

RESTRICTED – COMMERCIAL AND MANAGEMENT:
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COMMITTEE

Post Office Limited (“POL”)
Annual Review
10th January 2014

Attendees:

Richard Callard	Roger Lowe
Tim McInnes	Patrick Magee
Peter Batten	Craig Lester
Ceri Smith	Rajesh Kedia
Rachel James	Emma Sharp (minutes)

Actions

- Undertake a confidential and internal review to assess the suitability of POL's current CEO (e.g. deliver POL's strategy, lead the organisation)
- Work with POL to understand the financial, strategic and stakeholder impact of key contract renewals and renegotiations
- Establish procedures / documents in order to formalise the relationship between the POL and Royal Mail teams within ShEx.

Issues discussed:

The Review Team noted the various achievements of the ShEx POL Team, including the completion of the funding agreement.

POL Strategy

The Review Team agreed that the principle strengths of the POL are the brand value and the established network. It was agreed that there is a political imperative to maintain the POL network, in order to meet the access criteria, and that POL has a political, social purpose as well as commercial objectives.

The strategy of POL has shifted from a network-focused business towards a product-driven model, with the aim to minimise the government subsidy required to operate and meet government's objectives. POL will provide new services (such as the new 'Drop and Go' service targeted at SMEs) and build upon their existing services by moving up product value chains, in order to generate a higher profit margin and better control the product offer and product development. It was noted that there could be a significant opportunity to create further SME-targeted products. The British Business Bank now has PRA approval to provide guarantees, to reduce capital constraints, which could be rolled out through the POL.

By owning their products, POL will be able to own and collate customer data which can be used to inform strategy. In addition, POL has introduced a new IT system which allows them to analyse customer behaviours and provide a more personalised offer to customers. Furthermore, the new centralised financial services team are in the process of 'up-skilling' the financial services

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advisors so that they better understand the needs of their customers and can meet regulatory and compliance requirements.

POL is also looking to replace many of the incumbent sub-postmasters with more entrepreneurial employees as part of Network Transformation – of the 8,500 branches expected to convert as part of the strategy up to 3,000-4,000 branches are likely to take the form of one of these “offsite” conversions. By moving subpostmasters from fixed pay contracts to variable pay, selling-behaviours will be better incentivised, leading to higher planned top line performance (i.e. both in individual branches and in aggregate across the network).

A third of POL’s estate is believed to be made up of “unviable” branches that are only kept open in order for POL to meet government’s commitment to maintain a network of at least 11,500 branches. These “Community” branches are expected to be in receipt of subsidy after the new funding agreement comes to an end in 2017/18. It will be important for incentives to be in place to ensure that POL minimises this remaining funding in the long term.

The POL Board have endorsed this strategy. The majority of the strategy now has clear plans to support its proposals, with clear ownership over the different strategic areas. There is currently no detailed delivery plan to support the proposed cost reduction challenge but POL are looking to procure a consultant to analyse how costs will be reduced.

Business Plan

The Review Team questioned whether the POL Business Plan was too aggressive, and if the proposed revenue growth was feasible. It was noted that buying into the value chains will lead to increased revenue but also increased costs and therefore there may not be a substantive increase in profit. As a result, it was noted that there needs to be flexibility in the cost base (or sufficient headroom) so that POL is not forced to ask for a bigger subsidy in the event targets are missed.

The ShEx POL Team outlined that they set parameters, within which POL formulated the Business Plan and strategy. The Business Plan was initially more aggressive when first presented but the ShEx POL Team tasked POL moderate it in certain areas due to concerns expressed by Ministers.

The ShEx POL Team also highlighted that not all proposed growth will be led by financial services as there will also be growth through other services, although this will be offset to a degree by declining revenues from more traditional services.

However, if POL did not achieve its objectives, it is likely that government might be expected to step in to provide support to ensure POL and its network could be maintained (i.e. an implicit level of support that applies under a possible mutualisation scenario as well). Nonetheless, the Review Team noted that as these targets have been agreed within ShEx, there is a

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reputational risk if POL is unsuccessful in reducing the government subsidy (or if it fails to meet other government objectives for POL and its network).

POL Management

The ShEx POL Team outlined that certain key vacancies have been filled over the course of the past year and a more appropriate management structure has been implemented. Yet, vacancies have also arisen. Sue Barton was brought in as Head of Strategy and is recognised as being highly valuable. She is leaving at the end of January on a 12 month career break.

The Review Team also discussed the suitability of the current management team (i.e. capability and capacity) and in particular whether Paula Vennells was the right person to hold the CEO position long term. Questions were raised and it was agreed that a confidential and internal review would be undertaken to assess her suitability.

Mutualisation

The Review Team noted that mutualisation of such a large, complex business will be a complicated process and will require a bespoke model. Nevertheless, there has been progress towards mutualisation. A PO Advisory Council has been established, and the Stakeholder Forum will soon publish a statement of the public purpose of the POL. This will be announced alongside a timeline detailing key milestones. ShEx will set the parameters of the public purpose but it is important that the purpose is formulated through a 'bottom-up' process. Engagement with stakeholders, including employees, unions and Crowns, has been more open and collaborative.

POL and its stakeholders (including government) are in the process of setting up consultative bodies which are expected to be a useful guide to possible governance structures of a mutual organisation (e.g. stakeholder communications board).

However, the Review Team noted that financial stability (proven by track record, break-even and flexibility of the business to downsize without government interference) was an important pre-requisite for mutualisation. The Review Team also noted that POL cannot have the genuine features of a mutual organisation until it is able to borrow externally.

Contract Concentration

POL is currently reliant on 5/6 contracts which generate a material proportion of its revenue – management are looking to diversify this in order to de-risk the business's operations. The Review Team noted the importance of creating contingency plans in case certain contracts are not renewed or are renegotiated on materially less favourable terms.

It was noted that POL are conscious that ShEx also looks after Royal Mail. The Review Team noted that certain procedures/documents need to be established to formalise the relationship between the POL and Royal Mail teams within ShEx.

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Top Priorities

The main priorities for the ShEx Team include;

1. Transformation of POL and new strategy implementation including management, state aid and contracts
2. Continued progress towards mutualisation
3. Continual monitoring and resolution of policy and stakeholder issues, including overcoming obstacles with government contracts