

**To:** 1. Jo Swinson  
2. Secretary of State  
**From:** Robert Faulk ShEx – tel: **GRO**; mob: **GRO**  
**Date:** 12 November 2013



Department  
for Business  
Innovation & Skills

**Subject: POST OFFICE LIMITED – DIRECTORS' REMUNERATION**

**Purpose:**

Consideration of POL's proposals for a Short Term Incentive Plan (STIP) and a Long Term Incentive Plan (LTIP) for its two executive Directors for 2013/14.

**Recommendation:**

That you:

- approve the proposals (see detail at Annex A) which broadly carry over the existing LTIP framework (although with tighter metrics) for Paula Vennells and Chris Day and the existing STIP for Paula. The proposal also brings Chris Day's STIP framework into line with Paula's; and
- note that there is no increase in the maximum payments that they could receive and base salaries are frozen.

BIS's Senior Remuneration Oversight Committee (SROC) has reviewed the proposals and is content for them to be passed to you. The initial reaction from HMT officials is these proposals can be put to CST.

**Timing:**

Routine but we are already well into the financial year and should aim to clear with HMT during November.

**Summary:**

**STIP**

- No increase to the maximum payments for Paula Vennells (CEO) with her STIP framework broadly remaining the same as last year.
- The threshold targets have been tightened for the STIP and three of them (instead of one last year) are now the same as the on-target metric.
- At ShEx's request, Paula Vennells personal metrics include work driving cultural change in the business and the development of its public benefit purpose to take forward the mutualisation project.
- Chris Day's current STIP framework to be replaced with CEO STIP framework to give consistency.
- Chris Day's potential maximum bonus to be reduced from 90% of salary to 67%.
- Clawback provisions improved.

**LTIP**

- No change to existing framework agreed for 2012/13 but proposed changes to the targets:
- Streamlining of LTIP targets from 4 to 2 targets to cover long term objectives of maintaining the network and financial sustainability.
- Threshold provisions on profitability metric tightened from 70% to 80% of target to drive performance) ie no payments unless 80% of the on-target metric is achieved).
- Clawback provisions improved.

Further detail is set out at Annex A.

## Background

1. The Secretary of State holds a special share in POL and any changes to the executive Directors' remuneration requires his consent. The Directors' remuneration will be reported in POL's annual report (likely to be published June/July 2014).
2. POL has previously provided benchmarking which showed that compared to equivalent sized FTSE 250 companies Paula's base salary was 40% below the lower quartile and Chris' 20%. In terms of LTIP payments POL's benchmarking suggested that main Board Directors would receive 140% of salary at stretch%.
3. It is clear from our past discussions with the POL Remuneration Committee that, on the basis of their benchmarking, they wished to increase the base salaries for both Directors. We strongly advised against this and the REMCO has not put this forward on this occasion.
4. POL's proposals effectively mean that Paula Vennells' potential remuneration is frozen for a second year and Chris Day's potential maximum bonus has been reduced.
5. We wish to retain both Directors who are more than half way through the transformation programme and do not believe that it would be appropriate to seek further downward pressure on executive pay for this year.

**Copied to:** Cable MPST, Anthony Odgers, Will Gibson, Mike Whitehead, Peter Batten, Tim McInness, Cable SPAD, Stephen Darling

### Advice received from:

Finance	SpAds	Press	Legal	Analysts
Yes - SROC	N/A	N/A	N/A	N/A

**Annex A****Detail****STIP****a) Paula Vennells**

1. No change to CEO STIP in terms of structure and potential payments. She can receive a maximum of 80% of salary if the full stretch target is achieved and 48% for on-target performance. The targets are split between operational targets set out in the POL Scorecard (80% of bonus available) and Personal Objectives (20%).

**Potential Payments**

	On-target (48% of salary)	Stretch (80% of salary)	Threshold (24% of salary)
Paula Vennells (Base salary £250k)	£120k	£200k	£60k

2. Following our discussions with POL's Remco, the STIP framework targets have been tightened at the lower end so that three of them only pay out for on-target performance and the threshold for the other three have seen the threshold limits raised from as low as 80% of target to at or above 96% when compared with previous years.

3. At our request, Paula's personal objectives also include specific reference to cultural change to build mutual ways of working and taking forward the stakeholder forum's public benefit purpose work to drive Ministers' mutualisation agenda.

4. We **recommend** that the 2013/14 STIP be agreed on the basis that there is no fundamental change, the metrics have been tightened and it would not be appropriate to unsettle the CEO (and endanger POL's transformation plans) by seeking a further remuneration reduction.

**b) Chris Day**

5. The POL Remco has decided to make changes to FD's STIP so that there is consistency in both the structure and potential rewards profile with the CEO.

6. Currently the FD's bonus award is wholly based on the Scorecard but with a multiplier based on his Annual Appraisal. Depending on his "box" marking, his bonus award could be multiplied by up to 2 giving a potential maximum bonus of 90% of salary. We have voiced strong reservations about the continuation of a methodology with such scope for subjectivity and POL's Remco has agreed to change this.

7. The proposal is for the structure to mirror that of the CEO but the maximum reward would be 67% of salary for achieving the stretch targets and 40% for on target performance. Under the FD's current STIP, the on-target reward is 30% but would be subject to the "appraisal" multiplier so could have been as much as 60%.

#### Potential Payments

	On-target (40% of salary)	Stretch (67% of salary)	Threshold (20% of salary)
Chris Day (base salary £215k)	£86k	£144k	£43k

8. We consider that the changes to the FD's STIP be approved on the basis that:

- they align the CEO and FD framework;
- the overall maximum reward is reduced by 23%; and
- the overall reward for the FD as a percentage of salary is lower than that for the CEO (in line with common practice).

#### c) Target Metrics

9. The POL 2013/14 Scorecard and the personal objectives for the CEO and FD are set out at Annex 1.

10. We are content that the operational targets are appropriately linked to the transformation of the business - the metrics are in line with the Strategic Plan and Annual Budget, have been tightened at the lower end compared with previous years and are, therefore, considered to be robust. The Personal Objectives are SMART and cover BIS's shareholder interests.

#### LTIP

11. No changes are proposed to the LTIP rewards. The max rewards for the CEO are 70% of salary for on-target performance and 98% for achieving the stretch target. For the FD, the corresponding figures are 35% and 49%.

#### Potential Payments

LTIP	On-target	Stretch	Threshold
Paula Vennells	£175k (70% of salary)	£245k (98% of salary)	£61.25k (24.5% of salary)
Chris Day	£75.25k (35% of salary)	£105.35k (49% of salary)	£26.3k (12.25% of salary)

12. The structure remains broadly the same with a gateway target and a primary target, however, following our engagement with the Remco, the threshold targets have been made more stretching than in previous years to ensure that the LTIP begins to pay out when at least 80% of the profit target is

met, as opposed to 70% in previous years. The 2013/14 LTIP will pay out against the targets in 2015/16.

13. The one change is the streamlining the number of targets. For the 2012/13, the targets were:

Gateway 1	POL has to have adhered to Access Criteria and provided at least 11,500 post offices
Gateway 2	Completion of 6,000 Network Contract Conversions
Primary 1	Net income
Primary 2	Crown Office deficit reduction

14. The proposal for 2013/14 is for the following target:

Gateway 1	POL has to have adhered to Access Criteria and provided at least 11,500 post offices
Primary 1	£0m Earnings Before Interest and Tax, Depreciation, Amortisation and Subsidy (EBITDAS)

15. The POL Remco's reasoning for the change is that the LTIP should be designed to reward sustained performance over the long term. POL wanted performance measures that would maintain the network and link to the financial stability of the company. It also wanted to have targets that were not replicated in the STIP.

16. The Gateway on access criteria is the same as before and it is something that the Treasury wished to be featured in the LTIP.

17. We are content to accept the removal of the second Gateway target. It was highly unusual to have two Gateways (the previous LTIP only had two because of HMT's wish to include the access criteria as a target). The number of conversions will be a specific target in the STIP and strict monitoring regimes will be required under the funding agreement relating to the relevant period (currently under discussion).

18. The EBITDAS target is consistent with the POL Strategic Plan and reflects a break even position for POL in 2015/16. This would be an improvement of £61m over the previous year. We are content to accept this as to achieve this figure POL would have had to have put in a good performance on both the previous targets (net income and reducing the Crown Office deficit – which is forecast to have been eradicated by 2015/16 in any event).

### **Clawback**

19. The clawback arrangements for both the STIP and the LTIP have been strengthened.

20. The key features are:

- the clawback period is 3 years;
- individuals would be subject to clawback:
  - if there was a mis-statement of the results;
  - if there was an error in calculating any performance achievement; and
  - gross misconduct (which only came to light later) that would have resulted in the individual being dismissed.

21. Amounts can be clawed back from:

- future STIP bonuses;
- outstanding LTIP awards; or
- if the individual has left repayment will be sought.

22. There is also a "Cross-Clawback" which means that the Remco can reduce the STIP award to give effect of a clawback provision in the LTIP (and vice versa).

Shareholder Executive  
November 2013

Annex 1

Proposed Post Office Scorecard for 2013/2014

Key Performance Indicators		Bonus %	2012-13 results	Threshold 2013/2014	Target 2013/2014	Stretch 2013/2014
<b>Growth</b>						
Total Net Income (excl NSP) £m	Existing	20%	902.4 <sup>1</sup>	890 <sup>2</sup>	900	920
Operating profit £m	Existing	25%	94.2	102	102	120
<b>Customer</b>						
Easy to do business with	New	20.0%	41%	44%	44%	46%
<b>People</b>						
Engagement Index % (Quarterly)	Existing	10.0%	65.0%	12-13 outturn held	12-13 outturn +1%	12-13 outturn +2%
<b>Modernisation</b>						
Crown Profit (Loss) £m	Existing	12.5%	(37)	(23)	(23)	(20)
Network Conversions	Existing	12.5%	1450	2,880	3,000	3,600

<sup>1</sup>2012/2013 is a 53 week year

<sup>2</sup>2013/2014 is a 52 week year

## **Personal Objectives for the Chief Executive**

### **1) Talent**

Continue to build on the progress made to increase the capability and effectiveness of the ExCo and SLT to give the PO the leadership it needs to deliver the Strategic Plan over the period to 2020.

- a) present the June Board Awayday with plans for reshaping the ExCo (size and composition) with a clear timetable for making the changes. Implement these in the light of the discussion.
- b) continue to increase the effectiveness of the ExCo as a whole through team-building, clear prioritisation, and the increased accountability of its members, both individually and in partnership with colleagues: change ExCo ways of working by end Q2; review individuals' objectives quarterly, self-led to drive accountability.
- c) following the presentation to the June Board Awayday and taking account of inputs from this, ensure that by end Q2 there is an updated plan in place for raising the capability of the SLT, including succession to the ExCo. (This should continue to focus on improving diversity, on effective performance & potential assessment and should complement the strengths of current ExCo members.)

### **2) Culture**

Lead the delivery of a redesigned organisation and the cultural change necessary to deliver the Strategic Plan over the period to 2020, with two particular emphases: firstly increasing its commercial capability, its pace and its cost focus; and secondly, introducing changes to engage mutual ways of working as outlined in the Patrick Burns report.

Present the June Board Awayday with plans and milestones for making these changes and lead their implementation in the light of the discussion.

Update plans by end July 2013. Provide two further updates to the Board throughout the year.

### **3) External Relationships**

Continue to develop relationships with key stakeholders to create a helpful and supportive climate for implementing the Strategic Plan over the period to 2020.

Focus this year especially on creating active and strategic discussions with key commercial partners:-

- a) the multiples - demonstrate a step change in the relationship to ensure they are engaged at the right level and in the right way to maximise the successful delivery of the NTP. Ensure all majors are visited at CEO or Director level during this year.
- b) Royal Mail - stay close to RM during the privatisation period, and ensure that the Post Office is vigorous in its drive to create value with RM in exploiting the growing parcels market. Click and Collect launch by end of Q2; Drop & Go and discount offers by Q3; introduce CEO mails review twice a year.
- c) Bol - ensure that the Post Office manages its relationship with the Bank, to include: regular meetings at CEO/Chair level; bolstering PO director level support (end Q1); sponsoring mutual ways of working and joint team building (two joint meetings a year); ensuring clear joint milestones are in place by end Q2, in order to deliver the step-change planned in FS.
- d) Public Purpose - continue the work to produce a public purpose for the final meeting of the Stakeholder Forum (Q3) to recommend to the PO Board and to Government. Work with the Board, Government and stakeholders to plan the next phase - to include metrics, methodology and oversight (Q4).

## **Personal Objectives for the Chief Financial Officer**

### **1. Managing business performance – hitting the numbers:**

- Hold ExCo colleagues to account for additional deficit reduction challenge
  - ❖ £102m PBIT / £12m deficit reduction
- Identify “CFO stretch” top line target
  - ❖ £5m identified H1 / delivered FY
- Implement NT performance scorecard
  - ❖ Performance scorecard effective end Q1 / driving decisions

### **2. Driving commercial value – delivering a commercial business:**

- Create Financial Services schematic P&L to enable devolved profit responsibility
  - ❖ FS P&L (H1)
  - ❖ FS / Commercial revenue growth targets achieved (H1/FY)
- Implement simple financial model to support commercial assessments for pricing / sales purposes
  - ❖ Model developed and embedded (Q3)
- Refocus Procurement to drive savings through
  - improved commercial / contractual negotiations (nb risk appetite)
  - tighter “in-life” contract management
    - ❖ £3m direct savings achieved

### **3. Strategic cost reduction – reducing fixed costs by 20% by 19/20:**

- Lead definition and adoption of new target operating model
  - ❖ TOM agreed (Q1)
  - ❖ Efficiency opportunity defined (Q2/Q3)
- Define Service Delivery activity scope and shared services / outsourcing opportunity
  - ❖ Conditions created to maximise 14/15 FY cost savings

### **4. Delivering an effective Corporate Financial Strategy, setting the course for financial self-sufficiency:**

- Secure funding for 15/16 and 16/17 (plus State Aid approval)
  - ❖ Funding secured (Q2)
  - ❖ State Aid approval (Q4/Q1 14/15)
- Treasury
  - Reduce cashflow volatility whilst continuing to improve working capital management
    - ❖ WC improvement target £10m

- Tax
  - VAT recoverability
    - ❖ Exceed plan target by £10m
  - Corporation tax transfer
    - ❖ Complete (Q1/Q2)
  - Sale of tax losses
    - ❖ Realise £5-10m

**5. Implementing a FTSE 100-standard framework of financial controls, financial reporting, finance systems and internal audit:**

- Financial system separation from RMG with updated Management Information by September 2014
  - ❖ Key 13/14 milestones (time / budget) hit
- Continue to improve external reporting narrative; clear and consistent CFO messaging / no surprises
  - ❖ 12/13 ARA “fit for purpose” and published (Q1/Q2)
  - ❖ HY trading statement published (Q3)
- Raise Risk Management to “plc standard”
  - ❖ ExCo risk appetite and PO risk footprint established (H1)
- Maintain new quality benchmark of internal / IT controls
  - ❖ Clean 12/13 audit (Q1); no new material findings at interim (Q3) – ARC to verify

**6. Building a FTSE100 – standard finance capability which drives commercial value and ensures value for money on all spend:**

- Increase effectiveness of FLT in people development / capability build
  - ❖ Finance Competencies implemented (Q1/Q2)
- Coach Direct Reports to increase contribution on strategic issues / SLT debate
  - ❖ Peer review of Finance functional effectiveness (Q3)

**7. Visible leadership – internally and with key stakeholders:**

- Deliver Project Robin pensions solution (or alternative at affordable cost) through Trustee/Board/Union negotiation
- Build Union/NFSP/BiS engagement on PO financial plan
- BOI/FRES role