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Date: 15 January 2020
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Kelly Tolhurst MP (Minister)		X
Permanent Secretary	X	
Special Advisers	X	
Secretary of State	X	

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UPDATE ON THE GOVERNMENT'S SPENDING REVIEW FOR POST 2021
SUBSIDY AND DRAFT LONG-TERM VISION FOR POST OFFICE LIMITED

Summary

- 1) This submission provides a further update on our long-term vision project on the Post Office, with the immediate priority on developing a robust post 2021 Spending Review (SR) case. The purpose is to update you ahead of your meeting with Nick Read on 22 January (briefing submitted separately). Your steers will help inform:
 - (a) our immediate steps working with UKGI to obtain and scrutinise the best available evidence to support POL's expected subsidy request for up to £50m p.a
 - (b) our proposed refreshed definition of the Post Office's 'social purpose' and an engagement plan to test this with a broader set of stakeholders and
 - (c) the medium-term approach to reviewing the network size and access criteria

Timing

- 2) Routine in advance of meeting with Nick Read on 22 January.

Recommendations

- 3) That you:
 - (i) **confirm** that you are content for BEIS (and UKGI) to work with POL to develop a SR bid for up to £50m p.a. We would like to provide you with fuller advice in late February 2020, together with an assessment of the strength of the business case
 - (ii) **agree** to us developing and testing our approach to define a clearer, relevant and impactful social purpose with key government and external stakeholders and
 - (iii) **agree** to us developing a SR bid based on the current network size and access criteria and explore the case for changing these in the medium term
 We can also discuss these points with you at our meeting on 27 January.

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Background

POL's 5 Year Plan (5YP)

- 4) Nick Read has commissioned McKinsey to work on POL's Five-year Plan (5YP) and 'Purpose, Strategy and Growth (PSG); two strategic pieces aimed at setting a new vision for the company and make strategic investment choices ('big bets'). The BEIS policy team and UKGI expect to see the draft 5YP following the January Board meeting (and a further iteration in February) with the aim of feeding into it ahead of it being agreed at the Board meeting on 24 March. It will then be submitted to you for approval.

SR preparation and case for a post 2021 subsidy

- 5) POL recently provided data on their uncommercial network (as an initial response to our SR commission– see Annexes A and B). BEIS analysts are currently reviewing this data and UKGI plan to procure external assurance support during February-March (paid for by POL) to scrutinise this and the 5YP.
- 6) Although POL have said in writing that they will not ask for any further investment funding, through a recent discussion with POL's Finance Director, we understand POL intend to seek the continuation of network subsidy at or slightly below the current level of £50m p.a. As discussions continue with POL and we obtain more information, which will give a better understanding for us to test POL's proposed level of subsidy. Given that the Government expectation when the 2018-21 funding was agreed was for POL to become commercially self-sustaining by the next SR, we recognise the need to provide HMT with a robust SR case that explains why a zero-subsidy option would pose a significant risk to the operation of the uncommercial network.
- 7) In addition to the subsidy, currently POL have a one day £50m Working Capital Facility (WCF). POL will also request a renewed £950m WCF but may need some of the security definitions relaxed to avoid needing to increase the figure.
- 8) POL have also indicated that they plan to request a loan facility to borrow for material investments, but it is unlikely that HMT will agree to this due to the uncertainty about the timing, size and nature of what their spending would be for. We will explore this further, as we receive more information from POL.
- 9) POL do not consider it feasible to be able to make dividend payments to the Shareholder as a part of the next SR settlement, due to the need to finance significant ongoing investment. However, as BEIS maintain the right to take dividends, this will need to be monitored. We will test this further as a part of our SR bid preparation.
- 10) Obtaining the relevant State Aid approval, getting the final Funding Agreement updated and sign-off the updated WCF require careful sequencing, given the interdependencies and the possibility the SR may be pushed back to the Autumn.

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For example, POL's 2019/20 accounts need to be validated by auditors by December 2020 (in compliance with accounting obligations under the Companies Act). To be able to do this, the auditors will need to be comfortable at that point that POL is a going concern and so a new WCF will need to be in place to cover the period post-March 2021. Further, pre-notification discussions with the EU Commission will need to commence by May 2020 to secure necessary compliances e.g. SGEI Framework and State Aid regulations. It is therefore necessary for Government to have an agreed position– at least in principle– on the continuation of subsidy post 2021 before approaching the European Commission in May.

Further Update on the Long-Term Vision project

11) In our advice of 23 October 2019, we set out the key strategic questions on the Government's future aspiration for the Post Office in 2030 (and rationale for a future subsidy). These included the network size and access criteria (taking account of changing market trends), social purpose and future government services offer, given the shift to digitisation and relevance of cross-government strategies. You have agreed that these are the right questions. During purdah, we have:

- kept abreast of the direction of POL's PSG work lead by McKinsey and held a discussion with POL's Finance Director on their emerging SR bid
- worked with OGDs (particularly MHCLG, DCMS and DWP) to develop clearer thinking on the future role of the social purpose and future government services offer via POL. We have also lead discussions with the Financial Conduct Authority and Payment Services Regulator on their aspirations to increase regulation to secure access to cash in future years and
- reviewed the available evidence on the strengths and weaknesses of the current network and access criteria and potential opportunities to make future changes. Although there are lessons to be learnt from a variety of international comparators, in many cases this is complicated due to the individuality of the separation of Royal Mail and POL.

12) On this basis, we think the key objectives for the longterm vision in 2020 are twofold: (a) to define a **clear, relevant** and **impactful** social purpose and (b) ensure that Government's network and access criteria help strike the **right balance** between supporting POL's commercial growth and meeting the accessibility requirements of citizens, particularly the most vulnerable. To achieve these objectives we will need to work with POL and cross-government stakeholders to develop a clear plan and tangible outcomes and test these with key stakeholders e.g. Citizens Advice, Plunket Foundation and NFSP.

Advice

SR case for continued post 2021 subsidy

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- 13) Based on initial discussions with POL, they are likely to request funding for the next SR period at or slightly below £50m p.a. (current amount). This is disappointing but not unexpected given POL's initial analysis that shows that 50% of POL's network revenues are driven by just 14% of branches. Excluding the Directly Managed Branches (DMB) network, loss-making branches (those in unprofitable locations) account for around 45% of POL's network and c£73m loss (2018/19). On this basis we can see a case for a level of continued subsidy, particularly to ensure access for a range of SGEIs, including government services for the most vulnerable in society e.g. digitally excluded and SMEs in rural locations. Citizens Advice, ACS and the recent Select Committee report on the Future of the Post Office Network have also highlighted the importance of the Post Office's role in ensuring access for these groups, particularly those on low-income and older customers. However, we have not yet received all the data that will allow us the opportunity to scrutinise the case for POL's desired subsidy level. We may want to consider requesting from HMT a subsidy on a declining trajectory over the funding period (and potentially a dividend). **Are you happy for us to start to work up a bid with POL?**
- 14) In any event, as it will be essential that Government collects better data on how the subsidy is spent and to monitor the on-going demand for SGEI services offered through POL's network. We are therefore considering additional conditions to a possible subsidy for the next Funding Period. For example placing a requirement of POL to provide us better, more regular and granular data on the uncommercial network and for an SGEI audit to be carried out annually. assessment to help provide the Accounting Officer with more robust VFM assurance. We would like to provide you with fuller advice on this in late February.
- 15) Further, whilst to date there has been a political imperative of maintaining the current network size and access criteria, POL's PSG work has taken account of changing consumer trends and indicated POL's interest in exploring a refreshed minimum product offering, given the changing demand for services^[3]. POL think this could open the door for more diverse branch formats^[3] enabling a change in the network size and potentially also a minimum service offer e.g.. change in SGEIs for those citizens who prioritise 'convenience' and increased roll-out of automation via self service kiosks.
- 16) BEIS policy and UKGI agree that these opportunities are worth exploring further with POL; however, for presentational and potentially public law reasons it will be difficult to make any changes to any one or combination of the network size, access criteria and SGEIs ahead of the next SR. This is because these changes would require a formal consultation, so that the public and key stakeholders, particularly those affected, have a fair opportunity to be consulted. Given the extent of those affected it is likely it would need to be a longer (e.g. 12 weeks) rather than shorter consultation. Consultation have to be carried out in a fair manner to minimise the risk of a Judicial Review. Therefore, we believe it is unlikely to be feasible to formally consult on changes ahead of the SF. However, we would like to explore the prospect of a consultation, particularly in light of POL's 5YP with the aim of a potential launch post SR/late 2020. **Are you happy therefore for us to**

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assume for our SR bid that we should be looking to retain the current network criteria?

Next Steps on the Long-Term Vision work

Social Purpose -delivering a clear, relevant and impactful future social purpose

17)The social purpose is currently defined by the Post Office's access criteria (see Annex C), ensuring members of the public live within reasonable distance from a branch, and the delivery of Services of General Economic Interest (SGEIs)¹. Government provides a subsidy to support POL in fulfilling these requirements, even where it is uncommercial to do so. Cumulative evidence demonstrates that branches and postmasters add additional social value to their local communities², however the current definition does not capture this nor the significance of these services for the most vulnerable in society. Therefore we need to take a three-pronged approach to developing and delivering a clear, relevant and impactful social purpose for POL:

- (a) we need to drive initiatives that **deliver social and economic value** to all citizens, SMEs and local economies. This is critical for the access to cash agenda which is central to both POL's social purpose and its commercial growth. POL have identified the potential for growth of their banking and financial services due to the rise in bank branch closures and changing consumer trends in the use of cash. Evidence² suggests that, although the number of cash transactions has been declining, 17% of the UK population would be unable to cope in a cashless society, which places POL in a unique position. Therefore, it is vital that we work with HMT to ensure that Government sets a clear vision for access to cash and POL's role in maintaining a physical cash infrastructure and supporting the financial inclusion agenda e.g. via POL's existing self-service ATMs and SSKs;
- (b) we need to **re-frame** the role of the Post Office in providing declining government services (40% revenue decline over 5 years) to being the **backstop** for key services for the most vulnerable e.g. digitally excluded (ONS suggest this is around 10% of GB). We have had early discussions with DCMS libraries and DWP to explore their appetite for co-locating their key services with Post Offices but will also need to test this further with POL to identify suitable branch types and location; and therefore
- (c) we need to **develop an evidence-based definition** (with KPIs) that reflects the requirements of the most vulnerable, fosters local innovation amongst postmasters for their communities, supports community cohesion and supports POL drive the delivery of key cross-government strategies e.g. net zero, loneliness etc

¹ SGEIs are listed in the 2018 Entrustment Letter under five categories— processing benefit and tax payments, processing identity and licencing applications, payment of public utilities, postal services, and banking services

² BEIS & London Economics, *The Social Value of the Post Office Network*, 2016; Select Committee Inquiry 2019 – Written and Oral evidence.

³ Access to Cash Review, Final Report, 2019

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- 18) Following discussions with key OGD stakeholders to develop a definition, we propose testing and iterating this through informal consultation channels e.g. developing a script for you to use with relevant stakeholders such as NFSP. In the medium-term data collected on the uncommercial network via the subsidy conditions could be used to refine the definition and develop clearer KPI to ensure the social purpose is impactful. **Do you agree that the future social purpose for the Post Office should be based around (i) support for the vulnerable, (ii) community cohesion and (iii) access to cash & financial services?**

Size of the Network and Access Criteria

- 19) Whilst the network size and access criteria were set in 2012 and reviewed in a 2016 consultation, a combination of factors suggests that the current framework is unsustainable in the longer term and will require a review. However, for the reasons set out in paragraphs 16 and 17, it will not be feasible to run a formal consultation as timings will cut across the SR (whether it is in June or Autumn). Given the sensitivities linked to any change in network size, access criteria and/or SGEIs we propose to in the short term work with POL to develop a careful handling plan that helps lay the groundwork for a launching a consultation in the medium term i.e. late 2020 or early 2021. **Are you happy for us to look further at whether there is a case for reviewing the network size and criteria in the medium term?**
- 20) In the short – medium term we also need to review key issues linked to outreaches which may help inform our longer term approach. There has been a **significant rise in outreaches** which are all loss-making branches and have more than doubled (900 to 1600) in the last ten years, resulting in £5.7m loss in trading profit (Jan 2020). Whilst these plug a gap in smaller and remote communities (following closures), the outreaches solution currently allows POL to meet their access criteria requirements rather than citizen's needs. It is a limited-hours provision that is not sustainable and also creates burdens for postmaster^g. Therefore, in the short term there is a pressing need for POL to explore alternatives to outreaches, such as community hubs, and assess whether a different approach ahead of the next SR (within the current requirements) could be more effective. **Are you happy for us to set POL the challenge to explore alternative solutions to outreaches ahead of the next SR?**

Media Handling

None.

Contributors

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Annex A – BEIS and UKGI Joint SR Commission for POL

Preparations for the 2020 Spending Review– Post Office

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At this first stage, we are looking at evidence and information from the Post Office to support officials in considering policy options ahead of formally entering the Spending Review process. The aims of this exercise are to:

- gather evidence to enable us to estimate the value of the social purpose and the extent to which subsidy covers for the delivery of SGEIs throughout the uncommercial network; and
- develop thinking on the various SR scenarios for a post 2021 subsidy.

The Post Office is required to deliver a social purpose to customers across the network. This includes the universal delivery of SGEIs, physical access across the UK particularly for the most vulnerable customers and those in remote locations and the broader social value provided by postmasters to local communities. Therefore, a subsidy is paid in return for delivering a key element of the social purpose— to maintain a presence in locations that are uncommercial and delivering SGEI services. At this stage, we propose that we use the planning assumption that there is no change to the social purpose or accessibility criteria.

1. Preliminary Factual Questions *(deadline Early January)*

To help us better understand the cost basis of delivering the social purpose that Government requests of POL we have outlined a set of factual questions:

- 1.1. How many branches are uncommercial? What is the branch-type breakdown of these: outreaches, community, multiples, mains, locals. Regional breakdown. Urban v rural. Deprived v non-deprived?
- 1.2. How does POL categorise lossmaking branches and how many of these are in the network? Is the number growing, diminishing or staying broadly the same?
- 1.3. What are the costs of sustaining these? How are these costs made up?
- 1.4. Have POL made any assumptions regarding the number of branches that will no longer be lossmaking in the short-term due to recent measures including a) agent pay review and b) area managers?
- 1.5. Are there losses made by branches that you think are avoidable? If so, what further efficiencies can be generated in the loss-making network, where and how? Can POL make any of these branches more profitable?
- 1.6. How do you forecast the rise in NMW and potentially in business rates will affect branches (including lossmaking ones)? Are there any other external factors that are relevant?
- 1.7. London Economics/YouGov estimated the value of the Post Office network of between £4.3bn and £9.7bn per annum. Have POL done any other estimates of this? If so, can you quantify the benefits of the POL network on communities?
- 1.8. Which services are the most relevant for customers of uncommercial branches? How many customers regularly use these services?
- 1.9. Is the supply of services in uncommercial branches meeting or exceeding customer demand? Can you provide a breakdown of the spread of customer use/demand for services by region?

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- 1.10. What else is the subsidy spent on? Can you provide a breakdown for the current funding period? How does this compare to previous years i.e. 2012-2016/17?

2. Post 2021 Subsidy – Key Questions

To help us plan ahead of the formal SR process, we have set out three key questions for you which will help model possible scenarios linked to a post 2021 subsidy.

Our assumption is that the network will need to be maintained in each of these scenarios. You will recall when the last transformation fund/ subsidy was awarded, there was an expectation that this would facilitate POL becoming commercially sustainable, and therefore we do need to consider the zero-subsidy argument and consider using this in the business case argument.

i. Zero case: What would the impact be on POL if there were a requirement to deliver on social purpose without an ongoing subsidy?

- a) Could you provide scenario(s) on how this could be made to work without changes to the access criteria, highlighting the economic, social and commercial trade-offs?
- b) In addition to the base case, what alternative access criteria would you propose, and what would be the economic, social and commercial trade-offs?

ii. £xx case: What would POL request in subsidy to deliver on the social purpose?

- a) Based on POL plans, what subsidy would POL be seeking to request to deliver services in the current framework?
- b) What are the opportunities that this would deliver that would not be achieved under different support models?
- c) In addition to the base case, what alternative access criteria would you propose, and what would be the economic, social and commercial trade-offs?

iii. £x case: What would the impact be of 50% of the figure that POL is seeking?

- a) How would this vary POL's plans as set out in response to Q.2?
- b) Could you provide scenarios on how this could be made to work, highlighting the economic, social and commercial trade-offs?
- c) In addition to the base case, what alternative access criteria would you propose, and what would be the economic, social and commercial trade-offs?

Annex C – Definition of the Social Purpose (Framework Document)

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The below is an excerpt from the Framework Document, which is in the process of being finalised with POL.

“Governance and accountability

2 Overall aims

2.1 POL’s public ownership is founded on its social purpose, as set out in Appendix 3, and as amended by the Shareholder from time to time.

2.2 To deliver its social purpose, the Secretary of State has stipulated that the principal objectives of POL are the following:

- (i) to maintain, during the term of the Funding Agreement, a network of post offices beyond its optimal commercial size as detailed in the Entrustment Letter. A specific minimum branch threshold of 11,500 is specified by the Secretary of State in the Funding Agreement;
- (ii) in so doing, meet the minimum access requirements specified for this network of post offices as detailed in the Entrustment Letter; and
- (iii) provide this network of post offices to make available the services of general economic interest (SGEI) detailed in Annex A of the Entrustment Letter.

2.3 The Shareholder may also issue a periodic Chair Letter (the “Chair Letter”), which, while not legally binding, will typically:

- (i) provide clarity over the Shareholder’s shorter-term aspirations for POL; and
- (ii) ask POL to ensure strategic alignment with wider BEIS or Government policy objectives, where POL’s business is relevant to such policy, such as financial inclusion or the rural economy.

2.4 In delivering its objectives, the Shareholder expects POL to operate under sound commercial and financial principles, and in accordance with all applicable laws, seeking to deploy its capital, brand and products as a responsible commercial operator and manage risk to deliver positive financial returns, notwithstanding the network requirements in paragraph 2.2 above.”

APPENDIX 3 TO SHAREHOLDER RELATIONSHIP FRAMEWORK DOCUMENT

POL Social Purpose

POL’s current agreed Social Purpose is as follows:

“The Post Office is unique: a commercial business set apart by its public purpose. We believe in the importance of connecting communities and enhancing the powerful role they play in all our lives. We will stay true to this commitment by meeting customer needs through our unrivalled local presence across the UK.

This statement is underpinned by a set of principles and pledges.

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To deliver our purpose POL run our organisation by following four principles:

- Keep customers at the heart of everything we do
- Build relationships based on trust
- Treat everybody with fairness and honesty
- Make a positive social and economic contribution to all the communities in which we work

As an organisation POL pledge to:

- Maintain ethical attitudes in our behaviours
- Invest in the organisation to secure the business for the future
- Listen with care to the views of customers, colleagues and others with an interest in the Post Office, and support their development