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RESTRICTED: POLICY AND COMMERCIAL

Note of Mutualisation Workshop hosted by Post Office Ltd

Alice Perkins, Chair of Post Office Ltd (POL), chaired a meeting with experts from the mutuals sector on 26 April to develop POL's assessment of the mutualisation policy. ShEx and the Treasury attended as observers. This note summarises the discussion.

In attendance

Alice Perkins (Chair)	Chair, POL
David Erdal	University of St Andrews
Chris Jones	Welsh Water
Dennis Holt	LV; Bank of Ireland
Nicola King	Rothschild
Paula Vennells	Chief Executive, POL
Susan Crichton	General Counsel, POL
Chris Day	Financial Director, POL
Belinda Crowe	Consultant on mutualisation, POL
Neil McCausland	Senior Non-Executive Director, POL
Will Gibson	Shareholder Executive BIS
Katie Wake	Shareholder Executive BIS
Vicky Edmonds	HM Treasury

Discussion Topics

- Financial stability: a pre-requisite but what does it mean?
- Options for raising capital and funding for future investment
- Business leadership and governance: allowing the Board to retain strategic control of the business with directors free to run the business professionally, whilst managing competing interests of members
- Cultural change: who would become members, how could POL create the cultural change required?
- Other issues: the Post Office brand; business benefits and pitfalls.

Key Points

Purpose: There was initial scepticism amongst external experts, particularly Chris Jones (Welsh Water) and David Erdal (University of St Andrews), as to why the mutual model would be the optimal for POL given its financial difficulties. Eventually they concluded that, whilst the financial difficulties of the business may not be allayed upon the transfer of ownership alone, the withdrawal of Government's ownership could make the business more efficient by removing Government as a direct safety net to whom stakeholders could plead for funding. Nevertheless, it was agreed that clarity of purpose of the mutual through the articles and its contracts would be paramount. The mutual would be less likely to succeed if Government was expected to intervene should the Post Office get into trouble. A clear purpose would need to be articulated to set benchmarks against which a regulator could act if it was not met, to avoid 'too big to fail'-type moral hazard. Government must be

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clear as to what it seeks to achieve through mutualisation and embed it in the mutual's articles.

Financial stability: Alice Perkins's assessment was that financial stability would not be achieved until the subsidy POL receives from Government and its longevity was more clearly defined to give investors the certainty to invest. This would be likely to mean ring-fencing those unprofitable branches that Government wished to maintain to be able to clearly delineate and channel subsidy to them. David Erdal noted that transfers of shares to employees have happened successfully even when businesses are not profit-making. Subsidy could be replaced with a 'distribution fee' i.e. funding from Government delineated clearly for maintaining outlets in unprofitable areas.

Alice was sceptical that a formal transfer of ownership would be possible until after the network transformation programme had been completed (2017, based on current projections). Nicola King (Rothschild) and Chris Jones shared this scepticism given the difficulties of effecting business succession whilst a business is in flux. Chris Day, POL's FD, anticipates that £50m profit will be required from 2017/18, following the network transformation, to meet POL's capital needs (impairments, interest payments). On top of this, POL currently requires £1.15bn working capital to meet the demands for cash within the network, which Government currently provides as a loan. Accessing listed bond finance involved corporate governance requirements with a cultural effect that could hamper the public interest purpose. However, raising debt on the financial markets would not necessarily be a pre-requisite for Post Office mutualisation; Foundation Trusts were cited as an example of public sector-funded mutuals.

Failure regime: David Erdal stressed the importance of a realistic threat of bankruptcy to galvanise the business to perform. Failure must be possible. Alice questioned whether this would be politically imaginable given the Government's commitment to the Post Office network. David proposed a localised failure regime whereby unprofitable branches could be re-franchised to new providers. This would better bring into effect a cultural shift of responsibility from Government to owners/stakeholders.

Producer-dominated membership: Chris Jones and David Erdal felt it would be counter-productive to have both consumer and producer representatives on the representative body. Rather than aligning stakeholder interests, it could internalise conflict, stifle innovation and end in deadlock. Paula Vennells agreed with Chris's view that 'skin in the game' is an important incentive to participation in a mutual. The prospect of profit sharing amongst 'producer' members may be more important conceptually than practically. Social value was felt to provide an incentive that could eradicate the necessity to distribute profits amongst members. The architectural firm Arup, for example, is driven by its commitment to good design.

Governance: Dennis Holt (LV) emphasised the importance of ultimate Board accountability with the Chair answering to members through consultation. Information should be disclosed freely. He recommended conventional

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appointment by members of the representative body who should be well-informed about the business, subject to annual re-election by employees. At LV (the UK's largest friendly society), the Chair stands for annual re-election and the remainder on the board are elected on three-year cycles. John Lewis has a month's cooling off period between the first and second round of votes, with a Q&A between staff and the Board quarterly, published verbatim (Hansard-style) for all to see. Welsh Water's six monthly consultation sessions have never had less than 75% member attendance over 11 years. A charity board on which Neil McCausland sits has 70 expert members which provides ample knowledge without being too diffuse. Alice cited Peter Marks's (Co-op Group Chief Executive's) observation that elections are very costly.

Culture and consultation: David Erdal cited the information-sharing and consultation between managers and the staff who serve customers (not just their representatives) as the route to successful mutualisation. He recommended prioritising 'producers' within a Post Office mutual, involving consumers through 'Advisory Councils' comprising their representatives to whom producer members should defend themselves. Two-stage elections could ensure expertise is reflected on the representative body. Chris Jones believed bifurcation of the public's commercial interests from POL's was unhelpful: the interests of the customer would be served by decisions taken in the interests of the business. The Eroski supermarket chain in Spain was cited as an example of a successful majority employee/minority consumer co-operative. Alice expressed reservations that the NFSP may focus on its members' short term interests rather than the long term future of the business.

A potential business benefit of mutualisation cited was greater responsiveness to regional conditions through, for example, regional councils of post offices identifying local services e.g. Local Authority work that they could bid for. Although these steps could entail greater resource costs, it could replace some of the costly engagements through the NFSP and unions that take place currently.

Path to mutualisation before transferring ownership: Neil McCausland proposed as intervening steps before any formal transfer of ownership:

- Better articulation of the purpose of the Post Office
- Improved communication with stakeholders and consultation with employees and subpostmasters
- Formalising consumer Advisory Groups
- Sharpening performance incentives e.g. introduction of independent quality ratings of individual post offices, possibly regulated by the consumer panel

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