriers would be able to concentrate on city and urban areas where the cost of delivering letters is lower. The resultant loss of business would make it impossible to maintain the uniform tariff.

3 Accordingly, the Government recognises that a degree of monopoly will be needed to support the maintenance of the universal service and uniform tariff structure. Nevertheless it remains committed to reducing the letter monopoly limit closer to the level of the first class stamp. At one time, it was assumed that Royal Mail required an absolute monopoly over all written communication. In 1981, however, the Government introduced a monetary limit to the monopoly, by allowing anyone to carry letters provided they charged at least £1 per item. The practical effect of this reform was to allow the growth of the courier business, which has been of considerable help to businesses which need mail delivered urgently, usually within cities and urban areas. Although it was argued at the time that this reform would be a major threat to the viability of Royal Mail, it has not proved to be the case, even though the value of the £1 limit has been eroded over time. Indeed, the increased choice and range of services available has been a benefit to consumers, whether private or business, while protecting the public services. The Government made a further reduction in the monopoly in 1981 by authorising document exchanges which allow mail to be interchanged between nests of post boxes, with customers taking their mail to and from such nest boxes. Again, this has increased choice, without damaging the service to the public.

4 In addition to a reduction in the monopoly limit, the Citizen's Charter also set out a number of further proposals for competition. These were:

- to extend the range of discounts available for those companies who pre-sort their mail to include additional discounts for companies who wish to transport the mail to the end destination themselves, though with Royal Mail still being responsible for door to door delivery ("downstream access"). This would place competitive pressure on the costs of Royal Mail's transport network;

- a subsequent extension of such discounts for companies collecting and sorting such mail on behalf of third parties (“consolidation”). This would extend the availability of cost related discounts to a wider range of customers; and
- a willingness to consider applications for “niche licences” to deliver specific services within the monopoly. This would allow further development of value-added services. For example, such licences currently allow the operation of document exchanges (described in paragraph 3 above) and the delivery of Christmas cards by charities.

5 In the main, the Citizen’s Charter proposals would require primary legislation before they could be implemented. The legislation that would be necessary to implement other proposals in this paper would provide, therefore, the opportunity to move forward in all these areas.

6 Additional competition must not be allowed to put at risk Royal Mail’s ability to maintain a universal service at a uniform and affordable tariff. In order to achieve the correct balance in this area, further detailed work will be needed to ensure that sufficient empirical information is available on which to base judgements. In the light of this work, the Government will introduce a package of pro-competitive measures in parallel with the other aspects of the new regime. It would then be for the postal regulator to monitor the new competitive structure of the industry, ensuring that the correct balance between the necessary level of monopoly protection and the interest of customers is maintained. The Government expects that competition will be introduced progressively, to ensure that any implications for the universal service and uniform tariff structure can be closely monitored.

Parcels

7 In the parcels market there is no monopoly and anyone can offer a parcels service at any tariff. As now, therefore, there will be no monopoly protection for the services currently provided by Parcelforce. The new company will, nonetheless, have an obligation to provide a universal service at a uniform and affordable tariff available at every post office. The Government will ensure that the new company can continue to provide this public service and believes that it should be possible for the new company to do so profitably. The Government will be considering whether the existing exclusive access granted to Parcelforce at post offices needs to continue, or whether other companies should be allowed to offer parcel services at post offices in competition with the new company.

8 Whatever the arrangements for the parcels services at post offices the Government regards it as essential that there are no cross-subsidies between the public letters or parcels services and the wide range of non-obligatory and non-monopoly services, for both letters and parcels, that the new company might offer in future. It will be a key function of the regulator, therefore, to ensure that this boundary is properly scrutinised and the legislation will provide for powers to require the disclosure of accounting information.

CHAPTER 8

CONSUMER REPRESENTATION

1 A more commercial Royal Mail, operating within a clear regulatory framework in a more competitive market place, would provide the consumer with a reliable and improved postal service. But the consumer's voice should still be heard and given appropriate weight.

2 At present, the interests of the consumer are represented by the Post Office Users National Council (POUNC). There are separate Users Councils for Wales, Scotland and Northern Ireland, and local Post Office Advisory Committees throughout the country. The Post Office is obliged to consult POUNC before taking certain steps such as putting up postal charges. POUNC are obliged to look into consumer complaints about the Post Office, and are also free to comment on any matter which they believe affects Post Office users.

3 Under the regulatory system set out in Chapter 6, the Government believes there are two possible models for consumer representation. Either POUNC could be retained as a separate consumer organisation, along the lines of the current Gas Consumers' Council, or the regulator could be charged with specific consumer responsibilities, thus absorbing the functions of POUNC. The Government is already consulting over whether the present arrangements in the gas industry should continue or whether consumer issues would be better represented within the regulatory framework.

4 Whichever model is chosen, the Government will also ensure that the consumer's voice continues to be heard in relation to Post Office Counters. It will therefore ensure that arrangements similar to those under which POUNC represents the interests of consumers on matters such as queuing times and closure procedures will be maintained.

5 The issue of consumer representation is one where the Government is particularly anxious to receive the views of the Post Office's many customers. An address for responses is given at the end of this document. The Government would also welcome views from POUNC and other consumer bodies over what arrangements should be made in the event of the Government's preferred option going ahead.

CHAPTER 9

POST OFFICE EMPLOYEES AND SUB-POSTMASTERS

1 People are the Post Office's most important asset. The business of the Post Office is very labour intensive: even if new technology has been able to take over some of the sorting and processing functions, the daily delivery round cannot be done by machine. The Post Office is a very large employer (around 200,000-employees) and staff costs make up some 65% of total operating costs. In addition Post Office Counters relies heavily on the 19,000 sub-postmasters and their assistants, who work for the main Post Office on an agency basis.

2 Under any option, all three Post Office businesses will remain important employers. As this paper has shown, however, all three businesses face competitive pressures which can be expected to increase over time. These pressures will apply whether the businesses are in the public or private sector, so the key to long term employment prospects is to ensure that the structures adopted for the businesses are those most likely to improve their competitive position. The Government thus believes that the greater commercial freedoms proposed in this paper offer the best future for those who work in the Post Office businesses.

3 The Post Office is committed to motivating and training its employees to give the highest levels of service. Almost all of them have undergone quality training, the results of which can be seen in the greatly improved levels of service quality achieved in recent years. Each of the Post Office businesses intends to continue and strengthen that commitment to training and to excellence, and the Government welcomes this.

4 The Government is anxious that the people who contribute to the success of the different businesses should be able to participate in their future. If an option involving the sale of shares is adopted the Government will ensure that employees have special opportunities to acquire such shares. Experience has shown that employee share ownership is mutually beneficial to a company and to its workforce.

5 The Government intends that sub-postmasters will benefit from the proposals in Chapter 4 for the future of Post Office Counters, which will enable them to offer new services to their customers. Because postal work remains a significant proportion of total Post Office Counters turnover, the Government hopes that sub-postmasters would also wish to take up shares in Royal Mail.

6 Subject to Stock Exchange rules, therefore, preferential share entitlements would be available to Post Office employees and sub-postmasters. In order to encourage maximum take-up the Post Office would intend to make it possible for employees to save at preferential rates in advance of the sale of shares.

Pensions

7 Pensioners and employees will also want to know whether their pensions will be affected by the Government's proposals. The Government will ensure that under any option all pension rights are safeguarded.

CHAPTER 10

VALUE ADDED TAX

1 As made clear earlier in this paper, there is no possibility of VAT on stamps for letters or parcels. This chapter sets out the issues in more detail.

2 Postal services are subject to a particular VAT regime set out in the sixth EC VAT Directive, which provides for public postal services to be exempt from VAT. The VAT arrangements following any changes in the structure and organisation of the Post Office would need to conform with the provisions of this directive.

3 In the light of discussions with the European Commission, as well as earlier jurisprudence of the European Court of Justice, the Government is satisfied that none of the options it is considering for Royal Mail and Parcelforce would mean imposition of VAT on the universal letter and parcel services which they will continue to provide. This is why the stamps which customers buy in order to use these services will continue to be free of VAT.

4 A specific issue which arises in relation to the parcels market is whether the new company should charge VAT on *contract* parcels – that is, parcels which are carried under a negotiated contract with the customer and not under the universal service obligation imposed by the regulatory system. At present Parcelforce does not charge VAT on such services, whereas all other operators must do so. This is not necessarily an advantage for Parcelforce, as is often claimed, because it means that Parcelforce is unable to reclaim VAT it pays on its inputs, but the different VAT treatment clearly affects the competitive playing field.

5 If the Government proceeds with a change in the status of Royal Mail and Parcelforce it will be considering, in the light of EC law, the appropriate VAT treatment of *non-obligatory* services provided by the new company. The Government will, of course, wish to take the interests of customers fully into account in any change. The Government's consideration of this issue will not however result in the imposition of VAT on the ordinary letters or parcels services provided to individuals at post offices.

CHAPTER 11

THE ROYAL ASSOCIATIONS

1 The Government recognises the historical character of the Royal Mail business and its continuing Royal connections. As will be clear from this Green Paper, the Government believes that the organisation will continue to have a unique role in British life. It is therefore pleased to report that Her Majesty the Queen has graciously agreed that under any of the options which the Government is considering the traditional Royal connections should continue. In particular, Her Majesty has consented that

- a depiction of Her head should continue to appear on all stamps issued by Royal Mail, the designs of which will be submitted to Her for approval;
- the Royal emblems, the Crown and the Cypher should continue to appear on such items as post boxes, vehicles and of business premises;
- the new company may be registered under the new name "Royal Mail Plc".

2 The Royal connections, important both to Royal Mail customers and to stamp collectors, will remain symbolic of the essential national role which Royal Mail will continue to play. Measures will be put in place to ensure that they are used in an appropriate way.

CHAPTER 12

CONCLUSION AND NEXT STEPS

1 The Post Office's commercial environment is changing rapidly. To meet this, the Government believes that change is now necessary in the structure and organisation of the Post Office. The management of the business has made clear that the current arrangements are against the long term interests both of the Post Office and of its customers. The all-party House of Commons Trade and Industry Select Committee has accepted this view.

2 The Government is firmly committed to a universal letter and parcels service, at a uniform and affordable price, with a nationwide network of post offices. The best way of ensuring these services is through the commercial success of the businesses which provide them, backed by effective regulation. Subject to consultation, the Government has concluded that;

- for *Post Office Counters*, the existing structure is effective and should remain. The Government recognises, however, the desire of the business, the sub-postmasters and their customers for greater freedom to widen the scope of services available in post offices and believes this can be met, by building on existing activities. It also intends to automate the post office network. Work is underway to implement both decisions. They will do a great deal to further the commercial prospects of the network, to the benefit of Post Office Counters, its clients and customers and the sub-post offices;
- for *Royal Mail and Parcelforce*, more radical change is necessary to allow the business greater flexibility in the fast expanding communications market. The Government believes that this will be consistent with the introduction of more competition in the supply of postal services, and will greatly benefit consumers. It has provisionally concluded that the best way forward is a private sector partnership with shares owned by the public, the employees and the Government. This would provide the business with the scope to improve its service and to increase efficiency in a more competitive environment. It would ensure that decisions on investment and business strategy were taken on commercial grounds alone. It would remove the current conflict between the Government as sole owner of the business and the Government as regulator and enhance fair competition with the private sector.

3 Some of these proposals require legislation before they could be implemented. Pending final decisions in the light of consultation, preparatory work for such legislation has been put in hand. Such legislation would:

- provide the necessary powers to restructure the Post Office businesses;
- establish a regulatory system to maintain and improve the standards of postal service under the Citizen's Charter;
- provide powers for the progressive introduction of more competition;
- establish a new legislative framework for Post Office Counters.

Consultation

4 The issues raised in this paper are complex, but of fundamental importance to the public. If you wish to comment on them, please write to:

Post Office Review Team
TP Division
2nd Floor
Department of Trade and Industry
151 Buckingham Palace Road
London
SW1W 9SS

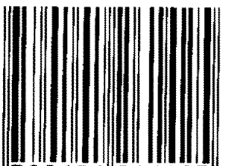
If you wish to fax your comments you can do so on (calls charged at local rates⁴).

5 You can also dictate your comments over the telephone on This number will be operational between 8am and 8pm, seven days a week, from 11 July to 30 September. Again, calls will be charged at local rates⁴.

6 All comments and representations should be received by Friday 30 September.

⁴ May not apply if you are not a BT or Mercury customer.

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