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CEO's Report – September 2015

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

- Following a busy month in August, the pace has continued into September. At this Board meeting we are considering a number of people issues underpinning our transformation, significant changes to the structure of the business with the completion of Project Hawk (Insurance) and a substantive update on Project Iris (Supply Chain).
- In this update, I have also returned to a number of issues discussed at the June Board Awayday, notably Mails and Financial Services strategies. Section 4 – key change programmes - has been recast to offer an over-arching view of our transformation, reflecting the enhanced governance structure and supporting processes that David Hussey has introduced. Finally, our senior leadership team are all undergoing training to enhance their skills in writing Board/ business papers. This is ongoing and some of this month□s papers have adopted the new approach: your feedback would be welcome.

Key decisions for this Board:

- The Board is being asked **authorise engagement with the Pension Trustee to agree closure of the Royal Mail Pension Plan from 31 August 2016**; and to **agree the design of the new defined contribution scheme** they will be transferred to. This is a proposal that we have considered very carefully and we believe that this change is necessary to deal with the likely event that pension fund surplus runs out in early 2018, in the way that best protects the benefits accrued by members. Engagement with both the Unions and the Trustee would follow the Board□s agreement, with consultation with members likely to commence in December or January. The Pensions Committee has endorsed the recommended approach.

- Further to the Board□s consideration in July, the Board is asked to **authorise the completion of the acquisition of Bank of Ireland's interests in the Post Office Insurance JV and its transfer to POMS (Hawk)**. If the acquisition is approved, signings will take place on 30 September 2015.

- Al Cameron and Mark Ellis have provided an **interim paper on options for the future of Post Office supply chain (Iris)**. The Board is asked to confirm that it is content for the project to continue, including entering into a 3 month, exclusive dialogue with a 3rd party – Vaultex – to develop and assess a business combination.

- The Board is also asked to **approve the award of the Back Office IT contract to Accenture**. This is the final major procurement in the new IT Supply Chain and follows the Board□s consideration of the IT strategy presented in January this year. The capital cost of £10.6m generates benefits against current costs of £4.1m per annum. The total contract is worth £35m over seven years.

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2. Business performance overview

Overall performance

- At the end of Period 5, EBITDAS was a loss of £24.3m which is £2.1m adverse to budget. Income relative to budget is lower in financial services, telecoms and supply chain, offset in part by above budget performance in mails and government services, and lower postmaster and non-staff costs. Al□s papers provide a fuller update on Period 5 for discussion at the meeting. We continue to focus on driving up income, with another 2000 agency branches receiving additional training and ongoing support in time for peak season. Close scrutiny of cost plans continues.

3. Other updates of note for the Board

People & Cost Transformation Issues - IR Risk Mitigation & Planning

- Neil Hayward and Al Cameron have provided an update to the paper on cost reduction levers presented at the June Awayday. The analysis of the potential benefits has been completed along with the associated IR risks and risk mitigation planning. The Board is being asked to note the progress since June; and to accept the level of risk and the risk mitigation planning to deal with it.

Mails Strategy

- As discussed at the Board Awayday, I committed to a regular update on progress with our Mails Strategy - an omni-channel approach within the parameters set out in the MDA, and on key aspects of the Financial Services Strategy. Both now have programme plans, with milestones and activities reviewed fortnightly by the GE. Progress is set out below:

Royal Mail Negotiations

- We have continued a positive dialogue with Royal Mail and have agreed to enter into negotiations to secure adjustments to the current MDA in January 2016. Our desired outcomes from the RMG negotiation remain as outlined in the June Board paper:
  - Post Office online sales channel (omni-channel, paid for sale & accept of RMG products).
  - Owning customer data; developing sustainable revenues by collecting and analysing customer profiles and providing associated rewards and incentives to purchase more and stay longer.
  - Potentially extending the term of the agreement.

- We are now entering more detailed negotiation planning and, recognising its complexity, are in the process of engaging with a short-list of specialist providers to procure support.

- In the meantime, we have continued to work with RMG to progress priority projects around enhancing the customer experience:
  - Tactical improvements to drop-off and collections in branch – target is to identify and deploy, where possible, solutions pre peak 2015.
  - Enhanced proposition for marketplace sellers (post-start up to pre-RMG account).

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  - Commercial discussions around segregation, service credits and bar-coding.

- We have completed a review of the Mails Distribution Agreement (MDA) with respect to what can/cannot be done within the constraints of the agreement. The internal audit of our compliance with contractual obligations under the MDA is now scoped and will be commenced later this month. In addition to highlighting any specific areas for attention/improvement, we expect the audit to provide valuable insight in how best to manage the MDA going forward. Obligations on both Post Office and RMG are tracked using operational KPIs that are reviewed and actions agreed at the monthly joint operations forum.

Small Business Club (SME)

- We have reviewed the provisions for a Small Business Club (SBC) in the MDA, which sets out some quite specific requirements and tiers to manage accounts and offer incentives.
- From this and subsequent market analysis a high-level view of the Small Business Club proposition has been defined along with the associated proposition development phases (high-level). This shows the journey from today (Drop & Go) to the desired future state (Small Business Club); an omni-channel customer management and sales capability with associated analytics and loyalty schemes.
- We are now in the process of defining the delivery details of phases 1-3 (there are 5 phases in total) to align the initial physical/digital elements, the accompanying support model and the customer journey. We aim to complete this work in the next few weeks to gain funding approval for target launch of an initial SBC digital offer in April 2016. At a tactical level we are in detailed discussions with a 3rd party to undertake a low cost online pilot for Drop & Go customers. This could form part of our capability in April 2016 subject to further validation.

Digital Intermediary

- The strategy work identified the potential for POL to develop its own □digital aggregator□ platform in mails. Work is underway to define the business case for this Plan B/ disruptive play, which will go to GE before the end of the calendar year.

Financial Services Strategy

- Personal Financial Services: as indicated above, we are due to consider a paper at this meeting on Project Hawk in order to drive growth in our insurance business. We are seeking to grow the savings book by an additional £500m this financial year and have requested the Bank of Ireland revise their balance plan for the remainder of 2015/16 and improve pricing. Post Office Current Account proposition development continues, and although the two propositions should be compelling for target customers, a successful business case looks challenging - the GE will review in November. On investments, our focus will turn shortly to analysing options, with the aim of business approval on the preferred option by end November.

- We continue to develop effective sales capabilities across all channels, including:
  - Regional and Area Managers in Financial Services have all completed a development and assessment centre to understand current capabilities, identifying

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both talent and performance risks. Following this all Area Managers have tailored development plans to raise capabilities; these are primarily focused on coaching to develop needs identification skills and customer conversations.
- The Post Office Money Academy has redesigned the way we induct our people; stripping out a lot of product knowledge based content to be completed as upfront online learning, leaving face-to-face courses to focus on sales conversations and holistic selling. All new inductees are now following the digital-enabled process.
- We have commenced the definition phase of Digital POM Branches, engaging with stakeholders across POL to prioritise the capabilities required for development over the coming 16 months. In parallel, we have progressed with a number of high priority initiatives, such as the digitisation of FS/MS incentive schemes and scorecards.
- Hub & Spoke – Working in partnership with the POL Agency team and BOI, roll-out continues of the "Hub & Spoke" initiatives, including the extension Financial Specialist distribution in WHSmith branches.
- Incentives – we have gone live with both Counter and Financial Specialist incentive schemes and gone through the first payment cycles. Critically, this is the first performance-based payment for FSs in two years; the incentive scheme is tapered, based on performance, service and compliance outcomes. The scheme was introduced mid-Q1 and c.35% of FSs were awarded a bonus. The initial response from FSs and FSAMs is positive, and the scheme has driven renewed engagement within the Specialist community. We will continue to monitor outcomes following Q2 results.

- We have also continued at pace to develop the other growth levers:
  - We are in the final stages of a business case to develop a digital front end capability which enables us to build relationships with our customers and leverage cross-sell opportunities
  - We are enhancing the use of data analytics and have built propensity models, starting with Mortgages and Loans
  - We continue to build customer awareness of Post Office as a financial services provider, including through our summer travel campaign.

- Nonetheless, competition in travel money has been particularly fierce; competitors such as M&S and the supermarkets have dropped their margins significantly and to improve their pricing in branches. We are trialling a similar approach in the North East and monitoring the impact closely, both on foreign exchange and other related products eg travel insurance.

Verify

- In July, HMRC unexpectedly limited the number of services using Verify because of their concerns that up to 50% of customers were either dropping out or failed to successfully create an identity. This is disappointing as we are dependent on HMRC□s support to meet budgeted net revenue targets and their decision came without warning to the Government Digital Service (based in Cabinet Office) and consequently to Post Office. GDS insist on communications being channelled through them to departments and vice versa. However, we are following up with contacts in HMRC.

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- We are targeting a 70% success rate in 15/16 through a series of product improvements which include a new App which reduces the need for both a passport and a driver□s license, simplifying the verification journey. We have also launched a WorldPay functionality which brings forward credit history details additionally enabling us more easily to establish verification. Overall, WorldPay has brought a 6% increase. We are seeking to persuade HMRC that if they reconnect services and endorse Verify more strongly, they will provide greater motivation for customers to complete the journey and increase the success rate further. This is coupled with our knowledge of the demographic - HMRC□s selfAssessment customer - would enable us to realise a higher conversion rate (c90%) given the high likelihood that they will have a Passport or a Driver□s License.Achieving 90% will allay concerns and increase confidence in Verify.

- Post Office currently has a Verify market share of 47%, and customer insight suggests that it can expect a market share of c30% as competition in the market increases. Based on this and Cabinet Office□s analysis of when government departmentswill use Verify, we have forecast net revenue of £43m over three years.

End User Computing

- The End User Computing (EUC) admin rollout – the replacement of personal comport equipment - to our Customer Support Centre and Crown Network back office colleagues has been delayed by 3 months. This has impacted securing closure on separation from Royal Mail and will require additional cost. An extension to the existing MSA agreement is being discussed with Royal Mail, as closure of the separation programme is dependent on completing the rollout. The additional funding required has been estimated at £8m. In October 2014, the Board approved a minimum capital commitment of £70m for the provision of our new EUC capability, and the forecast to complete the programme is now £78m. However, the £70m included a £6m cost challenge as the agreed business case investment was set at £76m. The additional cost can be funded from the remaining contingency provisioned in the three-year plan financial profile. The increase is subject to on-going challenge with our IT business partners and we expect to reduce our exposure and provide further contingency.

- The EUC branch counter rollout remains on schedule for commencement in January 2016. There is no change to the overall EUC benefits profile.

- The Technology Transformation programme is highly complex and delivery is reliant on both our new IT Supply Chain members and key existing suppliers who are now in exit mode. The EUC element of the programme has added complexity owing to the inter-dependency on Royal Mail separation. We have recently appointed Deloitte to undertake a review of EUC so that other transformation initiatives benefit from the lessons learnt. Al will provide a further update in October.

Sparrow

- Further to my August Update, letters to scheme applicants (not subject to a previous court ruling) requesting dates for mediation to be put forward to CEDR by 4 September have produced agreement of 49 applicants to mediation sessions between now and the end of the year. Only 8 cases have not agreed dates, 5 of whom have confirmed they are withdrawing from the Scheme.

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- Following the BBCs inaccurate Panorama programme, a meeting was held with the BBCs most senior news executive, James Harding. This was useful to record, formally, our grievance and press for balance in potential future coverage by BBC news outlets in general. We are also making a formal complaint about the reporting in Panorama.

- Colleagues have also had a constructive meeting with the new Chairman of the BIS Select Committee, Iain Wright MP last week. The meeting was followed up with a letter outlining the rationale for the Post Offices view that any inquiry by the Committee would be premature - the investigations of the Criminal Cases Review Commission and the mediations of almost all other cases need to be allowed to run their course. While the Chairman understood our position, he was frank about the pressure he is receiving from some MPs. Nonetheless it is positive to have opened up a dialogue with the new Chairman.

- That pressure is reflected in an Early Day Motion put down in the House by the CWU-supported MP for Vauxhall, Kate Hoey, on 10 September. The EDM echoes the concerns expressed in the Panorama programme and calls for an independent judicial inquiry. It has so far been signed by 22 MPs, the majority of whom have no case in the scheme. We are rebutting the assertions in the EDM and and have offered meetings to all the MPs who signed the EDM. All the one to one meetings we have had to date with MPs with constituents in the scheme have been effective in balancing the highly selective information shared with them by their constituents.

Public Relations

- Our PR focus has shifted further towards financial services in 2014/15. We will be launching the Post Office Savings Report from the end of September (w/c 21/9/15) and into October and November with three strong PR initiatives aimed at driving customer interest in our savings products. Q1 figures for PR coverage show a 4% uplift year on year to 92% in positive PR for FS, with 575 articles secured with PR value of £7m. Travel-related PR also increased in the period (92% to 96%), but there was a fall in positive coverage for the network at 69% (77%), though negative coverage remains within target at 5% (compared with 3% in the same period last year).

Transformation Narrative

- Further to the discussion at Julys Board meeting, in October, we will be launching the Post Office vision and transformation narrative to the business, alongside a refreshed internal communications platform to create a drumbeat of communications as we transform the business. The One Post Office approach will include a new digital communications hub, regular magazine and weekly updates for all colleagues, a signal of our commitment to reach to the edges of the business and provide our people with a clear vision of the future alongside a grounded view of the challenges ahead. The vision and narrative will roll out with interactive events for our 500 most senior leaders, followed by a communications cascade and regular updates.

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Charity Ball

- Plans for the first Post Office Charity Ball, to take place in November, are well advanced. We hope to raise £200k from the evening for Children in Need, with a highly impressive line-up of entertainment including Kylie Minogue and Michael McIntyre. Our target is to sell 100 tables and with 50 already gone, our suppliers are confident that we will do so. In addition to enhancing our role as a key partner of Children in Need, the evening will send out a strong message of confidence about the business. It is also an opportunity to celebrate and strengthen our relationships with partner organisations whilst looking forward to an exciting future.

4. Update on key change programmes

Introduction

Our Transformation governance structure and supporting processes have been strengthened. A new control framework has been embedded across the business and reflects our growing maturity in enterprise-wide programme management. We are also taking the necessary steps to build the capability and capacity required to deliver this scale of transformational change. The Executive Team have increased the frequency in which they review the performance of transformation programmes. This improves visibility of plans, critical risks and issues; and provides an opportunity for deep dives into specific areas of concern. Our Business Design activities on the development of a Target Operating Model are progressing to plan.

Greater awareness of the transformation journey and its impact on the organisation has been communicated through the launch of the “1000 day” plan–the schedule of key activities to deliver a transformed Post Office by March 2018. This will be supported by a concerted communications campaign designed to fully engage our senior managers and their teams in delivering our plan.

Transformation Dashboard

	Overall RAG	Delivery Progress	Cost	Benefits	Risk
Overall Transformation	A	A	A	R	R

Delivery – Detailed planning activity is underway to develop and agree a fully integrated plan, this is a consolidated view of all key transformation milestones and inter-dependencies. The integrated plan is due to be baselined at the end of September.
Cost – Year to date spend is currently behind budget although a number of larger programmes are now mobilised therefore the underspend is expected to reduce throughout the year.
Benefits – Good progress is being made on in year costs saving initiatives with £29.3M of savings on track to be delivered against the £30M target for Q2 however there remains a cost saving benefits gap of £4.75M over the full year. An enterprise Benefits tracking mechanism is in development and is due to be implemented in October. This will give more focus and visibility to track benefits across the programmes

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Risks – A Risk Management approach has been defined and is being integrated across all programmes. Currently, 50% of the total Portfolio risks are deemed as "high" risks. This is expected as we are at the start of many programmes and mitigation plans have not been fully developed.

Network Programmes

As at the 28th August the **Network Transformation** programme is reporting 404 new contracts signed in year (121 Mains and 283 Locals) and 621 new model branches open in year (225 Mains and 396 Locals). This takes the overall number of contracts signed to 5509 and the total number of new model branches open to 4718. The pipeline of volunteers, as predicted, has significantly slowed during July and August and the programme is now behind target for contracts signed.

Business agreement was reached on our approach to the remaining branches and letters were sent to them on the 13th July outlining their options. The programme is currently flagging a risk of c.350 branches against the 2015-16 branch opening target of 1850. An updated forecast will be provided in October. The ability to achieve the target will be dependent upon the number of postmasters that agree to convert and sign new contracts by 31st December.

The **Crown Network Development Programme** is investigating options for 66 loss making branches. The Crown network is on schedule to achieve run rate break even by 30th September 2015 and overall break even by 31st March 2016. This is, however, dependent on our being able to take a provision for onerous contracts.

The **Front Office** programme, which will deliver a new Point of Sale (POS) application, is nearing the end of mobilisation. High level design has been completed with detailed design underway and on track to be completed by the end of September. The programme□s focus has been to build the delivery team, establish and embed business led governance and the development of a baseline plan. The plan will align the Post Office business readiness activities to the new supplier□s (IBM) delivery plan. It will alsodefine the dependencies on other programmes. The Front Office plan will form the back bone of the overall Transformation integrated plan and will be baselined by the end of September.

Technology Transformation Programmes

The revised Business Case for the **End User Computing** activity, which replaces the POS and admin hardware (laptops, printers etc), was agreed by the Transformation Executive Steering Group on the 1st of September, see section 3 for more details. Deployment of the POS hardware is dependent on a Fujitsu IT change to allow the current Horizon application to run on the new hardware. Confirmation of this Fujitsu change will be received in early October. The admin hardware roll out is due to start with a pilot on 22nd October.

The **IT Network programme** will implement a new IT and communication networks for our branches and our Customer Support Centre□s. Verizon are our new business partner replacing incumbent suppliers BT and Fujitsu. To minimise disruption and to reduce cost we are planning the branch implementation will be delivered alongside the EUC hardware roll out.

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The **Back Office** contract will provide a new supplier to host all our back office platforms. This is the final major procurement in the new IT Supply Chain – see section 1 for recommendation to award preferred bidder.

Overall across the IT programmes costs are within budget and benefits are on track. The EUC costs continue to be subject to negotiation with our IT suppliers. Some key risks exist between Front Office, EUC and the IT Network programmes. A major challenge to the programme will be the management of our IT supplier base, as the complexity of the programme has increased due to the all major IT suppliers exiting at the same time we are on-boarding our new business partners.

For the **Separation** Programme four worksteams are left to close, one of which is Admin EUC, with the others being HR, IT Supply Chain and IT Networks. Final separation is due to complete early January 2016. The Master Services Agreement agreement supporting the revised timeline will be agreed during September.

Reducing our Costs Programmes

The programme continues to work with business functions to ensure there are robust delivery plans to realise the benefits and additional cost saving opportunities are identified. **The Support Services Transformation Programme** has been initiated following business case approval in July. It is focused on the design and implementation of the right support structure to deliver effective and efficient support to our postmasters and in-branch colleagues at minimum cost. We will close three support centres by April 2016; there are eight sites in total and our objective is to move to one or two. The programme benefits are c. £20m over 5 years with c. £5m annualised from 3 onwards.

Commercial Portfolio Programmes

Post Office Card Account service to DWP is on track to implement the new supplier solution by the end of March 2017 and contract signed before Christmas 2015. The Competitive Dialogue phase is currently underway and will complete with Board approval to the preferred bidder in November.

The Post Office **Mobile** prepaid offering has now been launched online nationally and via a branch pilot in 212 branches in the North West of England. The Mobile business is in the early stages of a six month Trading Pilot. The launch of 4G and Post-paid (pay monthly) will now follow the decision for national branch launch in January 2016.

The **Winning with Retailers** programme is currently in the design phase, following budget approval in May. This phase includes identifying business requirements, high level design of the Access Point solution, developing the remaining areas of the commercial proposition, and planning for implementation. Work is currently on track and within budget, and a revised business case is scheduled for review at the October Transformation Executive Steering Group.

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Financial Services Programmes

Project **Hawk** – as highlighted in section 1, the acquisition of the Bank of Ireland□s share of the Joint Venture Insurance Business into Post Office Management Services (POMS) is nearing completion and is on track to achieve the POMS go live scheduled for 1st October 2015.

People & Engagement

People & Engagement activities are progressing with a significant milestone achieved in August with the New CWU Collective Engagement Framework being put in place. The revised CWU representative structure will go live in September. Industrial relations risks continue to be closely monitored.

Further progress has been made in developing the communications plan and the narrative to underpin our transformation journey. A communications programme is in place with engagement events starting in September and continuing in October and November.

5. Market, political and external developments

The convenience store sector continues to grow

- The Association of Convenience Stores Local Shop Report 2015 has revealed that the total value of sales in the convenience sector in the year to April 2015 was £37.7 billion with turnover growing by 5% over this period. There are now 51,524 convenience stores across the UK, compared to 50,747 last year. This marks a net growth rate of over two shops per day. The report stresses the wide range of services offered; 53% of convenience stores offer bill payment services, 53% have EPoS and 27% have a loyalty card. The report also showed that the **presence of a Post Office was identified as having the most positive impact on a community;** and that Convenience stores and Post Offices are the two services deemed to have the **most positive impact on high streets** by consumers. **A Post Office was the third most wanted service in the local area** behind specialist food shops and banks respectively.

The UK has seen a large rise in contactless payment methods

- A survey for Lloyds Bank shows that a quarter of people in the UK think they will no longer need cash in five years' time. The forecast comes amid the growing popularity of mobile payments and contactless cards. MasterCard says there has been a 560% rise in payment values using the cards in the last year, while Barclaycard says the figure has trebled although the technology is still relatively new so the increase in payment values comes from a low base point. Barclaycard also says contactless cards are most likely to be used in supermarkets, then restaurants and public transport. Those over 50 account for half of all contactless payments, with 20% of them over 65. August 2015 also saw a rise in the payment limit of contactless cards to £30. Apple launched its contactless payment service, Apple Pay, in July; the service is already available at around 250,000 till points nationwide with the number expected to rise sharply in the coming months.

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Consumer attitudes to bank account switching are changing but established banks are still the most trusted

- The number of people switching bank accounts rose by 4% year-on-year in the year to 30 June 2015, according to figures published by Bacs. A total of 1.1mn people switched bank accounts, compared with 1.06m a year earlier. New rules were introduced in October 2014 to make switching quicker and easier. Bacs said 69% of consumers were now aware of the switching scheme. **Barclays** and **NatWest** lost the most customers, while **Santander** and **Halifax** gained the most new customers. Despite the rise in customer awareness of switching a survey of 2,000 consumers by MoneySuperMarket found that consumers trust established high street banks more than alternatives. Some 28% of respondents gave **Barclays**, **NatWest** and **Santander** a trust score of at least eight out of ten.

Competition in the mails market is being driven by convenience and price

- Parcel delivery comparison website **Parcel2Go.com** has launched a new delivery pricing option for small items. The new service will apply to small items weighing up to and including 1kg, which can be sent across the UK for £2.16 ex. VAT. Meanwhile **Doddle** have announced that they will soon start a five-week trial project which will involve using neighbourhood agents to deliver parcels. The agents are to be people who work from home and are available four nights a week between 18:00 and 22:00 to hand over parcels. A new fulfilment initiative has also been launched by **Doddle**. The firm has unveiled **Doddle** Runner, a new snap and send parcel service. Pictures of up to five items to be sent can be taken by users of the smartphone app and the parcels are personally collected by a runner within an hour of the order.

Internet-only stores to overtake retail giants' online sales this year

- Sales made by internet companies without physical stores, such as **Amazon** and **Asos**, will surpass online sales of store-based UK retailers for the first time this year. So-called "etailers" are expected to generate £21.8bn-worth of sales in 2015, an increase of 18pc from last year, while traditional stores should grow their online sales by 11pc to £21.5bn, according to a report from market research firm Mintel. Despite this, Amazon has announced that it will no longer be delivering to Collect+ stores from 24 August. However it has stated that customers can now get free standard delivery to any of its 13,000 UK Pickup Locations.