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From	Chris Nicholson	Ref cn/cm/270
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Telephone	GRO	
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Date	9 October 1998	
Subject	**BA/POCL Progress Report**	

Please find attached a 4 page document.

BA/POCL Progress Report

KPMG were requested to examine 4 key areas of the fallback options for BA/POCL:

a) the impact on the network of the loss of BA income and associated footfall.

b) the timescale and costs of an alternative technology platform.

c) the viability of pursuing Horizon without the benefit payment card.

d) the viability of an early shift to ACT including the impact on the banks.

in order to help establish the value for money of the alternative options, options 2 and 3.

a) The impact on the network of the loss of BA income and associated footfall

The critical assumptions

PO closure figures

Estimates of PO closures under the 3 options are of interest per se but are also significant determinants of each of the key figures for:

- first round effect on PO profits.
- sub-postmaster compensation.

as well as logically affecting profits from banking (through in practice these figures have not gone into the determination of POCL banking profits).

The figures for Post Office closures used in the original HMT report were derived from a separate exercise which was not directly linked to the analysis of fallback options. POCL analysed 2 scenarios of how they might respond to a loss of BA business:

- Scenario A: Managed closure: The closure of 500 Crown Offices and 4,500 most vulnerable sub-offices (vulnerability defined as offices most dependent on BA related income). This process to be managed over time by POCL (8-10 years) to facilitate maximum migration of business from closing offices to those remaining open;
- Scenario B: Unmanaged closure: The closure of 13,000 most vulnerable sub-offices, in an unmanaged way ie. as a result of economic decision by sub-postmasters in the face of dramatic loss of business, so reducing the possibility for POCL of migrating businesses to other offices;

Under both scenarios there is a very similar "first round impact on POCL profits" (contained within this are a number of critical assumptions considered in Appendix 1) but a very different impact on number of offices, sub postmaster compensation, and, by implication, potential for banking business income.

However POCL stress that:

- these scenarios were not prepared for the purpose of examining Options 1, 2 and 3.

- would not be how in practice they responded to the loss of BA business in each of the options e.g. there is no logical reason why they would close Crown offices in Scenario A, not Scenario B, and the most "vulnerable" offices to loss of BA business may in fact be the offices most valuable to them in the context of their emerging banking strategy e.g. those in rural areas.

POCL have therefore undertaken to model more realistic responses under the 3 options. Results expected 9.10.98

POCL profit from banking

POCL's estimate of profit from banking are critical to their case for being able to maintain a nation-wide network of POs post-ACT in the absence of subsidy. POCL estimates of profit from banking have been derived from a McKinsey study. The McKinsey study examined, in the context of a vision for POCL in the year 2015, the potential profit from offering banking services in response to banks reducing substantially their branch network and to making arrangements with POCL for customers to gain access to their accounts through sub-Post Offices. This yields a potential contribution for POCL of £130-230M. The low point of this range has been used for the contribution figure for Option 1.

The basis for the McKinsey assumptions are therefore different from a scenario where benefit recipients are transferred to ACT and a banking service is offered through Post Office Counters. POCL stress that until a full banking strategy is developed, expected to take up to 2 years, it will be difficult fully to assess the scope for banking profits. We have discussed with POCL the feasibility of developing alternatives scenarios based on more developed assumptions but they do not feel able to do this within the time available to KPMG are giving consideration to alternative scenarios.

POCL consider that banking profits will be less under Options 2 and 3 because they do not believe that by October 2001, when ACT implementation would begin, that they will have been able to:

- develop their banking strategy, and.

- specified their requirements, and.

- worked with Pathway or A.N. Other to develop a banking capability on Horizon, and.

- negotiated and signed contracts with enough banks to ensure that a full banking service can be provided through POCL, as ACT is implemented, in order that benefit recipients continue to use the P.O., rather than being lost to the P.O.

The long timescales inherent in POCL's contentions are a function of their placement within a long term banking business strategy, and the assumption of existing timescales for development of banking functionality on a automated platform. Our judgement is that under the circumstances of Options 2 or 3 "going live", the business imperatives may be such that POCL may not have the luxury of such lengthy timescales whilst recognising that this may enhance

HMT00000005

implementation risk. We will continue to consider what alternative assumptions might be made, using our banking consultants.

Cost of banking technology

Given the very early stages of development of a banking strategy, all figures on the cost of banking technology under Options 1 and 3 are very approximate.

Figures for Options 3 have been derived from what is known of the cost of the Horizon platform in relation to the requirements for banking functionality and an automated platform but are inevitably subject to large margins of error. KPMG banking IT consultants are working on verifying/constructing estimates.

Figures for Option 2 contain £75M per annum assumed payment to ICL for the life of the contract to generate a return equal to what they would have got if the BPC had not been cancelled. KPMG have sought figures on this matter from ICL Pathway.

Other key assumptions

Migration

POCL assume 50% migration of business is achieved from 5,000 P.O. closures under the "managed closure" and "unmanaged closure" scenario it is assumed that there is no migration of business from the further 8,000 P.O. closures. The assumption of 50% migration is based on information from a small closure programme in the mid 1980s and more recent data on relocation, though neither is particularly comparable, particularly in a non-BA environment as typically it is easiest to migrate BA customers.

Footfall

Whilst footfall does not directly affect any of the figures in the VFM analysis it does underpin POCL's analysis of the vulnerability of offices to closure once BA income is lost. POCL's analysis assumes that where customers carry out transactions first in the Post Office and then the private business side, then potentially at least those private sector sales are last they no longer visit the Post Office. This is in our view an extreme assumption.

b) The viability of an early shift to ACT including the impact on the banks

Interviews with banks are programmed for week commencing 12 October to seek to check DSS/BA assumptions. Project plan has been reviewed but key assumptions largely concern bank responses.

c) Option 3 costings and timescale

See earlier comments under cost of banking technology.

HMT00000005

d) *Option 2 viability*

Having examined the high level architecture of ICL Pathway it would appear that Option 2 is technically feasible. Indeed Pathway are actively marketing the system to overseas Post Offices, without the Benefit Payment Card.

Information on Commercial feasibility will be obtained from ICL Pathway (see earlier).