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 Director General: Sarah Munby
 Lead Official: Pranita Bhargava/ Beth White
 Lead Official Telephone: GRO

Recipient	To Note / Comment	To Approve / Decide
Kelly Tolhurst MP (Minister)		X
Permanent Secretary	X	
Special Advisers	X	
Secretary of State	X	

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UPDATE ON THE GOVERNMENT'S DRAFT LONG-TERM VISION FOR POST OFFICE LIMITED

Summary

- 1) Before summer recess you agreed that the Post Office Policy team take forward work to design a long-term vision for the Post Office up to 2030. We have undertaken a rapid policy analysis to identify the key strategic questions and drivers that could support Government's future aspiration for the Post Office and developed an initial set of options. Your steer will help inform:
 - (a) In the immediate term, the joint Spending Review (SR) work with UKGI on a post 2021 subsidy; and
 - (b) The next stages of our long-term vision work, which we will co-design with Post Office Limited (POL). This focuses on questions relating to the future role of the social purpose (and rationale for an on-going subsidy), future size, accessibility and sustainability of the network, and the future government service offer via the Post Office as well as ensuring that POL's broader service offer is fit for the future.

Timing

- 2) Routine – it would be helpful to have a steer by 30 October to help inform next steps on (a) the SR business case for the post 2021 subsidy; and (b) our ongoing engagement with Nick Read (POL CEO) and POL colleagues. We would like to be able to discuss this with them at the BEIS/UKGI/POL shareholder meeting on 13 November.

Recommendations

- 3) That you **agree** that BEIS (and UKGI) should work with POL over the next few months to gather data on uncommercial branches to potentially inform the development of policy options on a post 2021 subsidy with conditions. We would like to provide you with fuller advice in January 2020; and
- 4) That you **agree** to us working with POL on the specified range of key strategic questions, which we will discuss with POL over the next month.

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Background

Approach to long-term vision programme of work

- 5) At our meeting with you on 15 July, we agreed that the scope of the long-term vision work would look ahead to 2030, with an immediate focus on what we would like to achieve by the end of the next SR Period. We discussed five priority areas with you:
 - approach to funding, commercial sustainability and business model;
 - ensuring sustainability of the network and positive workforce relations;
 - re-defining and delivering on POL's social purpose agenda and its role in communities;
 - alignment of POL's activities with Government's wider objectives; and
 - championing POL's role in the delivery of government and other services.
- 6) By drawing on a wide range of available evidence including discussions with UKGI, BEIS finance and analysts, OGDs (mainly MHCLG and DCMS) and Citizens Advice¹, we have undertaken a rapid policy analysis to identify the emerging opportunities and barriers linked to each priority area to develop a set of strategic problem questions.
- 7) We have had early engagement with POL on the Long-term Vision, as you heard during your intro chat with Nick Read last week. We have agreed with him that our work needs to be informed by the project he has started with McKinsey on 'Purpose, Strategy and Growth'. This is due to report early findings on purpose and strategy for POL by the end of the year, with iterations for a final product in February. We will undertake a series of engagement pieces with POL as we develop the long-term thinking.
- 8) We have divided the advice in this submission into two main parts: the immediate focus on the next five years to reflect the next SR/Subsidy period; and an update on the longer-term vision work. Although the next subsidy question requires immediate consideration, we have set out our advice on this in terms of policy considerations that will impact the longer-term vision, particularly on the role and value of the social purpose.
- 9) The Government subsidy to POL is made on a quarterly basis and is contingent on it meeting a range of access criteria set out in Annex A. UKGI review POL's performance against these obligations ahead of each payment. In paying the subsidy we have taken account of not only POL's commercial sustainability and increasing profits but also state aid rules. In considering the advice on the next subsidy it is also worth noting that whilst POL is on a profit trajectory (potentially over £100m in 2020/21), on-going litigation will also present costs. Therefore, the settlement payout could also impact POL's ability to remain on a glide path to

¹ BIS, *Building a Mutual Post Office* 2012; Post Office Limited analysis; RSA, *Making the Connection: Post Office's as Community Enterprise Hubs* 2014; Select Committee Inquiry 2019 – Written and Oral evidence, BEIS & London Economics, *The Social Value of the Post Office Network*, 2016

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become 'subsidy-free'. UKGI will provide an update separately on the litigation settlement strategy in due course.

Advice

The next Post Office subsidy: rationale for continuing post 2021

- 10) Having allocated £2bn to fund the Post Office's modernisation and transformation programme (2010–18), in December 2017 the Government agreed a new funding package of £370m for the Post Office to run until March 2021, of which £160m was the subsidy.
- 11) Government's aspiration, made clear when the last Funding Agreement was agreed, has been for POL to become financially self-sustainable post-2021. Over the years, the subsidy has been steadily reduced from £210m in 2012 to £50m in 2019/20 as POL decreases operating costs and begins to create an operating profit. This is shown by its first trading profit in 2016/17 which has grown to £60m for 2018/19 and is expected to exceed £100m by 2020/21. While there has been a decline in government services such as Post Office Card Accounts (POCA) which are due to cease in November 2021 (revenues have fallen from £75m in 2015/16 to a budgeted £20m for 2019/20), the implementation of the new Banking Framework in January 2020 will bring up to £100m in additional revenues that will more than offset this. Therefore, in line with our previous reasoning we think the starting point for determining a post-2021 subsidy ought to be zero.
- 12) Further, the Consolidated Budget Guidance² (CBG) normally requires that Departments pay full costs for a subsidy, however BEIS has an exemption from doing so with regard to POL. This is because paying the full cost would be unlikely to deliver significant additional VfM, given Government's aspiration for POL to become financially self-sustainable. The CBG also normally requires a dividend to be linked to a subsidy payment for transparency reasons. In 2017, whilst the derogation from a dividend payment was applied by HMT, they did indicate a need to review this as a part of future funding agreements.
- 13) However, whilst this approach helped secure HMT approval to the previous funding package, it would require POL to sustain the c. 4,500 uncommercial network (cost estimated c.£67m in 2018/19) from within its own capabilities 3,200 of these are the 'last shop in the village' and in rural locations and would otherwise close if they were on a standard commercial variable model. The zero-subsidy option would risk undoing the benefits achieved from the network transformation and the pressure you have applied on increasing agent pay.
- 14) We would also lose the direction of travel Government is seeking. While being consistent with BEIS & HMT's previous expectations, discontinuing the subsidy is likely to give rise to numerous campaigns from postmasters, unions and other stakeholders. This is because, as the 2017 Conservative Party Manifesto committed Government to protect the Post Office's presence, especially in rural areas and increase banking services, POL is required to maintain at least 11,500

² Consolidated Budgeting Guidance 11.41 and 11.38

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post offices that meet strict access criteria. However, due to the increased political scrutiny and campaigns surrounding postmaster pay (Select Committee Inquiry and Daily Mail campaign) and the ongoing litigation, there are many presentational risks to discontinuing a subsidy without an alternative measure in place or proper consultation. The upcoming SR therefore requires BEIS and UKGI to develop an appropriate VfM structure for any future HMG funding.

Commercial sustainability vs payment of subsidy

- 15) The cost of maintaining the uncommercial network is growing year-on-year due to the reduction in the demand for traditional POL services such as mails, bill payments and government services such as benefits and pensions. This therefore raises questions about the purpose and size of a post 2021 subsidy, as the operation of uncommercial branches will continue to present a real cost to POL. Also, even though POL is on a profit trajectory, POL may not yet be on the glidepath to be able to pay a dividend during the next SR period.
- 16) In terms of wider funding, we do not propose further investment funding as POL should be in a position to self-fund BAU investments.
- 17) Whilst we recognise that discontinuing a subsidy is the starting point, we propose working with POL to collect better data on specific areas to help inform any future HMG funding. The Funding Agreement allows us to request any data linked to POL's strategic plan. We would like to also use this as an opportunity to discuss top-level aspirations. For example, based on our initial data gathering work with POL, we could develop more detailed policy options on a subsidy with conditions to encourage data reporting, develop a stronger VfM rationale for any future HMG funding and improve transparency (and accountability for the social purpose). It would also inform longer term thinking on the:
 - (a) *role and value of a social purpose*: whilst the cost of the uncommercial branches was estimated at c.£67m in 2018/19, in a 2016 report³, the social value of the Post Office was estimated to be between £4.3bn and £9.7bn (based on households and SMEs' willingness to pay for the service). POL data on the uncommercial branches would therefore not only help us better understand the associated costs (and benefits) for this part of the network but also help shape our approach to understand the broader 'social value' - what works, for whom, and where.

Further, whilst there is a definition of the social purpose in the current Framework Document (see Annex B), given this was last agreed in 2013 between BEIS, unions and POL, we think the SR presents an opportunity to build an evidence-based approach to reviewing the overall definition and measurement approach to the social purpose (see paragraph 25). This is to ensure a stronger VfM rationale so that services are directed to those who need them most; and

³ BEIS & London Economics, *The Social Value of the Post Office Network*, 2016.

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- (b) *definition of a branch* particularly to understand what the minimum service offer ought to be e.g. selfservice kiosk for some and face to face provision for others

Recommendation 1: to work with POL over the next few months to gather data on the uncommercial network to inform the development of policy options on a post 2021 subsidy with conditions

- 18) The advantages of attaching further conditions to help achieve the above aims through better data collection⁴ are three-fold:
- (a) Firstly, better data would help UKGI and BEIS provide stronger Vfm assurance to the Permanent Secretary as well as enabling you to proactively handle any criticisms directed at Government's role in delivering social purpose (and any trade-offs linked to the commercial sustainability of POL).
 - (b) Secondly, a more detailed understanding of the use of the subsidy across the network will inform an evidence-based approach for re-defining and measuring the social purpose and reviewing the network criteria. We will also as a result of this exercise be in a better position to identify and balance trade-offs associated with the commercial sustainability of POL.
 - (c) Thirdly, better data would enable us to develop a better cost and benefit analysis and counterfactual for future SRs to secure HMT approval.
- 19) POL may object to further Shareholder control and associated costs linked to data gathering. Further, an ongoing subsidy may not be supported by HMT given their steer for POL to be subsidy-free by 2021. However, we believe that POL should already have this data, so it should not present an undue burden. We would look to work with POL to make this ask reasonable and practicable.
- 20) Alternative options to the recommendation would be to (i) continue subsidy using the current reporting approach or (ii) as outlined in paragraphs 11 – 14, remove Government subsidy and require POL to sustain the uncommercial network from within its own capabilities. As stated above, while being consistent with BEIS & HMT's previous expectations, discontinuing subsidy is likely to give rise to numerous campaigns from postmasters, unions and other stakeholders.

The Next 10 years – key strategic questions

- 21) We have identified four strategic questions that need further exploration to inform the longer-term strategic direction of the Post Office. Annex C has further information. We are keen to seek your steer before we engage POL and start further work with analysts:

⁴ Conditions related to data collection could include a focus on areas like as (i) the cost/benefit of the current network size (ii) a breakdown of the cost of POL uncommercial network (iii) a demand/supply analysis of POL services; and (iv) the development of a no subsidy counterfactual to better understand the trade-offs between POL commercial objectives- to be profitable and less reliant on the Exchequer- and the Company social purpose

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- (a) *What is Government's aspiration for the Post Office in 2030 and what will the rationale for a future subsidy be?* This addresses the approach to funding and commercial sustainability.
- (b) *What is Government's aspiration for the future size of the Post Office network and access criteria, taking account of both changing market trends and workforce needs?* This addresses the sustainability of the network and positive workforce relations and future business model.
- (c) *What is Government's aspiration for POL's Social Purpose, taking account of the need to deliver services to those who need these the most?* This addresses the defining and delivery on POL's social purpose agenda and its role in communities and alignment of POL's activities with Government's wider objectives.
- (d) *What should a future Government services offer via the Post Office look like taking account of the government wide shift towards digitisation?* This addresses the championing of POL's role in the delivery of government and other services. Calling the Post Office "the front door to Government services" may not be tenable in the future due to the shift to online services.

Do you agree that these are the right strategic questions?

Recommendation 2: work with POL on a joint programme of work to explore key strategic questions, with the aim of providing fuller advice to you in January 2020.

- (a) *What is Government's aspiration for the Post Office in 2030 and what will the rationale for a future subsidy be?*
- 22) As outlined above, the question of the subsidy payment cannot be looked at in isolation. The considerations as to whether and to what level, to publicly fund the Post Office to deliver the public benefit need to be based on evidence as value for money principles. These considerations are also inextricably linked to policy questions including the Government's goals for the Post Office network – in terms of network size, minimum service offer (given changing market trends and consumer behaviours) and the balance between social purpose and commercial sustainability. Working with POL to answer these questions through data gathering (and potentially other means e.g. call for evidence review or public consultation) will help determine Government's aspiration for the Post Office Network, commercial sustainability and the nature and level of Government's future oversight, funding and POL's accountability.
- (b) *What is Government's aspiration for the future size of the Post Office network and access criteria, taking account of both changing market trends and workforce needs?*
- 23) The Government's access criteria were originally designed to ensure fair access to post office services across the UK; however, with the changing market conditions,

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declining footfall and multiple operational issues (branch closures; increase in outreaches) raises a fundamental question about whether the current framework will equip POL to navigate these challenges over the next 5 – 10 years as consumer and retail patterns continue to change. Working with POL, NFSP and other stakeholders such as Citizens Advice we will explore options on the future design of the network and access criteria, drawing on future trends analysis (e.g. retail and financial services sector) and international comparators.

- 24) Changes to the business model (linked to the New Transformation Programme) have exposed issues for postmasters relating to low morale and skills deficiency. These issues have contributed towards an increase in postmaster resignations and tension between Post Office Limited and postmasters. While agent pay is a clear concern, NFSP, Citizens Advice and others have suggested the need for an improved wider support package provided to postmasters. We will work with POL to explore what makes an attractive support package for postmasters (e.g. ranging from peer support networks to accreditations and apprenticeships) as well as longer term options to identify ways to create a stronger and more inclusive workforce e.g. mutualisation (as suggested in the Government's 2010 report 'Securing the Post Office Network in the Digital Age').

(c) What is Government's aspiration for POL's Social Purpose taking account of the need to deliver services to those who need these the most?

- 25) Whilst the social purpose is currently defined (focused on meeting access criteria and delivering services of a social nature) it does not meet Ministers' or the public's aspirations. It includes access across the UK and provision of services that support some of the most vulnerable in society. However, it is unclear and does not take account of the social value provided by many postmasters or the value that the public perceives the Post Office to provide to local communities⁵.

- 26) As outlined above, we do not know whether uncommercial branches are providing a social value/benefit that could be considered to 'offset' the opportunity costs linked to the running of 4500 branches. Therefore, by collecting data as a condition to the post 2021 subsidy, we will have a better grasp on the cost/benefit of the uncommercial branches (which includes the value from the 'customer' and 'community' perspectives). This may be combined with broader evidence gathering on innovative local practice, which will give us a better picture of vulnerable customers' needs, how this varies across locations, and the 'social value' community branches and postmasters provide. The data analysis and customer insight will firstly help inform the definition and measurement approach of the Post Office's social purpose. Secondly it will enable us to explore alternative 'future' approaches to providing 'social purpose' services in rural and urban deprived areas and pose a credible counterfactual to the status quo.

- 27) Alongside working with POL to collect more data ahead of SR we propose working with OGDs and POL to develop options for a future social purpose following your

⁵ BIS, Building a Mutual Post Office [2012](#); Post Office Limited analysis; RSA, Making the Connection: Post Office's as Community Enterprise Hubs [2014](#) ; Select Committee Inquiry [2019](#) - Citizens Advice written evidence, Post Office Policy team branch visits [2019](#), et al.

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letter to them in the summer. So far, we have led discussions with MHCLG and DCMS and identified various opportunities to join up to ensure the social purpose is 'customer focused' and reflects local needs. We are also planning to meet with Defra and HMT (particularly to explore the future aspirations for the access to cash agenda) and will update you on our progress on joining up with these strategies in January 2020 (See Annex D). This work will be linked to the development of minimum service provision criteria which could range from a minimum service offer for vulnerable customers who require face to face provision, to a local services offer by innovative community branches (which could be supported by HMG innovation funding through local partnerships and creative use of community assets) to exploring a broader range of services of a social action nature.

(d) What should a future Government services offer via the Post Office look like taking account of the government wide shift towards digitisation?

28) We want to work with POL and OGDs to identify the key risks and opportunities linked to the delivery of future government services. For example, learning from DWP's channel shift approach on Universal Credit to develop a minimum value product for Universal Credit may be instructive. This may involve further engagement with DfT, MoD, DfE and others. We would like to explore whether we have the right incentives in place for POL to develop both cost effective and customer-focused options such as co-location of government services (e.g. libraries) as well as digital options.

Media Handling

None.

Contributors

Jane Corera, Alicja Hermann (BEIS Legal), Richard Beckett, Nigel Richards (BEIS Finance), Alex Cole, Tom Aldred, Tom Cooper (UKGI), Michael Morondiya (BEIS analyst), Cecilia Vandana, Shanice Swales, Will Wilson, Carl Creswell (Post Office Policy Team).