CEO's Report – March 2015

1. Introduction to this month's Board and overall strategic priorities

- Ahead of our final Board meeting of this financial year, I want us to celebrate the unprecedented pace of transformation now underway across the business, and draw confidence from this as we accelerate our turnaround plans further in 2015-16. This report provides more detail on developments over the last month, but I would highlight:
  - We have had a number of recent successes across our product portfolio: signing the new POCa contract to safeguard the service for a further 7 years; reaching a successful conclusion on the valuation of the general insurance business to support our buyout from BoI; and launching the public trial of the Post Office's identity assurance service 'Verify';
  - With the Board's support, we have taken greater control of the Mediation Scheme by closing the Working Group, and through adept stakeholder handling seen negligible press coverage;
  - We are well ahead of targets for Network Transformation with 5,000 contracts now signed and the 4,000th transformed branch opened;
  - I am personally delighted by the increases in positive engagement across both our postmasters (up from 44% to 45%) and staff (up from 58% to 62%). This would be worthy of celebration in any event, but is even more remarkable at time of very significant change, and reflects both strong leadership and open and honest engagement with our people;
  - And finally, the move to the new Customer Support Centre in Finsbury Dials on the 16th March has been a great success, with excellent feedback from staff and a real buzz around the office. I am already seeing the benefits of the Group Executive beginning each day around the 'hub' and I am confident this move will be a decisive enabler of a more open, collaborative and agile working culture across the Post Office.

Key issues for discussion at this Board:

- We have three substantive topics for discussion at the March Board meeting:
- Firstly, I have asked Nick to provide the Board with an update on how we propose to exercise our option to buy the Bank of Ireland's share of the joint ***insurance business (Hawk)***. As you know, the Independent Insurance Expert (IIE) concluded that the valuation of the Business is £43.9 million and, whilst 9.8% outside the Board mandate, this is within the Post Office's value horizon.
- The Board is asked for approval to allow management to proceed with the acquisition of BoI's share of the Business at the given valuation, and approval to negotiate potential alternative structures with the BoI, which could allow us to utilise POMS to pursue an investments strategy. Alice and I had a positive and constructive meeting with Christopher Fisher and Des Crowley from the Bank on the 11th March, which confirmed both their interest in continuing to work with us on general insurance and a shared commitment to developing the broader partnership between POL and BoI.
- Alisdair will then talk us through the latest in-year financial performance followed by leading a discussion to seek the Board's approval of the ***financial plan and scorecard***

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for 2015-16. At the Board in January we discussed a draft of the financial plan which was designed to reduce the EBITDAS loss from £64m to £34m. The latest version of the plan addresses the Board's feedback, and is substantially more realistic than both the previous year's plan and the draft submission in January. Al and I have led challenge sessions to review the assumptions underpinning income projections for next year, and the Group Executive has reviewed the plan on two occasions. This version sees a reduction in net income to reflect the removal of optimism bias and creation of contingency, offset by additional cost reductions to retain the EBITDAS target at -£34m. Whilst more realistic it is important to note that the plan remains challenging.

- The ***KPI scorecard*** builds on the changes agreed with the Remuneration Committee, and includes financial targets focusing on EBITDAS, digital income, and refinements to the customer satisfaction measures. The scorecard also proposes further changes to the non-bonus related metrics to rationalise them in number, following discussion by the Group Executive.
- Finally, Martin George and Geoff Smyth have prepared a paper to facilitate a Board discussion on the strategy for our ***telephony*** business, and specifically our homephone and broadband services. At the June Board Awayday last year we agreed to prioritise the mails and financial services businesses, recognising that telephony, along with government services, would be secondary pillars going forward. Given this, I wanted the Board to have the opportunity to review the strategic options available to us for the telephony business, and in particular whether it should be retained as part of our group portfolio or divested to release capital and reduce management distractions.
- The paper provides analysis of a range of options and seeks the Board's agreement to retain and grow the business, at least in the short-term. This recommendation recognises the positive (and growing) Direct Product Contribution the business provides, with minimal funding requirements and a low impact on the network. We could then resume talks with potential partners to discuss divestment and franchising to our timetable and as they are allowed by the regulator.

2. Commercial and business performance overview

Overall performance

- Net income in February was favourable to budget driven primarily by the additional revenue for the new POCA contract. Total expenditure also remains favourable to the budget, meaning the £99m EBIT target is still within reach. However, the forecast remains in line with the update to the board in January of £95m-£97m. Our focus for the final weeks of 2014-15 remains on delivering income in line with forecasts and maintaining tight cost control.
- The CFO's Performance Report for this Board provides additional commentary on performance across the pillars so these are not summarised here to reduce duplication.

3. Other updates of note for the Board

Sparrow

- As the Board will know, Post Office announced on 10th March that it had completed all of its investigations under the Complaint Review and Mediation Scheme, and that it had decided to mediate all cases that had not been subject to a court ruling. In addition, Post Office published a 187 page report detailing progress on the Scheme so far; announced that the Working Group overseeing the Scheme was to close with immediate effect and gave notice of termination to Second Sight.

- Despite extensive hostile briefing by JFSA, there has been limited media coverage. PA ran a very short, balanced piece picked up by some regional media. There was a very hostile piece in Computer Weekly that does not seem to have been picked up and has now been amended to add more balance. In Parliament, James Arbuthnot attempted to secure an Urgent Question on 11th March. This was rejected but he was called as the first supplementary question at Prime Minister's Questions, suggesting that Post Office had "sacked" Second Sight and were attempting to suppress their Part Two Report – inaccurate on both counts. The PM committed Vince Cable to writing to JA and the Sparrow team have provided material to BIS in support.
- The priorities now are to progress as many cases to mediation as quickly as possible. Second Sight have also given us their updated draft of their "Part Two" Report which is intended to assist in the mediation process. Post Office will respond to that draft shortly.
- I am sure the Board will wish to join me in thanking Mark Davies and Jane Macleod in particular for their leadership in helping us take control of this agenda.

Digital income

- As mentioned earlier, the RemCo supported the proposal to include digital net income as one of the bonus KPIs for 2015-16. This reflects the increasing importance of this revenue stream for the business, with ambitions for 25% of net income to come from digital channels by 2019-20. As such, I thought it important to provide the Board with a short update on the work that is underway to secure this income, ahead of a fuller paper to the Board in May.
- The Board has heard previously of the significant progress made in separating our IT systems from Royal Mail, and of the successful creation of the Common Digital Platform to give us full control of postoffice.co.uk. Work is already underway to grow income generated from digital channels from 3% of net income in 2014-15 to 5% in 2015-16. This 5% assumed £6m income from online mail, but in the absence of a defined launch plan, this has since been removed. When the Group Executive reviewed these activities in January we asked the team to work up a plan to accelerate the growth in digital, recognising the stretch to our 2019-20 ambition. The team are now focussed on two streams of activity:
    1. *'Fixing the 'funnels'* to increase the proportion of online enquiries which result in a completed application, with a particular focus on Financial Services. This work includes improving our marketing to drive up visits to the website, making the website better at getting customers into the application journey and making it easy to complete the online application. We have already increased the target for online income to £24m in 2015-16 compared to an outturn forecast to be £15.5m in 2014-15 and early analysis suggests a potential additional revenue of £2m (6 months' worth of benefit) in 2015-16 from a further investment of £2.8m.
    2. A parallel stream of activity to '*own the customer*' and drive usage of a Post Office 'MyAccount' service. This service would allow customers to access

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their range of Post Office accounts, but more importantly drive cross-sell of additional products. This is a longer-term strategic development, central to delivering the FS strategy, and has the potential to return a further £3m income in 2015-16. Over 5 years, an investment of c£23m is forecast to deliver £70m additional revenue via this service.

- We expect these initiatives in financial services will enable us to deliver the original digital income target of 5% in 2015-16. And, once established, this focus can be applied across all pillars allowing cross-selling throughout our product portfolio.

Engagement with the NFSP and Unions

- We are reaching a critical point in our discussions with the **NFSP** relating to the MoU, NT Cliff and Network Extension and I therefore wanted to update the Board on progress. As part of the settlement we reached with the NFSP relating to the 2013 NT funding, the Board endorsed the establishment of a 15 year agreement with the NFSP, the agreement itself dependent upon the NFSP re-structuring their organisation and supporting the Post Office in the delivery of NT, particularly elements related to compulsion, noting that any network extension was excluded from the parameters of the MOU. We have made good progress in the last 12 months in achieving delivery of NT and moving the NFSP towards a position of supporting further business change including our plans for Network Extension. This is in an environment where we have yet to sign the Grant Agreement (GA) whilst maintaining our position of wanting to work collaboratively but only in circumstances that are right for the business – this approach has improved our position substantially.
- It should be noted that the NFSP continue to push for additional funding using the possibility of withdrawing support for NT and joining the CWU. Our approach has reduced their demand position significantly and we will continue to press for further agreement/concessions as we do not believe a merge with CWU is their preferred outcome (though this risk cannot be ignored). Our approach remains well within the mandate agreed with the Board and we will keep you updated on progress.
- We have now also secured agreement from both **Unite** and the **CWU** to a new Post Office pension arrangement which will be launched with effect from 1 April 2015. The scheme will be called the Post Office Pension Plan and is applicable to all employees who are currently in the Royal Mail Defined Contribution Plan.

4. Update on key change programmes

- Work is well advance to establish the necessary governance, processes and capability to implement our change programmes as an integrated portfolio. This includes strong central governance led by the Transformation Director, and activity is now being managed to an integrated plan through the Transformation Management Group. Particular attention continues to be given to the implementation of the new Front office solution given its business-wide impacts.
- Revised reporting is being developed to manage the portfolio of change programmes and it is our intention to introduce this for the Board in May. For this month, updates are provided to the existing format.

a) Crown Transformation Programme

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Status overview: 292 branches have now been transformed with 4 more expected by end of March, achieving the original target. Staff cost reductions, staff training and SSK implementations are all achieving or exceeding targets. Around 19 branches will not be franchised under CTP as no suitable partners have been secured. The P&L run rate for the retained Crown estate at March 2015 is forecast to be around £3m loss with P&L break-even run rate targeted for later in 2015.

Programme KPIs:	**YTD**			**2014/15 FY**	
	Target	**Actual**	**Period**	**Target**	**Forecast**
P&L run rate	[redacted]	-£7.6m	P10	[redacted]	-c£3m
Number of branches transformed	292	292	P11	292	296
Number of branches franchised	70	46	P11	70	51
Customer satisfaction in transformed branches	85%	84%	P11	85%	85%
Queue time satisfaction	85%	86%	P11	85%	86%

Key milestones ahead:

Milestone	**Target date**	**Current status**
292 retained branches transformed	By end Mar 15	292 complete, 296 transformed by end-March
70 franchises live	By end Aug 15	On track to deliver 50
505 Self Service Kiosks rolled out	By end Mar 15	Complete

b) Network Transformation Programme

Status overview: The programme is on target against all key metrics, and end of year targets have already been achieved for both contracts signed and branches open. The programme continues work on implementation plans for the 'cliff', including engagement with the NFSP as discussed earlier in this report.

Programme KPIs	**YTD (P11)**		**2014/15 FY**	
	Target	**Actual**	**Target**	**Forecast**
Contract signed (cumulative)	4,555	4,886	4,800	4,950
Branches Open (cumulative)	3,523	3,894	3,708	4,000
Customer Satisfaction (all branches)	90%	97%	90%	97%
Operator Satisfaction	70%	74%	70%	75%
Average increase in opening hours	40%	70%	40%	69%
Cost reduction (in-year cumulative)	2,056k	3,170k	2,500k	3,824k

Key milestones ahead:

Milestone	**Target date**	**Current status**
4,800 contracts signed	End March 15	On schedule (currently ahead of plan)
3,708 converted branches open	End March 15	On schedule (currently ahead of plan)
Agent scorecard trial evaluation complete	End of Mar 15	On track
Cliff management – 'Come on the journey' letter	End of Mar 15	On track
Transitional locals – Final Tranche	End of May 15	On track
Cliff management – Notice of contract change	End of Jun 15	On track
Cliff management – Deadline for signing a contract or CRP	End of Dec 15	On track

c) 'Win in Mails'

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Status overview: The build of the Access Point solution continues, including the additional products required by retailers. Taking the learning from the Ivy trials, the project has decided not to trial a mails only solution in May 2015, but instead launch when the minimum viable solution for McColl's is available in spring next year. This will include a more developed payments proposition to take on our main competitors.

The Win in Mails milestones and dates are in the process of being re-baselined following submission of a new business case for 15/16 scope.

d) Business Transformation (Transition to Delivery)

Status overview: The programme is coming to the end of the transition phase to establish the foundations and governance to commence delivery from April 2015: TMO Design, governance bodies and thematic programmes.

Transition Phase Key milestones ahead:

Milestone	Target date	Current status
Governance bodies operational	End Mar 15	Design Authority Group delayed pending the appointment of the Head of Business Design
Transformation Management Office (TMO) operational	End Mar 15	On track
Delivery programmes operational	End Mar 15	On track
Assess Success Criteria	End Mar 15	On track

e) Separation

Status overview: The programme remains on track to deliver as expected and achieve the agreed MSA target completion date. 257 sites have now separated onto the Post Office IT Network, leaving a further 87 to separate.

Programme KPIs	YTD (P11)		Full programme	
	Target	Actual	Target	Forecast
Separation of IT systems	148	148	256	256
Separation of Business Services	120	120	131	131
Finance – headcount reduction	27.5	27.5	27.5	27.5

NB The team will also be monitoring the number of post -launch incidents for the newly separated systems such as Finance and HR.

Key milestones ahead:

Milestone	Target date	Current status
HR: Nemo Go-live	End of Mar 15	On track
HR Common Components separated	End of May 15	On track
Networks site migration end	Apr 15	On track

f) IT Transformation

Status overview: The **Front Office** procurement remains on plan with three bidders (CSC, IBM and Accenture) submitting proposals on time and the preferred bidder decision due in April. Our ability to successfully complete the implementation by March 2017 remains a key business risk and is the focus of significant management attention. Negotiations continue with Fujitsu on potential extension mechanisms to ensure service continuity.

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The **Back Office** workstream has been re-started following conclusion of the BPO review, and an impact assessment is underway. We are currently targeting procurement to start from April and initial estimates for Contract Award late August.

Programme KPIs	YTD		Full programme	
	Target	Actual	Target	Forecast
Towers Contracts Awarded	2	2	5	5
3rd parties transitioned to Service Integrator (SI)	90	90	96	96
SI operating model processes accepted	23	23	23	23
Financial savings	£0	£0	£25m	£25m

Key milestones ahead: * Dates re-baselined

Milestone	Target date	Current status
F/O Contract awarded	End May 15	On track
Network contract awarded	End May 15	On track
EUC Admin service commencement	Mid May 15	On track
B/O contract awarded	End Aug 15	On track
F/O Contract awarded	End May 15	On track
Network contract awarded	End May 15	On track
EUC Admin service commencement	Mid May 15	On track
EUC Admin service complete	End Aug 15	On track
EUC Branch service commencement	End Nov 15	On track

g) *People & Engagement*

Status overview: Executive sessions continue to develop the second wave of headcount reductions focused on the management population. Consultation on the changes is currently planned for mid-April to allow the process to conclude in July. Good progress has been made in reviewing the facilities time for CWU representatives. This work remains on track. The first of our Business Consultation Forums with the Unions took place this month, involving the CFO and other senior leaders in attendance.

Negotiations with the NFSP on the MoU are reaching a critical stage with discussions ongoing as referenced in Section 3. Work on the Post Office vision continues to develop through engagement with the Group Executive as well as colleagues and postmasters. We remain on track to present the Vision statement and approach to the Board in May.

Key milestones ahead:

Milestone	Target date	Current status
CWU facilities time review complete	Apr 15	On track
POL vision sign-off	May 15	On track
Grant funding for NFSP in place	May 15	On track
People and Engagement plan/leadership capability and capacity update to Board	May 15	On track
Wave 2 complete	July 15	Date re-baselined

h) Titan/POMS

Status overview: POMS commenced trading from 1st January with the business performing to date as forecast. The FCA "minded to approve" has been received with POMS targeting a stand-up date of 1st May (this is subject to Post Office Board approval). The key management focus is to bed down the new processes and close off the outstanding issues from the Grant Thornton report to enable POMS to take up its FCA authorisation.

At this meeting POMS will present its Plan for 2015/16 for Board sign off.

Programme KPIs	YTD (11 cum.)		Full programme	
	Target	Actual	Target	Forecast
Contractual relationships in place	13	11	13	13
Systems in place	4	4	6	6
Staff in place	5	3	6	6

Key milestones ahead:

Milestone	Target date	Current status
Strategic system implemented	End Aug 15	On schedule

i) Hawk

Status overview: The IE (Independent Expert) provided a valuation purchase price for the business within the expected tolerance. The Board will decide whether to proceed at its March meeting. Benefits will be realised from effective valuation date (October 2014).

Milestone	Target date	Current status
Seek PO Board approval to proceed	End of Mar 15	On track
Initiate Hawk Implementation programme	End of Apr 15	On track
Buy-Out complete	Early 2015-16	On track

j) Financial Services Investments and Savings Negotiations

Status overview: Savings negotiations concluded and benefits will be realised in 2014-15. Investments negotiations have been on hold until Hawk negotiations have been concluded and will now commence subject to Board approval.

Programme KPIs	2015/16	
	Target	Actual
Incremental increase in net Savings revenues	£0 - £12M	£9m
Investments Negotiations	£0.25m	n/a

k) Financial Services Sales Effectiveness

Status overview: Work continues to drive up the performance of Financial and Mortgage Specialists (FS/MS) building on the launch of the Post Office Money brand. This activity includes:

- Work to recruit and retain a population of 100 Mortgage Specialists;
- Developing stronger performance MI to at every level to drive more and better referrals from the counter, and increase cross and up-selling;
- Developing an agency model for driving FS sales through two sales pilots, both of which are now well established and showing early successes in terms of increased sales revenue.

Key milestones ahead:

Milestone	Target date	Current status
Salesforce development live (web lead to branch appointment functionality)	End of March 15	On track
Technology for Frontline live (upgrading core mortgage system)	Mid Mar 15	At risk
Hub and Spoke Pilot phase 2 launched (expanding reach into agency and linking with FS/MS specialists)	Mid Mar 15	On track
Data enablement feasibility complete (developing a more agile reporting capability)	Mid June 15	On track
POM Academy Phase 2 complete (expanding curriculum)	End Aug 15	On track

5. Market, political and external developments

Third party parcel access point market growing

- DPD is set to open 2,500 PickUp stores as part of its parcel shop network on 1st June 2015. Numark Pharmacies, a network of 3,000 independent pharmacies, has been named as its first retail member. DPD say their aim is to have a DPD PickUp point within ten minutes of "most people in the UK". In 2013, DPD announced it extended its partnership with myHermes ParcelShops for HomeCall Returns, its own return service. At the time of the agreement there were 3,000 myHermes ParcelShop locations which has now grown to ~5,000. In 2013, DPD delivered 1.6m parcels a week. Doddle also announced plans to open 70 more locations in railway stations and shopping centres taking the total number to 100 by the end of 2015. Doddle has already signed up retailers such as Amazon, Asos, Charles Tyrwhitt and Misguided.

Amazon Logistics set to expand

- Amazon Logistics is set to expand after successful Sunday deliveries. Sunday deliveries quadrupled from last year. Amazon Logistics currently uses 45 different local and national delivery firms. The service is currently free for its subscription paying Amazon Prime customers. According to the head of Amazon UK, Christopher North, "Amazon Logistics is not about replacing a carrier, it is about complementing". Amazon UK has not revealed what portions of its products are delivered through Amazon Logistics, but it is understood to reach close to 50% some weeks. North insists Amazon has no interested in pushing all its deliveries through Amazon Logistics. He stated, "The answer is you want to spread your volumes across multiple partners. You don't want to have a single point of failure."

Competition in the challenger bank space grows

- Virgin Money is set to launch its current account nationwide by April 2015 after launching in Northern Ireland and Scotland last year. Tesco announced plans to grow its share of the current account market to rival its credit card business. However, both face a challenge in winning customers over with only 3% of accounts being switched since reforms were introduced according to the Yorkshire Building Society.
- TSB announced pre-tax profits of £134m in 2014, up 2.3% on the previous year. It added 0.5m new accounts in 2014. Understanding the challenges to get customers switching, it is exploring the option to raise its share of the current account market from 4.2% to 6% through acquisition.

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Annex A: Forward Board meetings: overview of the sequencing of discussions on key business strategy issues

Key agenda items	Description
21st May:	
Annual Report and Accounts	
Win in Mails	Update on the programme to date and next steps
3 year plan	Review options for our 3 year operating plan
Digital	Approval of in-year and longer-term priorities for increasing digital income
New Government paper	Debate options for a paper making the case to a new administration for continued investment in/support for the Post Office
Front Office	Approve award of the Front Office contract
Crown strategy	Approve Crown Strategy
Banking Services	Update on the new utility banking service
Cost acceleration	Initial discussion of the more radical options for reducing areas of uncompetitive spend
17-18th June Away Day:	
Win in Mails	Agreement of the Mails strategy
IDA	Agreement of the commercial strategy for identity assurance
3 year plan	Agreement of the 3 year plan
Plan B	Review of Plan B options for generating additional income
Network and channels	Review of network and channel strategy
New Government Paper	Approve paper making the case to a new administration for continued investment in/support for the Post Office