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Department of Trade and Industry

POST OFFICE REFORM:

**A WORLD CLASS
SERVICE**

for the
21ST CENTURY



Post Office Reform:
A world class service for
the 21st century

Presented to Parliament by
the Secretary of State for Trade and Industry
by Command of Her Majesty
July 1999

Foreword by the Secretary of State for Trade and Industry



The Post Office is a vital part of both our economic and our social life. With its regular delivery to every address in the country – an average of 75 million letters delivered every working day of the year – and its nationwide network of post offices visited every week by the equivalent of half the population of the country, it is not surprising that it is one of our best known and respected national institutions.

But the Post Office needs transforming. It needs further modernising as customer demands change, as technology advances and as new players – from private courier services to e-mail providers – emerge. This White Paper shows how the Government intends to deliver its pledge to provide a world class Post Office for the 21st century.


We have a vision of the Post Office as a thriving business:

- efficiently serving the needs of those who need to send and receive letters every day;
- expanding into new areas of electronic and hybrid mail, and complete distribution arrangements;
- making alliances with other players in the market;
- overseeing a nationwide network of post offices equipped with the latest technology with a place in every high street and rural area to offer an increasing range of services for an ever greater number of clients; and
- employing a highly motivated work force that enjoys job satisfaction which will ensure an effective response to the challenges.

The Post Office is taking steps to improve its efficiency, introduce modern services, and enter new markets. The Government will enable the Post Office to invest more in its future so as to realise this vision.

We also have a vision of customers being given greater choice in postal services by the entry of new players into the market, meeting developing customer demands as well as challenging the Post Office to provide ever more efficient services. We will help realise this vision by allowing more competition, strengthening the Post Office Users' National Council (POUNC) to ensure customers' interests are taken fully into account, and establishing a Regulator to ensure fair competition in the UK postal market.

This White Paper details the way we will set the agenda for a modern UK Post Office operating in global markets and providing high quality services to every user in the country. It also describes the way we will ensure that the postal services of this country develop in such a way that all businesses and individuals can be confident of having the communications services needed as we prepare for the new century.

A handwritten signature in black ink, appearing to read 'Stephen Byers', with a stylized flourish at the end.

Stephen Byers

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CHAPTER ONE

Our vision for the Post Office of the future

Introduction

1. The Government intends to ensure that the United Kingdom has a vibrant, competitive postal market and an efficient and effective Post Office to meet the country's needs in the coming years. This White Paper describes the Government's plans for the development of this postal market and the place of the Post Office within it.
2. Effective postal services which meet the commercial and social needs of the country are important to both competitiveness and social cohesion. But the environment in which postal services will be provided in future will differ greatly from the present. The challenges are:
 - changing customer demands (such as businesses seeking delivery to time and international end-to-end services);
 - greater liberalisation of traditional monopolies opening up European and world domestic markets;
 - new technology including the growth of electronic mail and the internet, and sophisticated logistics handling including track and trace technology; and
 - globalisation of postal services and consolidation amongst key postal players.

These call for:

- high quality services to meet differentiated and changing business and social needs;
- increasing efficiency and productivity in the face of competition from alternative means of communication and from both domestic and international competitors;
- flexibility and adaptability in changing markets; and
- a Post Office with the ability to respond to this more competitive and changing environment.

3. The Post Office¹ has been a vital part of the infrastructure of our country:
 - helping government, business and individuals to generate wealth and increasing social cohesion through good communications, swift flows of information and knowledge, and access to the wide range of services available through post offices; and
 - maintaining a successful and profitable business.
4. If the Post Office is to sustain this position and develop into a major global player it will need to change and adapt. But so will the Government's approach to the Post Office. The statutory powers which govern UK postal markets, the blurred relationship between the Government and the Post Office, both on strategy and management, and undue constraints on investment and commercial freedom – all of which have been acting as brakes on successful development – belong to the past.
5. The changes spelt out in this White Paper should ensure that high quality postal services are offered at a reasonable price and that a universal service under a uniform tariff structure can be provided without direct public subsidy. They are designed to enable the Post Office, as an important national asset, to maintain and enhance its value in the face of increased international competition and technological change.
6. The Government's twin goals therefore are:
 - enhanced postal services which satisfy developing business and individual customer needs at affordable prices, and
 - a Post Office which is able to succeed in an increasingly demanding national and international market place.
7. The Government is convinced that successful reform requires more than granting the Post Office greater commercial freedom. It requires greater competition in the postal market and the creation of a new, transparent and accountable regulatory framework. This will ensure that the demands of customers are given priority and that any greater freedom is exercised

¹ The Post Office currently comprises three main businesses: Royal Mail, Parcelforce Worldwide and Post Office Counters Ltd. In this White Paper the term 'Post Office' refers to the organisation as a whole, while 'post offices' is used to describe the network of nearly 19,000 outlets nationwide.

effectively, and will therefore provide the right environment for the Post Office to transform itself into a successful, competitive business.

Government objectives for the reform of postal services

8. The Government has developed five linked objectives which govern the reform programme. These are set out below, with the actions which flow from them.

Objective 1 To improve postal services for business and domestic customers through greater choice, better quality and falling real prices.

9. Experience with the utilities has shown that, in the right framework, greater competition can lead to improved services and falling real prices for domestic and business customers. Competition encourages innovation, productivity and growth. Where there is competition in postal markets, and where it is anticipated, here and abroad, it is already leading to a diversity of products, tailored to meet consumer needs.
10. The Government therefore intends to extend competition by liberalising the postal market. This approach will be combined with robust regulation to ensure fair competition and to provide a surrogate for market pressures where a monopoly remains to protect a universal service. The Government will therefore be establishing an independent postal Regulator (to be known as the Postal Services Commission) in order to achieve this objective.
11. The Government believes that greater competition will bring benefits to the consumer. At present competition is restricted to items costing £1 or more. The Government will take a major first step towards liberalisation by halving the monopoly currently enjoyed by the Post Office to 50p. The necessary order is being laid today to enable the change to take effect from 1 April 2000. From that date anyone may compete to offer postal services where individual items cost more than 50p to send, or weigh over 150 grams. The Government is committed to further liberalisation of the market. It intends therefore to ensure that the new independent Regulator will have a duty to promote competition through reduction of

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the monopoly area. One of the first tasks of the Regulator will be to examine the scope for further liberalisation subject to the need to ensure that the Post Office's obligation to provide a universal service at a uniform tariff is not compromised. The Government will be asking for a report within one year of the Regulator's appointment. The disciplines of increasing competition and independent regulation in its home market should have the additional benefit of strengthening the Post Office and improving its competitive position in the European market and beyond, as liberalisation extends and markets are opened up.

12. The primary duty of the Regulator will be to promote consumer interests by:
 - promoting competition;
 - insisting on high standards of service;
 - regulating prices; and
 - ensuring that the Post Office is able to provide the universal service obligation at a uniform tariff.

13. To inform the decisions both of the Post Office and the Regulator it is important that the voice of all types of consumers should be clearly heard. The Government is therefore strengthening and clarifying the role of the Post Office Users' National Council (POUNC). A strengthened POUNC will work with the Regulator to the benefit of all Post Office consumers.

14. Creation of an independent Regulator will be important for building market confidence and protecting the interests of Post Office users. It will be important to provide credible assurance that there is no undue cross-subsidy from monopoly to non-monopoly areas. The Regulator will have powers concurrent with the Office of Fair Trading (OFT) to oversee fair competition so as to ensure that the Post Office is not using its monopoly and size to suffocate innovation and enterprise, particularly in smaller companies.

15. Regulation is usually only necessary in a market where competition is not possible or where it is not fully developed. The UK market, outside the statutory monopoly, is a vibrant one with over 4,000 competitors. It is therefore the Government's intention that regulation should focus

primarily on the Post Office and any others operating in the monopoly area, leaving the rest of the market free to operate as now in the largely unregulated environment.

Objective 2 To maintain a universal service of postal delivery throughout the UK, and a uniform tariff.

16. It is vitally important that all customers, wherever they live or work in the UK, should be assured of a world class level of postal services provided at a reasonable price. The universal service which the Post Office has been providing at a uniform tariff, regardless of the distance for delivery for letters, registered post and postal packets up to 20 kilograms involves an element of geographical cross-subsidy. This has proved uncontroversial in view of the clear social and business needs that it has met. The Government is committed to its continuation. So whatever other services the Post Office wishes to provide and whatever ambitions it has to expand, the Regulator will need to be assured that its universal service obligations can be met in full.
17. However, not all customer needs in the monopoly area can be met by a single tariff. Without large volume users of postal services the Post Office could not maintain the infrastructure necessary for its universal service at such a reasonable price. Such large users can turn to other competing non-postal services (eg advertising through the media rather than through the post) and choose those services based on cost. The Government therefore judges it is in the interests of postal services generally that the Post Office should have greater freedom to offer commercial, competitive discounts to such users, provided that the flexibility is not used to reduce unduly the prospects for increased competition or to undermine unfairly the viability of competitors' activities in adjacent unlicensed areas.
18. The Government will be looking for the Post Office to maintain and improve the quality of service. The Government intends that required levels of service will be laid down by the Regulator, who will look for such standards to be improved over time, with power to impose

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Objective 3 To establish clear and accountable relationships between the Government, the Post Office, the Regulator and POUNC.

penalties on the Post Office for any shortcomings. In addition, the Government intends to enshrine in legislation, for the first time, a definition of the universal service obligation and uniform tariff structure.

Objective 3 To establish clear and accountable relationships between the Government, the Post Office, the Regulator and POUNC.

19. The boundaries between the responsibilities of the Government and the Post Office have become blurred over time. In addition, the Government has previously acted both as owner and regulator with no clarity as to how it balances its interests. Under the reform programme, clear boundaries and a genuine arm's length relationship will be established.
20. The Government will have two, separate, roles:
 - as the national authority setting the legal and regulatory framework and social and environmental objectives; and
 - as owner.
21. The Government will restrict its activity to the strategic level, both in setting social objectives and on matters of commercial direction. The Post Office Board will become clearly accountable for running the business successfully on the basis of a rolling, five year, Strategic Plan agreed with the Government. Separately, the Regulator and POUNC will be given clear duties and the necessary powers and resources to promote consumer interests. The Government intends that these arrangements should be as transparent as possible. All four parties will publish annual reports on their roles and their performance during the year.

Objective 4 To equip the UK Post Office to meet the challenges of the changing postal market both domestically and internationally.

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22. The Post Office will have to become more strongly competitive and customer focused in order to operate successfully in the rapidly evolving market place. It will need to be more responsive to change, and be equipped to take on and manage new commercial risks and opportunities. This will require a transformation in the way that the Post Office manages

its business, its openness to outside influences, and its willingness to engage with private sector partners.

23. The Government's intention is that in future the Post Office will be driven by market and regulatory disciplines. It will need to respond to these by improving efficiency and seeking out commercial opportunities. The Government recognises that to make this work the relationship between the Government and the Post Office has to change.
24. For its part, the Government has already announced that it will be reducing its financial demands on the business. The Government will expect a dividend at commercial levels – in 1999/2000 this will be 50 per cent of the post tax profits, and thereafter 40 per cent of such profits, subject to a cash floor to be set in the context of the approval of the Strategic Plan. This will, in effect, more than halve the rate at which profits will be taken out of the business, greatly increasing the Post Office's ability to invest in new technology and enhanced services in its core business as well as in new business areas. This will result in some loss of income to the Exchequer in the short term. But investment to grow the value of the overall business should not only improve services, but also eventually produce higher returns (and tax receipts) to the Exchequer on a sustainable long-term basis.
25. The Government recognises that to grow successfully, with new products, partners and markets, the Post Office may need to make larger growth investments including acquisitions, joint ventures, alliances and partnerships. These may not all be financed from retained profits. The Government is therefore prepared to see the Post Office borrow in such circumstances, at commercial rates. For investments of £75 million or less there will be timely notification with borrowing limited to a maximum of £75 million in each of the next five years. For investments over £75 million (or where the satisfactory return from a smaller investment is dependent on further linked investment) the approval of Ministers will be required. The Government will approve Post Office requests for borrowing for investment cases which are consistent with the Strategic Plan, commercially robust, and pose no undue risk to the taxpayer.

- 26.** As the boundaries of the postal and adjacent markets change, the Post Office should be able to invest and grow into these areas. Current legislation enables the Post Office to enter into a wide range of activities, and it is not expected to constrain the Post Office's current plans. But it did not anticipate the current changing market conditions. When the legislative programme allows, the Government will therefore clarify the Post Office's permitted range of activities to reflect the continuing evolution of the scope of the postal services market. The legislation will also provide for transforming the Post Office from a public corporation to a public limited company.
- 27.** In order to respond to commercial pressures, including increased competition and price regulation, the Government believes it is right to allow the Post Office more flexibility, within the necessary context of public sector pay policy, to increase the linkages between pay, productivity and performance. The Post Office already offers tailored productivity schemes to reward staff for their own particular contributions to more effective working. But, in addition, the Government and the Post Office will be looking at the possibility of developing a general framework of parameters for overall pay settlements, rather than requiring the Post Office to put forward each settlement for approval. They will also consider ways to share long term success of the business with staff, based on any increasing value of the organisation. These areas will be explored further over the next few months, with a view to implementation from 1 April 2000.
- 28.** The Post Office must also be free to meet the challenges of market developments by structuring its business as it decides best in the light of the changes. The Government will not involve itself in such decisions, but the Regulator will need to ensure that the necessary accounting transparency is in place to give credible assurance that there is no undue cross-subsidy from the business units operating in the monopoly area to those competing in other market sectors.
- 29.** This new framework will provide the scope for the Post Office as an independent business within the public sector to respond effectively

to the changing market. It is now up to the Post Office to respond to the challenges ahead.

Objective 5 To support a viable network of post offices so as to ensure nationwide access to a range of public and private sector services.

30. The Government remains firmly committed to a viable network of post offices across the country. The sub-post office plays a valuable role in local communities, particularly for the less mobile. But the Post Office cannot sustain a network if it is not sufficiently well used, and nor can Government. The network therefore has to offer products people want. Automation is vital to this since it will provide the opportunity to offer a wider range of products as more traditional business falls away. Following a major review, agreement has recently been reached with ICL to take forward the Horizon project to automate the network of post offices. The benefit payment card has been removed from the project, which in its restructured and streamlined form will enable all post offices to be equipped with a modern, on-line electronic platform by 2001. There will be no change in the existing methods of paying benefits until 2003, after which the Benefits Agency (BA) intend to move from the traditional paper based methods of payment to a more modern and efficient way of paying benefits, building on banking technology and using the existing automated credit transfer system to make benefit payments into bank accounts accessible throughout the nationwide network of post offices. Post Office Counters Ltd (POCL) and DSS/BA will be working together on plans to introduce the new arrangements in 2003. This will mean that all benefit recipients who wish to collect their benefits in cash at post offices will continue to be able to do so both before and after the change.
31. But customers must also play their part and offer their support through the use of a valued national institution if it is to remain viable.
32. POCL is a unique organisation. It is a public sector body which distributes its services through nearly 19,000 outlets, 97 per cent of which are privately owned by subpostmasters and franchisees, (usually in conjunction with another retail business) who make their own decisions

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about the commercial viability of their businesses. Whilst many of these businesses are successful, a minority may run into difficulties or the incumbent may retire. In some cases a new subpostmaster is subsequently found (often through joint Post Office/local community effort), but each year there are a number of post offices (around 200) which close in spite of best efforts. However, the Government is determined that this valued communications and community service should not lose its truly national reach by default. The Government will therefore set (as part of the Government's guidance to the Post Office and the Regulator on environmental and social issues) minimum criteria for access to post office counters' services. Both the Post Office and the independent Regulator will report annually on achievement against these criteria. The Regulator, with input from POUNC on behalf of consumers, will be required to advise the Government of any concerns particularly on rural parts of the network and areas of social deprivation, so as to give timely warning of a potentially serious reduction in access to Post Office facilities. The Government will then be responsible for consulting and deciding on the best way forward, taking account both of social needs and overall financial viability.

- 33.** The Post Office is committed to maintaining and modernising a strategically well-positioned network of Crown post offices. Such a network provides POCL with direct contact with the customer, and enables them to develop high standards of service and products which their customers need. For the foreseeable future at least 15 per cent of the total business transacted by the counters' network will be done at the Crown offices. The Post Office will convert some of the current Crown post offices to an agency basis where such conversion would be beneficial to customers and the business. In doing so, the Post Office will have regard to ensuring good customer service, cost effectiveness and the ability to manage related staff issues. The Post Office will also be enhancing the public consultation process associated with conversion.

Future developments

34. Events will, no doubt, continue to move rapidly in this constantly changing commercial environment so further structural changes may be required, to enable the Post Office to grow and to meet customer needs, which are in the best interests of the Post Office and its staff. The Government does not rule out the possibility of introducing private share-holding into the Post Office - for example through the sale of a minority stake in it or an exchange of equity with other businesses - at a later stage. However at present wholesale privatisation would not be a realistic option. Primary legislation will be necessary to convert the Post Office into a plc. The Government will propose that such legislation shall contain a commitment that if there is any proposal to sell or exchange shares, then there would need to be further approval of such a proposal by both Houses of Parliament.

The challenge of change

1. Throughout the world postal services have traditionally been provided by public postal operators rather than being driven by the market. In the United Kingdom that provider has been the Post Office (see box below), a product of its historic position and the postal monopoly. But this position is changing in the UK and elsewhere.

The Post Office

The Post Office has for centuries made a vital contribution to national life. It is part of our history and culture; and business and individuals rely on it for a wide range of services.

The Post Office has three main businesses:

Royal Mail which provides a national and international mail service, handling on average 75 million items a day;

Post Office Counters Ltd which runs the network of nearly 19,000 post offices (of which 600 are directly-operated Crown offices); and

Parcelforce Worldwide handling some 140 million parcels a year.

A fourth business **Subscription Services Limited** provides licensing and subscription management services, principally television licences for the BBC.

Surveys show that the Post Office is surpassed in the UK only by Coca-Cola in the strength of its branding. It employs some 200,000 people; in addition to which it has about 18,000 agents running sub-post offices. In 1998/1999 it had a turnover of £7 billion.

2. There is now a broad consensus that the postal sector worldwide has entered a period of fundamental change. The key drivers are changing customer demand (particularly in the business sector); greater liberalisation; new technologies and, in response to these pressures, globalisation and consolidation in the postal market. Looking ahead the market is likely to change much more quickly than it has in the past; and

the communications market and postal services within it will be very different in five to ten years from now.

The market

3. Despite the existing letter monopoly and the fact that it currently holds 96 per cent of the UK domestic letter market, the Post Office is beginning to face threats to the volume of business handled through the postal system and the Post Office network. Competition, both from within the postal sector and from alternative technologies, is increasingly fierce. A letter can be sent from one continent to another by fax in seconds; and e-mail is both cheaper and quicker than traditional post.
4. Several overseas post offices are now operating in the UK international mail market (see box below). And in the parcels and express delivery market in the UK, in which the Post Office enjoys no monopoly, there are over 4,000 competitors. In addition, mail order operators have tended to set up their own distribution operations – integrating the whole delivery chain from warehouse to customer.
5. There is increasing pressure for liberalisation around the world from competitors and customers; and increasingly from governments, who want to promote faster, more effective response to the changes that are already happening in the market so as to promote consumer interests through greater competition.

The competition

Within its traditional, protected market the Post Office has been regarded as something of a model by many other public post offices. But that position is slipping as its main rivals become more commercially focused, using their ability to make acquisitions and increasing their productivity, efficiency and effectiveness. For example, in 1992 Deutsche Post only handled 78,000 items per employee per year compared to 90,000 by the Post Office. But by 1996 Deutsche Post's productivity had increased 35 per cent to 105,000 items per employee, overtaking the Post Office which handled 102,000 items per employee, an increase of only 13 per cent.

Seven overseas post offices are now operating in the UK international mail market providing re-mail and value added services. There are also smaller companies focusing on high volume international city to city mail routes. In the parcels and express delivery market the Post Office has over 4,000 competitors operating in the UK.

In New Zealand, Sweden and Finland the post offices have become independent plcs. The Netherlands, Argentina and Singapore have privatised their public post offices; and Germany is moving in that direction.

Furthermore the UK Post Office is behind its competitors in entering new markets. Within Europe the Dutch and German post offices in particular have been investing in substantial acquisitions (the Dutch bought TNT; the Germans have made numerous investments including a 25 per cent share in DHL). The post offices in France, Sweden and Finland are also free to invest in other companies.

6. The EU Postal Services Directive adopted in December 1997 mandates the Commission to bring forward proposals for the next stage of liberalisation, following a review of the sector. Decisions are unlikely to be reached before 2000 but the expectation is that from 2003 onwards domestic letter markets within the EU will be opened up progressively. There is also demand for postal services to feature strongly on the World Trade Organisation (WTO) agenda for the next round of services negotiations in 2000.
7. Customers, particularly business customers (who account for some 90 per cent of the mail, directly or indirectly) are becoming increasingly demanding. They want faster, more reliable postal services; more choice of product (including more sophisticated products, such as tracking); and competitive prices which meet their individual requirements. They are increasingly looking for a pan-European (or international) 'end-to-end' delivery service. If the Post Office cannot meet these needs they will look elsewhere.
8. As the information society comes of age we can expect an explosion in communications, stimulated and enhanced by the growing acceptance and development of electronic commerce. New and existing technologies (eg fax, e-mail and the internet) will increasingly be used as a substitute

for physical mail. At the same time the growth in electronic commerce, including home shopping, will tend to increase the market size not only for parcels but also for related mail such as bills and direct mail advertising. The Post Office needs to embrace the information age as its customers increasingly do so, using new technologies in order to provide value added services and secure volume and value from these growth markets.

Need for change

9. Against this background it is no longer appropriate to think simply in terms of letters and parcels. Both are part of a wider communications and logistics market; and a monopoly limited to those markets will no longer provide automatic protection for postal business given the choices for information delivery available to customers. Faced with these challenges the Post Office needs to change radically if it is to have a long term commercial future. Market developments pose no immediate threat to profitability but there is a real danger it could be left behind in the medium term. It is clear that the old way of running a nationalised industry is no longer appropriate; and that the Post Office needs to change in order to maximise its potential.
10. More dynamic postal and wider communications markets offer opportunities as well as threats to the Post Office. Data from reports compiled by a number of authoritative sources show that the size of the global letters, package and express market is expected to grow from £126 billion in 1995 to £167 billion by 2010. Substantial growth is expected in the logistics market, including integrated mail order operations, and in the express and parcels markets. Growth in the letters market will be much less and is expected to be concentrated in direct mail, cross border mail, and mail order; and in new products that incorporate some electronic process.
11. Although it has lost ground in recent years to its competitors, most notably the Germans and the Dutch, there remains an expectation in the postal world that given the right commercial focus, the Post Office, currently the second largest exporter of mail in the world and with a

good reputation at home and abroad, has the potential to become one of the key players in the global market, alone or in partnership with others.

12. The Government has recognised that if it is to respond effectively in a changing market, the Post Office needs to be transformed. The Government can play its part by adjusting the framework within which the Post Office operates, in part by giving the Post Office greater commercial freedom. But a successful transformation of the business depends ultimately on how the Post Office itself responds to the challenges ahead.
13. The *status quo* is no longer an option. Hence the reforms outlined in this White Paper combine greater commercial freedoms, including the freedom to form partnerships and alliances, with the disciplines of competition and regulation, the better to prepare the Post Office to meet the challenges ahead.

Objective 1 – To improve postal services for business and domestic customers through greater choice, better quality and falling real prices

COMPETITION

Benefits of competition

1. Promoting competitiveness through increasing competition is a central objective of the Government. The Government has strengthened UK competition laws and is enhancing competition within the regulated utilities. Now it is increasing competition in the postal sector.
2. Together with robust independent regulation, greater competition in postal markets will bring benefits for consumers as it has in markets such as telecommunications and energy where consumers have benefited from greater choice, better quality and lower prices.
3. Greater competition will also help to change the business culture of the Post Office, challenging it to become more efficient and competitive. This should make it a stronger business which is essential if the Post Office is to become truly world class; and play its part in improving UK competitiveness.

Post Office monopoly

4. The Post Office currently has a statutory monopoly for letters priced at under £1. The traditional justification has been that a statutory monopoly is necessary to enable the Post Office to benefit from economies of scope and scale and therefore provide a universal service at a uniform tariff without direct public subsidy. However, there is growing evidence from studies carried out in Europe for the European Commission that, contrary to long-held assumptions, there may be considerable scope for introducing greater competition in postal services without undermining these essential services.

Liberalisation of the UK market

5. The European Commission is expected shortly to bring forward proposals for greater competition within the EU postal market. There has been debate about whether or not to open our own market in anticipation of wider international market liberalisation. It has been argued that any extension of competition in the UK in advance of any agreed EU-wide liberalisation might undermine the Post Office's competitive position in relation to other public post offices who would continue to benefit from protected home markets; and that in the longer term this could have negative consequences for consumers.
6. The Government is unconvinced by these arguments, not least in the light of the benefits of greater competition in the utility markets in the UK in advance of wider EU developments. There are some differences between the private utilities and the postal market. Barriers to entry into the postal market are lower than in energy and telecommunications. But the Government does not believe that the differences are so great as to qualify the assumption that competition should benefit the consumer in the postal sector.
7. On the contrary, exposing the Post Office to greater competition ahead of many of its EU counterparts should put it in a better position to take commercial advantage as markets are liberalised across Europe and beyond. Some other countries (see box below) are already seeing advantage in the early introduction of greater competition into their postal markets.

Liberalisation of overseas markets

A number of very different postal markets are now fully liberalised: Sweden, Finland, New Zealand and Argentina have all abolished their monopolies. In the Netherlands direct mail already falls outside the scope of the monopoly; and they are planning to reduce the scope of the monopoly this year to 100 grams and three times the first class tariff.

Halving of monopoly to 50p

8. The Government's judgement is that a reduction in the monopoly is entirely compatible with the continuation of essential services; and that

service levels will not only be maintained but enhanced by the introduction of greater competition to the postal sector.

9. The Government has rejected the immediate abolition of the monopoly. It believes that the best results for consumers, including the protection of the Universal Service Obligation (USO), can be achieved if the Post Office is given time to respond to changes in market conditions. Liberalisation will therefore be phased. As a first step the Government is halving the monopoly from £1 to 50p; or, expressed in weight, 150 grams. So, if an item of mail is priced above 50p or weighs over 150 grams it will not be subject to the monopoly and can be delivered by any operator. It is anticipated that this reduction will not have any significant impact on the profitable delivery of USO services by the Post Office. An order under section 69 of the British Telecommunications Act 1981 has been laid and with Parliamentary approval this reduction in the monopoly will take effect from 1 April 2000.

Further reductions in the monopoly

10. The Regulator will have a duty to promote competition in the interests of consumers. An early task for the Regulator will be to review the scope for increasing competition by further reductions in the monopoly, subject always to the Post Office's ability to meet the universal service and uniform tariff obligations efficiently. The Government will expect the Regulator to report within a year of appointment on its proposals, including a timetable, for further liberalisation of the market. In the meantime the Government has made it clear to the Post Office that it should proceed on the basis that following the Regulator's report competition will be further enhanced.
11. The Regulator will not be restricted to enhancing competition through reductions in the price and weight thresholds of the monopoly. Instead it is intended that the Regulator should be free to consider all appropriate mechanisms for introducing competition, including liberalisation by class of mail (eg direct mail) and the scope for licensed competition within the monopoly area, including the further development of 'niche licences' (see box over page). The Regulator will, of course, need to take fully into

account actual and prospective developments in the EU, WTO, and the Universal Postal Union; and to ensure that its own actions and proposed policies are compatible with those of these organisations.

12. Until new primary legislation is in place the Regulator will not have the power to introduce greater competition itself, but will make recommendations to the Secretary of State.

Niche licences

The Secretary of State may, under section 68 of the British Telecommunications Act 1981, grant a licence to operate within certain conditions within the area otherwise reserved as a monopoly for the Post Office.

A number of licences have been issued to cover postal operations within the monopoly area. These include a general (class) licence to cover the operation of document exchange (used by the legal and other professions); a licence covering the collection and delivery of Christmas cards by charitable organisations; a licence to cover internal mail between Government offices; and one individual licence to cover the collection and delivery of brokers' research. The Government believes there may be opportunities for extending niche licensing to give the consumer greater choice and will be asking the Regulator to explore the possibilities.

In the meantime, to facilitate operational management of competing services, the Government proposes to amend the class document exchange licence to clarify its boundaries.

Post Office privileges

13. The Post Office enjoys a range of special privileges granted through legislation in order for it to meet its USO and uniform tariff obligations. These include exemption from traffic regulations, the power to require the conveyancing of mailbags and compulsory land purchase powers.
14. The Government intends that these privileges should be maintained. However, the Regulator will keep them under review and advise the Government on their continuation, particularly in light of the effects of reductions in the monopoly. In addition the Government does not rule

out extending such privileges to other postal service providers if they are licensed to compete with the Post Office in the monopoly area.

REGULATION

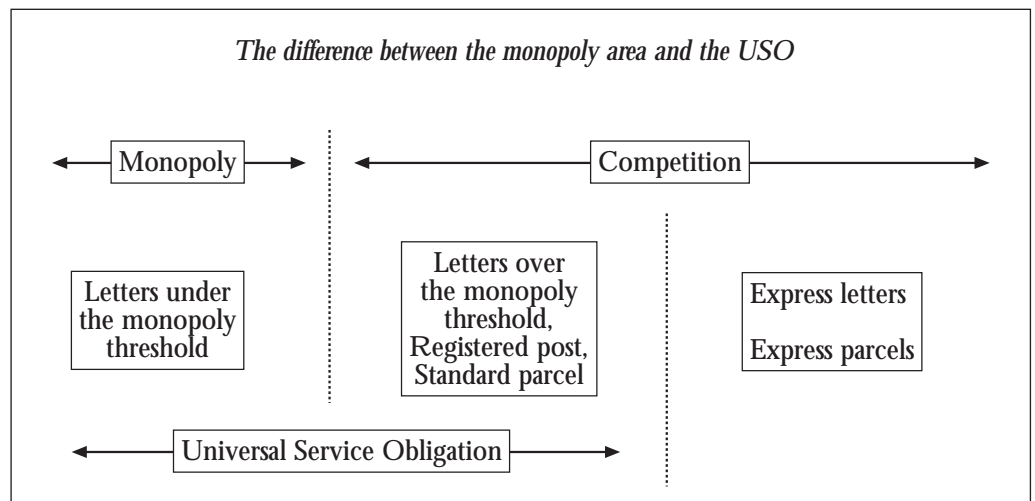
Need for regulation

15. The Post Office has a dominant position in significant parts of the market, most obviously the statutory monopoly it enjoys for letter post below £1. Whilst the Government is setting in train a reduction in the scope of this monopoly and envisages further liberalisation over time, it is anticipated that there will continue to be a statutory monopoly for some time. That in turn creates the potential for competition to be constrained outside as well as within the monopoly because of the possibility for the Post Office to abuse its dominance in the monopoly market to compete unfairly with businesses in competitive markets.
16. The Government therefore believes there is a strong case for transparent regulation. In principle this could be carried out from within Government. But this would involve conflicts of interest for the Government as owner and regulator and would not, therefore, maximise confidence in the transparency and effectiveness of the regulation.
17. The Government will therefore establish an independent Regulator. Key functions will include:
 - protecting and promoting consumer interests including standards of service;
 - regulating prices;
 - ensuring fair competition; and
 - ensuring that the Post Office is able to meet its universal service obligations at a uniform tariff.

The creation of an independent Regulator is widely supported; indeed many of those consulted prior to the announcement of the reform package saw it as a necessary accompaniment to the freedoms sought by the Post Office. The model proposed will be fully consistent with that proposed by the Government for the regulated private utilities.

Scope of regulation

18. The Government believes that economic regulation is only necessary in a market where competition is not possible or where it is not fully developed. Regulation and red tape should not extend into a market which is operating effectively to the benefit of consumers. The UK postal market outside the statutory monopoly is a vibrant, competitive market with over 4,000 competitors. It is therefore the Government's intention that regulation should focus on those who are operating within the monopoly area, leaving the rest of the market free to operate as they do now in a largely unregulated environment (see box below showing the different segments of the market). In the first instance this means that regulation will focus on the Post Office.



19. The Post Office will be subject to three broad tiers of regulatory control:
- full regulation, including price regulation, of services within the monopoly area;
 - regulation of provision and quality of services within the competitive area which are subject to the USO and uniform tariff obligations; and
 - regulation of fair competition of services provided within the competitive area not subject to the USO and uniform tariff obligations.
20. Other businesses operating under licence in the monopoly area will be subject to regulation. The extent of regulation for other businesses operating in the monopoly area will depend on the type of licence and the extent of the services offered. It is anticipated that any other bodies

licensed to operate a full service within the monopoly area will be subject to a regulatory regime similar to that for the Post Office.

Price regulation

21. Effective price regulation is vital in the absence of effective competition. It is therefore intended that the Regulator will regulate prices within the monopoly area. Whilst the method of price regulation will be a matter for the Regulator, the Government anticipates that this is likely to be a derivation of RPI-x which is the system of price regulation used by existing utility regulators. The Government will expect the Regulator to report its proposals on price regulation within one year of appointment.

Enforcing service standards

22. Ensuring the delivery of the required quality of service standards will also be a key role for the Regulator (see Chapter 4 for details of quality of service standards). The Regulator will be responsible for setting and enforcing service standards not only in relation to monopoly services, but also in relation to those services which are outside the monopoly but subject to a USO and uniform tariff obligation (ie standard parcels and a registered postal service). In carrying out this duty it will be assisted by POUNC which will have responsibility for monitoring the quality of service provided by the Post Office.
23. Subject to primary legislation the Government intends to give the Regulator powers to order that any USO service deficiency is put right; and to fine the Post Office for breaching service standards within the USO area.
24. The Regulator and the consumer representative body will each have a role to play in ensuring that there is an adequate system for individual consumers to seek compensation from the Post Office (and any other licensed postal operator) and that it is working effectively.

Fair competition

25. The Regulator will ensure that the Post Office (and indeed any other body subsequently licensed to operate a full public postal service within the

monopoly) competes fairly and does not act anti-competitively. This may involve intervention in the competitive area in respect of services which are not subject to the USO and uniform tariff obligations. In these cases intervention will be restricted to the use of general competition rules and apply only to the activities of bodies licensed to operate also within the monopoly. It is proposed therefore that the Regulator should have concurrent powers with the Director General of Fair Trading to apply UK competition rules in respect of the Post Office (and other licensed postal operators).

26. In particular the Regulator will ensure that any cross-subsidy from the monopoly area to competitive activities is the minimum required, in the opinion of the Regulator, to ensure the continued provision of services required by the USO and the uniform public tariff. It will also ensure that access to monopoly activities (either as a complete service such as first or second class mail or as an input into an activity outside the monopoly) is fair and non-discriminatory. And it will also need to ensure that there is no abuse of a dominant position, for example by the Post Office using predatory pricing to deter or drive out competition or by abusing its monopoly power to extend its dominance unfairly into adjacent markets.

Role of Regulator in relation to the Post Office Counters' network

27. Post offices deliver a wide range of Government and private sector services; and, on the private side of their businesses, individual post offices deliver a range of retailing services in an open market. The Government does not intend to see regulation of postal markets extend into such areas. The Government proposes that the Regulator's role will be confined to ensuring the general ability of the Post Office network to support the USO on letters and parcels; and to monitoring levels of access to the network, reporting any concerns to the Government (see Chapter 7).

Duties of the Regulator

28. The primary objective of the Regulator will be to exercise its functions in the manner best calculated to promote the interests of consumers,

wherever possible and appropriate through promoting effective competition. The interests of consumers will be interpreted to include:

- the continuity and availability of universal postal services at a uniform public tariff;
- the prices charged for services within the universal service obligation; and
- the quality of services within the universal service obligation.

In defining the interests of consumers, due weight will be given to their longer and medium-term interests as well as to their immediate or short-term interests.

29. Subject to the primary duty, the Government proposes that the Regulator will have a duty to exercise the functions assigned to it in a manner best calculated:

- to ensure that the Post Office can supply all demand for public postal services, so far as it is reasonable to do so, in the United Kingdom;
- to promote efficiency and economy in the provision of public postal services; and
- to enforce the Post Office monopoly.

30. Furthermore the Regulator will also be required in the exercise of its functions to:

- have regard to social and environmental guidance issued to it by the Secretary of State;
- advise the Secretary of State as to the exercise of his regulatory functions in relation to the Post Office under the Post Office legislation;
- keep itself informed about postal matters generally;
- prepare an annual report on the performance of its functions to the Secretary of State; and
- consult the Post Office Users' National Council on specific issues affecting the interests of consumers, including individual and overall standards of service; and on the Regulator's strategic forward planning.

Transparency

31. The Government is committed to the creation of a transparent regulatory regime, and the Government will expect the Regulator to consult widely. The Regulator will, therefore, be placed under a statutory duty to consult on, publish and follow a code of practice governing its consultation and decision-making processes. The Regulator will also be required to publish reasons for individual key decisions; and will be expected to make an annual report on the performance of its duties to the Secretary of State, who will lay it before Parliament.
32. The Regulator will have the power to require information relevant to the exercise of its functions from the Post Office and other operators licensed to operate within the monopoly; and a power to publish information for the benefit of consumers and in the interests of good regulation, subject to tests relating to substantial harm, including matters of commercial confidentiality and public interest.
33. In particular it is intended that the Regulator will be able to require the Post Office (and any other licensed public postal operator) to provide regulatory accounts and other financial information clearly distinguishing between monopoly and competitive services; and in the competitive area between USO and non-USO services. Subject to the introduction of primary legislation, refusal to supply such information will be an offence punishable by fines. It is also intended that the Regulator will have a power to impose changes in accounting practices if this would facilitate transparency.

Guidance

34. The Secretary of State will issue guidance to the Regulator setting out the Government's social and environmental objectives for the Post Office. The guidance will be subject to full consultation including with Parliament, and would be intended to last for a set duration of a number of years. The Regulator will need to take this into account when carrying out its duties.

Establishment of Regulatory Body

35. In line with the Government's policy for better regulation of the private utilities the Government proposes to appoint a Board of Regulators rather than a single Regulator. The advantages of the Board approach as identified in the context of the Government's review of the utility regulation are that: it de-personalises the regulatory process; provides collective but streamlined decision-making; spreads the burden and increases the scope for greater continuity and consistency when new regulators are appointed.
36. The Government intends to provide for the Regulator when the UK implements the EU Postal Services Directive.² The Regulator will act as an independent adviser to the Secretary of State until primary legislation empowers the Regulatory Board to act on its duties in its own right. It is intended that the Regulator will be funded by a contribution from the Post Office itself, and in due course any other licensees as appropriate. This is in line with the financing of regulation in the utilities.

CONSUMER REPRESENTATION

37. It is vital that consumer interests are safeguarded and that consumers share in the benefits of an increasingly competitive postal market. The Government therefore sees a real need for a strong consumer body at the heart of the regulatory system working with the Regulator but from a position of independence.

Current framework for consumer representation

38. Currently the interests of the consumer are represented by the Post Office Users' National Council (POUNC) which is an independent organisation, established under the Post Office Act 1969. Separate Post Office Users' Councils (POUCs) are established by statute for Wales, Scotland and Northern Ireland. These have particular responsibility to consider any matter relating to Post Office services in their respective geographical areas. POUNC is the national voice for Post Office users,

² Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service: Official Journal of the European Communities, 21 January 1998, page L15/14

responsible for developing national policy. But whilst the Chairmen of the POUCs are full members of POUNC they are not formally accountable to POUNC.

39. There is also an extensive network of Post Office Advisory Committees (POACs). These are locally based committees that represent the views of users of postal services at the local level. They are not statutory bodies; but they are provided for in statute.

New role for POUNC

40. The Government intends to strengthen POUNC, enabling it to play a key part in providing information and advice to consumers; articulating the consumer interest; working with, and where appropriate challenging, the Regulator in improving standards and ensuring that there is a tough regulatory framework which protects all consumers.
41. The Government proposes to give POUNC broad functions within the regulatory system for postal services. Their key functions will be:
- to act as the public advocate on behalf of all users of Post Office services (although it is not intended to prevent individuals, business users or groups of individuals representing themselves);
 - to provide strategic advice to the Regulator, the Government, Parliament and others on consumer interests;
 - to provide advice and information to consumers;
 - to handle and investigate consumer complaints not satisfactorily resolved by the Post Office (or other licensed postal operators), mediating as appropriate; passing on to the Regulator those where it appears a determination or enforcement action by the Regulator may be required;
 - to work constructively with the Post Office (and other licensed postal operators) to reduce the causes of complaints;
 - to monitor service performance against the standards set by the Regulator;
 - to make representations and recommendations on the level of fine to be imposed by the Regulator for failure to meet service performance standards; and

- to ensure that licensed postal operators have an effective complaints handling and compensation system.
42. The Government will expect POUNC to consult widely when fulfilling these functions. Moreover it is intended that these functions will be underpinned by a research capacity to monitor Post Office performance on service standards and complaints handling; and to identify customers' needs and concerns, including those of particular groups of consumers such as small businesses, those in remote areas and the disadvantaged.

Role of POUNC in relation to the Post Office counters' network

43. POUNC will have a direct interest in all aspects of the Post Office counters' business as it impacts on consumers. In conjunction with the Regulator, POUNC will monitor the network. However, unlike the Regulator, POUNC will have an interest in specific, often localised counters issues not just those generic to the network as a whole. In particular the Government proposes that POUNC should monitor the Post Office's code of practice on closures, relocations and Crown conversions. We also propose that POUNC will be able to comment and make recommendations on the need for post office provision in particular areas. We expect this to play an important part in protecting post office provision in rural and inner city communities.

Relationship between POUNC and the Regulator

44. To avoid confusion and maximise efficiency there needs to be an effective framework for collaboration between the Regulator and POUNC. To achieve this the Government intends to place a duty on POUNC and on the Regulator to agree and then publish a memorandum of understanding. The detailed content will be a matter for the parties to agree but the Government expects it to cover such matters as the arrangements for consultation on specific decisions, the exchange of information, and the co-ordination of work on consumer-related issues.

45. The Regulator will be placed under a statutory duty to consult POUNC on specific issues affecting the interests of consumers, including standards of service; and on the Regulator's strategic forward planning.

Access to information

46. Good quality, up to date information will be essential to an effective POUNC. It will generate some information itself through its work in dealing with consumers and their complaints, and through its research activities. But it will also need access to information, both from the Post Office and from the Regulator.
47. The Government intends that POUNC should have rights of direct access to the information that it reasonably needs from the Post Office in order to monitor and assess service standards and complaints handling procedures; and to investigate and mediate specific unresolved customer complaints. Other types of information – both information that the Regulator already holds and new information which needs to be obtained from the Post Office – should be obtained by making a request to the Regulator where it cannot be gathered from the Post Office on a voluntary basis. To facilitate this the Government intends to give the Regulator the power to demand information on behalf of POUNC as well as for itself, and the Government intends to make POUNC a body to which the Regulator can disclose information. The Regulator will be required to comply with or to facilitate all reasonable requests from POUNC. There will be a reciprocal obligation on POUNC to provide information to the Regulator.
48. The Government intends that POUNC will have the power to publish, at their discretion, information in the interests of consumers, subject to tests like those applying to the Regulator (see paragraph 32).
49. These are strong information gathering powers which will ensure that POUNC has the information it needs to play a key role within the regulatory system, consistent with the Government's broader vision of consumer councils as independent, effective consumer champions.

Organisational issues

50. The Government wants to see a strong consumer body at the heart of the regulatory system. The Government has concluded that, to maximise its effectiveness, consumer representation in the postal sector needs a strong national body which can speak on behalf of all users in a sector, rather than fragmenting consumer representation and thereby dividing and weakening the consumer voice. This is consistent with the outcome of the consultation on consumer representation in respect of the energy, water and telecommunications industries. A national body will, it believes, best meet the consumers' needs as postal services and the Post Office develop in an increasingly global market.
51. The Government proposes to designate POUNC as that body. The new POUNC will provide focal point for consumers for unresolved complaints, championing their interests and ensuring that their voice is heard by the Post Office, the Regulator and the Government.
52. In setting the framework for future consumer representation in the postal sector the Government recognises the need for an appropriate balance between issues of national importance and regional concerns and views. The Government wants to ensure that a reformed POUNC draws its strength from all parts of the UK in order for it to be truly representative of all postal service users. The Government therefore proposes to give POUNC a duty to ensure that regional needs are addressed efficiently and effectively, and that its work is fully informed by an awareness of regional issues. To meet this duty POUNC will be given flexible powers to establish regional offices, and to appoint regional committees or panels where these are needed to help address customer complaints and other issues. These powers will give POUNC the flexibility to shape their regional arrangements to ensure effective representation and to adapt them over time as the market changes.
53. The Government is particularly concerned to ensure that POUNC takes account of national identity in determining their organisational structure, providing adequately for the representation of consumers in Scotland, Wales and Northern Ireland. The Government proposes therefore to

give POUNC an additional, specific duty to maintain offices and an appropriate committee in Scotland, Wales and Northern Ireland.

54. These country committees, and the other regional committees, will operate as part of a single public body, pursuing consistent strategy and with the national council at its head. Appointments to the national council will be made by the Secretary of State for Trade & Industry. The national chairman of each of the Committees for Wales, Scotland and Northern Ireland will also be appointed by the Secretary of State for Trade & Industry. The Government intends that the national council will appoint the chairmen of any other regional committees, subject to consultation with the Government.
55. Representation at grass roots level is vital to a strong consumer voice. Currently this is provided by a loose network of some 170 Post Office Advisory Committees. Individually many of these POACs have done an excellent job in representing local consumer interests but because they have grown up in an *ad hoc* manner the network as a whole lacks clarity and strategic direction. The Government believes that this lack of strategic direction needs to be addressed and proposes that in due course POUNC should be given a clear and exclusive role in determining how best to provide for consumer representation at the local level.
56. The Government intends to introduce legislation to reform consumer representation as soon as Parliamentary time permits. In the meantime the Government will be consulting further with POUNC and the POUCs on how best to take forward its proposals for strengthening the consumer voice before finalising proposals for legislation.

Funding POUNC

57. As with the Regulator, it is intended that POUNC will be funded by a contribution from the Post Office, and in due course any other licensees as appropriate.

CHAPTER FOUR

Objective 2 – To maintain a universal service of postal delivery throughout the UK, and a uniform tariff

Maintaining and improving postal services

1. The Government believes that all customers should be guaranteed a good level of postal services and is committed to a universal postal service at a uniform tariff. The reform programme is intended to ensure that standards of postal services are at least maintained and wherever possible improved for all postal users. This will be achieved through greater competition and strong regulation; and by guaranteeing certain service standards in legislation.

Current UK position

2. Current UK law (section 59(1) and (2) of the British Telecommunications Act 1981) requires the Post Office “to provide throughout the United Kingdom ... such services for the conveyance of letters as satisfy all reasonable demands for them.” In carrying out its duty the Post Office must have regard to efficiency and economy; the social, industrial and commercial needs of the country; the desirability of improving and developing its operating systems; and developments in the field of communications and banking. Detailed service standards are not prescribed and have in practice varied over time.

Definition of USO in EU Postal Services Directive

3. The EU Postal Services Directive requires Member States to ensure that users enjoy the right to a universal service involving permanent provision of a postal service at all points in their territory. The Directive further requires that tariffs should be affordable, transparent and non-discriminatory. The Directive does not require a uniform tariff but allows Member States to apply a uniform tariff throughout their national territory if they so decide.

The uniform tariff structure

4. It is the Government's firm intention that a uniform tariff (ie the price of sending a letter within the UK is the same irrespective of where it is posted to and from) be maintained for those activities which fall within the obligation on the Post Office to provide a universal service. Whilst geographically averaged prices have developed through custom and practice there is currently no definition of a uniform tariff structure in UK legislation. The Government intends to rectify this position.

New statutory definition of USO and uniform tariff

5. For the first time in the UK details of the USO and uniform tariff commitments will be set out in legislation when the Government implements the EU Postal Services Directive. In the case of inland parcels the Government intends to go further than the minimum required by extending the obligation to 20 kilograms (instead of 10 kilograms), thereby bringing the obligation into line with the Directive's minimum USO requirement for international parcels. Furthermore the Government will include a uniform tariff structure for USO services. As now, there will continue to be provision for derogations from the USO and quality standards for exceptional reasons.
6. The USO service will be set out in the Regulations as:
 - at least one delivery of postal packets to each postal address in the United Kingdom every working day;
 - at least one collection of postal packets from collection points designated by the USO provider every working day;
 - the provision of affordable postal services for the collection, sorting, transport and delivery of letters of up to 2 kilograms in weight at an affordable uniform public tariff for the whole of the United Kingdom;
 - the provision of an affordable postal service for the collection, sorting, transport and delivery of postal packets (excluding letters) up to 20 kilograms (subject to the minimum and maximum dimensions laid down in the Universal Postal Union Convention and the Postal Parcels Agreement adopted by the Universal Postal Union) at an affordable uniform public tariff for the whole of the United Kingdom; and

- the provision of a registered post service at an affordable uniform public tariff for the whole of the United Kingdom.

The Regulations will also provide that the application of a uniform public tariff shall not prevent the Post Office concluding individual agreements on prices with customers.

7. At present, the Post Office provides free services for the visually impaired under its Articles for the Blind Scheme. This is a special service which allows for the free posting of non-print alternative form information, such as braille, and specified goods both to and from visually impaired people. The Government believes that there is a genuine need for such services and the Post Office will continue to be obliged to provide them under the reform programme.

Freedom to price commercially

8. Given the movements in the market discussed in Chapter 2, it is vitally important for the Post Office to be able to price commercially to keep and increase business customers, particularly in those areas where it is most susceptible to competition. The freedom to conclude individual agreements on prices with individual customers is in fact required by the EU directive.
9. Maintenance of the systems used to deliver social mail is dependent on the volume of mail generated by business. Without business mail (including business to individuals and vice versa) the USO and uniform tariff would be unsustainable without direct subsidy. It is critical, therefore, that business users should be able to negotiate competitive prices with the Post Office.
10. Royal Mail customers may currently qualify for discounts for pre-sorted work (based on avoided average costs). Further price flexibility is a logical extension of these current arrangements. Normal competition rules will apply. Such price flexibility must not be used anti-competitively, for example by excluding competitors through predatory behaviour or by

designing discounts aimed at foreclosing the market. The Post Office should not, therefore, charge different prices to different customers, or categories of customers, for the same service where the differences in prices do not reflect the quantity, quality or other characteristics of the service supplied. But subject to this the Post Office will be free to negotiate prices with individual customers taking into account volume and other specific characteristics of any contract (eg timing of delivery). The Regulator will ensure that the Post Office does not misuse such price flexibility to price in an anti-competitive manner.

Ensuring that price flexibility works to the benefit of all users

11. The general public and other small volume users of the Post Office will continue to benefit from a USO and a uniform tariff. Also the twin pressures of competition and regulation will act to deliver efficiency improvements and keep prices down. The Government therefore believes that commercial pricing for contract, large volume users of postal services should not lead to higher real costs for individual users.

Detailed quality of service requirements

12. Beyond the USO service standards guaranteed by statute the Regulator will set and enforce detailed quality of service targets. These will be at least as demanding as the current service standards provided by the Post Office (see box below). These will be published; and the Post Office will be subject to penalties for failure to deliver.

Current quality of service standards

92.5 per cent of first class letters to be delivered the next day to posting

98.5 per cent of second class letters to be delivered within three days of posting

88 per cent of Parcelforce standard service parcels to be delivered within three working days

Need for flexibility

13. It is intended that the detailed definition of service standards will change over time, both as quality targets are enhanced; and if and when new services are introduced to the USO. New products introduced by the Post

Office to reflect the changing consumer demand will not necessarily lie within the USO (especially those which are tailor-made for niche markets). This will be judged by the Regulator on a case by case basis.

Delivering high standards

14. The Government is confident that its proposals will ensure that current UK standards of service are maintained and enhanced; that services can be adapted and improved over time; and that UK consumers will continue to enjoy the most generous postal service specifications within the EU.

Objective 3 – To establish clear and accountable relationships between the Government, the Post Office, the Regulator and POUNC

An arm's length relationship

1. The Post Office was established as a statutory corporation by the Post Office Act 1969. The Act broadly defines the Post Office's powers and responsibilities, as well as the general responsibilities of the Government in relation to postal services. However, as the postal market has developed and the Post Office has broadened its business activities, so the boundaries between the responsibilities of the Post Office and the Government have started to look outdated. They now need tighter definition and more transparent operation. For the Post Office, this will mean clarity on those decisions and objectives which fall to the Board, rather than the Government, and for which the Board should take responsibility. For the Government, this will mean greater transparency and accountability, which is a key principle of the Government's review of utilities regulation *A Fair Deal to Consumers*.³
2. The responsibilities in the postal sector will in future be clearly divided between:
 - **the Government**
 - as the Post Office's shareholder, and **separately**,
 - as the authority responsible in the national interest for setting the legal and regulatory framework and the social and environmental obligations on the Post Office;
 - **the Post Office** – as a postal operator, including being the country's universal postal service provider;
 - **the Postal Regulator** – as guardian of consumer interests and promoter of competition; and
 - **the Post Office Users' National Council** – as promoter and advocate of the views of the consumers.

³ Cm 3898, The Stationery Office, March 1998 (ISBN 0-10-138982-5).

3. There will be a new arm's length relationship between the Government (as shareholder) and the Post Office Board. The Government will agree the strategic direction of the Post Office. The Board will be responsible for proposing and executing that strategy. The Regulator will undertake economic regulation and promote competition. These responsibilities are shown more fully in the section at the end of this chapter.

Reporting

4. The Post Office and the Post Office Users' National Council are required by the Post Office Act 1969 to provide the Secretary of State with their accounts and annual reports, respectively, and the Secretary of State is required to lay them before each House. These arrangements will continue, and an obligation will be laid on the Regulator to report annually to the Secretary of State, and this report will also be laid before each House.
5. In addition, the Government undertakes to report annually to Parliament on the progress of the reforms set out in this White Paper, particularly on the functioning of the arm's length relationship. The aim will be to report once the Strategic Plan has been approved (though commercially confidential details of the Plan will not be revealed). The report will contain key financial information, including the profit target, a forecast of the expected dividend for the year, and the outturn dividend and borrowings for the previous year.

The Strategic Plan

6. The five-year Strategic Plan will be central to the new commercial relationship between the Government and the Post Office. The Plan will set out the high level strategic approach by which the Board will secure the commercial success of the Post Office in the United Kingdom and worldwide. Endorsement of the Plan by the Secretary of State will define the strategic envelope within which the Post Office is free to manage commercially, and set the framework within which the Government will approve borrowing for major commercial strategies including acquisitions.

7. Consequently, the Plan will need to balance two fundamental objectives:
 - first, it will need to be sufficiently high level so as not to draw Government into second guessing the Board's day-to-day management of the business; and
 - second, the Plan will need to be sufficiently clear on the Post Office's objectives and provide sufficient financial information to allow the Secretary of State to endorse the strategic direction of the Post Office's activities, set the profit target and approve the framework for borrowing with confidence.

8. Without seeking to place a straitjacket on the development of the content of the Plan in subsequent years, the following elements are regarded as core to achieving the dual objectives set out above. The Strategic Plan should:
 - include a statement of the overall commercial direction and goals;
 - summarise the way in which the current Plan has evolved from the last Plan, including a high level evaluation of the value added by the new Plan;
 - analyse the commercial and regulatory environment in which the Post Office operates, including the way in which the market is evolving and the development of competitors' activities;
 - set out the strategic response to the commercial and regulatory environment, including principal strategic options, proposals for meeting the universal service obligations and for managing the nationwide network of post offices, key issues which need to be resolved in the next Plan, and the resources needed – especially people, technology and funding;
 - contain high level financial and performance projections, with sensitivity analyses of the major risks;
 - outline possibilities and plans for entering into partnerships and alliances; and
 - set out clear performance indicators which will enable the Post Office's performance, in achieving its strategic objectives, to be measured.

The responsibilities of the key players are outlined overleaf.

The Government will

Responsibilities of the key players

In setting the framework for regulation including the social and environmental obligations:

- Lay down the social and environmental obligations to be placed on the Post Office.
- Set the Universal Service Obligation and the framework for a uniform tariff in legislation within the context of the EU obligations.
- Issue Guidance to the Regulator on those social and environmental objectives.
- Appoint the Regulator and establish the principles of the regulatory regime, but will not be involved with other matters which fall to the Regulator.

- Strengthen POUNC, and continue to appoint its members, but not be involved in other matters which fall to POUNC. In appointing members, the Government will seek to ensure that the membership reflects the diversity of Post Office users.
- Determine criteria for minimum access to post office services throughout the country.
- Retain prime responsibility as the UK's postal representative within EU/WTO fora, and for determining the legislative framework.
- Agree parameters with the Post Office for the changes allowable in the pay of staff.

The Post Office will

- Prepare and present to the Government its Strategic Plan, setting out in particular its investment, acquisition and partnership intentions (while continuing to meet the Universal Service Obligation and the agreed service standards set by the Regulator) and financial forecasts (especially the profit forecasts and need for borrowing).
- Within this framework, manage the business in a way that maximises performance and the value of the business whilst at the same time meeting all agreed consumer, social and environmental objectives.

- Monitor progress against the Strategic Plan and report to the Government and the Regulator on the achievement of its targets so that the overall performance of the organisation can be monitored.
- Ensure that the organisation is financially and commercially viable.
- Maximise the shareholder value of the organisation (subject to its other obligations) and achieve the Government's financial targets.

The Regulator will

- Regulate the Post Office within the framework set by the Government including the requirement to take into account when carrying out its duties the environmental and social guidance from the Government.
- Have a primary duty to protect the interests of consumers.
- Set standards of service.

- In consultation with POUNC, monitor the Post Office's performance against the established service standards and performance targets for the main services offered by the Post Office, and impose penalties for failure to meet the targets.
- Regulate prices.

As owner:

- Appoint the Chairman of the Post Office, and the remainder of the Board (after consulting the Chairman), seeking to ensure access to the widest possible experience, internally and externally.
- Determine the Board members' remuneration, on the basis of advice from the remuneration committee of the Board.
- Approve annually a (five-year rolling) Strategic Plan, including setting the profit target for the organisation (thus determining the expected financial return to Government), and approve major acquisitions but otherwise will not be

involved in normal management and commercial matters which fall to the Post Office.

- Set guidelines on borrowing.

In both capacities:

- Report annually to Parliament on the fulfilment of the reform package in this White Paper.

- Ensure that investments are made within the framework agreed with the Government, examining the prospect for forming partnerships and alliances with other organisations, determining the organisation's market focus, and ensuring that it has the necessary management expertise.
- Set the prices of its services – subject to requirements of the Regulator (within the monopoly/universal service areas).

- Negotiate the details of pay settlements, within the guidelines given, and make arrangements for incentivising the workforce.
- Manage the Post Office network against the guidance provided by the Government on accessibility.

- Promote competition through phased reductions in the monopoly, subject to ensuring the ability of the Post Office to maintain the Universal Service Obligation and a uniform tariff structure.
- Ensure fair competition and in particular to ensure that there is no undue cross subsidy from the monopoly to competitive market, and to ensure non-discriminatory access to monopoly services.

- Monitor compliance with the USO.
- Enforce the Post Office monopoly.
- Monitor the network against the access criteria.

The Users' Council will

- Be responsible for all issues of customer representation, and the handling of complaints about Post Office services. (Ministers would expect to be able to refer all complaints to POUNC and not to be involved in specific complaints, except in the most exceptional cases involving the national interest, when consulted by POUNC.)
- Provide strategic advice to the Regulator on consumer interests.
- Provide advice and information to consumers.
- Monitor complaints and, where appropriate, make representations to the Regulator about remedial action, including the level of penalty to be imposed for a failure to meet service performance standards.
- Monitor and advise on the size and make up of the Post Office counters' network and make recommendations on the need for post office provision in particular areas.

Objective 4 – To equip the UK Post Office to meet the challenges of the changing postal market both domestically and internationally

1. If it is to provide the services demanded by its users, the Post Office needs to rise to the challenges presented by the changing market environment, and have sufficient freedom and finance to develop its commercial activities. This chapter describes:
 - the Post Office's plans for restructuring its business to equip it to meet the challenges (including the scope being given for the Post Office to redefine the boundaries between its businesses);
 - the Government's plans for facilitating the Post Office's commercial development; and
 - the changes the Government is making in the financial regime (together with the principles that will be applied to the future consideration of pay of staff within the Post Office).

POST OFFICE'S RESTRUCTURING

2. The Post Office is implementing a major review of the way it is organised to face the marketplace. This follows a fundamental reappraisal of its position in the markets in which it currently operates, and of its future commercial ambitions. This initiative is being taken forward under the banner '*Shaping for Competitive Success*'. The principal objective of the restructuring is to ensure that the Post Office is best placed to respond to evolving customer needs and market developments. The Post Office's ambition is to become a complete distribution company – connecting people, transactions and places, building on the unique capabilities it possesses.
3. Under the *Shaping for Competitive Success* initiative, the Post Office will be restructured to help it deliver its commercial strategy, creating a number of market-facing units, each of which will focus on a particular

market sector, bringing in, where necessary, managers with wider experience to enhance existing skills.

4. These units will be responsible for ensuring the Post Office has a comprehensive understanding of its markets, designing products and services that meet the requirements demanded of it, drawing in a flexible and creative way on the capabilities which the whole Post Office possesses, to develop novel solutions which meet particular customer needs.
5. The Post Office is also seeking to improve its efficiency – key to successful competition as European markets open up in the growth sectors – by continued investment in automation, new technology systems and more effective operational units. For example:
 - Royal Mail is developing the next phase of its automation programme for speeding mail through to delivery, and is looking to bring the full benefits of automation into the international mailstream. It will continue to invest in new mail centres, like the one recently opened at Gatwick.
 - Parcelforce is developing its operational effectiveness by deploying state of the art operational systems, particularly track and trace systems which allow continuous monitoring of packages as they travel through the network. Towards the end of 1999, Parcelforce will open a major new international hub operation in the West Midlands, and early in 2000 will open a companion hub to handle its domestic express and time-certain delivery traffic.

The Post Office also has a number of corporate-wide initiatives under way to improve administrative efficiency, leading to reductions in the level of expenditure on overheads and on support activities (eg accounting and payroll systems) as well as a number of major investments in information systems.

Employment relations

6. The Post Office remains a very labour intensive business, despite the advent of new technology in some of the sorting and processing

functions. But the daily delivery round cannot be done by machine, neither can the counter clerk or sub-postmaster be supplanted by a machine. The Post Office is thus a very large employer (with around 200,000 direct employees, and a further 18,000 sub-postmasters employing in turn around 40,000 other people). In the past the Post Office has not had a good history of employee involvement and has suffered from poor industrial relations over the years, but recently Post Office management and unions have made strenuous efforts to improve relations. The Government welcomes these efforts, but is anxious that there should be a greater sense of partnership between management and the workforce to enable the business to develop into the sort of organisation envisaged in this White Paper. In particular, the increasingly competitive environment will oblige the Post Office to increase productivity and be flexible, requiring postal working practices to become much more adaptable than before. The Post Office is committed to motivating and training its staff to give the highest levels of service; and to generally improving relations at the same time as introducing greater working flexibility. The Government welcomes the initiatives aimed at improving leadership, training and development, employee relations and reward that have been launched. The Government is also considering ways of providing additional pay flexibilities – see paragraph 34.

Boundaries between the Post Office businesses

7. The Post Office is realigning the boundary between Royal Mail and Parcelforce, by transferring Royal Mail Priority Services (registered and special delivery items) to Parcelforce (from April 1999), and the larger Royal Mail packets (from April 2000 or possibly later). The two business streams have revenue of approximately £145 million and £140 million respectively. The changes are in line with the Post Office's goal of creating a better customer focus; the division between Parcelforce's business and that of Royal Mail has been arbitrary and the overlap between them wasteful and confusing to customers.
8. The Government accepts that the Post Office should be able to rationalise the internal boundaries between businesses within the overall organisation on commercial grounds. However, it is vital that competing

businesses can be assured that this will not lead to undue and hidden cross-subsidy from monopoly to non-monopoly areas. Approved and transparent accounting structures must therefore be in place and effectively monitored. This will be the responsibility of the Regulator, but in this transitional period it rests with the Government.

9. Under the transfer of Priority Services, much of the operational activity, at least initially, will continue to be carried out by Royal Mail. This raises the possibility of the Post Office monopoly business improperly subsidising wider Parcelforce business in the competitive arena. The Government therefore asked its auditors for the Post Office to look at the business case for the transfer; at the basis on which revenues and costs would be treated under the new arrangements; and in particular whether this was on a defensible basis from a competition point of view and with accounting transparency. In the light of the advice from the auditors, the Government has confidence that the arrangements are satisfactory. They will continue to be monitored by the auditors until the Regulator has its own arrangements in place.

COMMERCIAL DEVELOPMENT

10. It is widely accepted that the commercial future of the Post Office depends on it being able to compete effectively with other service providers to give customers increasingly up-to-date and efficient services. The Post Office must therefore be equipped to develop the business to provide the postal services that will be needed by customers. This may well involve forging new alliances and commercial partnerships with those having complementary skills.
11. The Post Office envisages a number of major developments (see box over) to transform its business. The Government will help facilitate developments of this nature by establishing the arm's length strategic relationship described in Chapter 5, so as to reduce unnecessary restraints on the management of the Post Office, and by relaxing financial restraints. In addition, the Government intends to modernise the Post Office's statutory framework.

Activities in which the Post Office might become more involved could include:

- electronic commerce, hybrid mail and other ventures related to electronic messaging;
 - customer management ventures to help businesses looking to improve the services and support available to their customers from advanced technology, eg on-line enquiry handling and customer database management;
 - providing a one-stop shop for a whole range of distribution activities;
 - increased involvement in the logistics market;
 - greater provision of international, end-to-end delivery services;
 - greater involvement by POCL in the electronic delivery of Government services; and
 - greater involvement by POCL in the delivery of financial services products.
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12. The Post Office Act 1969 (as amended – principally by the British Telecommunications Act 1981) allows the Post Office to provide:
 - postal and related services;
 - banking and related services; and
 - services to British Telecommunications, the Government (and foreign governments), local authorities, and certain bodies corporate which have public duties.
13. The Post Office is obliged by the Act to exercise these powers in order to provide services for the conveyance of letters that satisfy all reasonable demands. The nature of what is generally described as the Universal Service Obligation is considered more fully in Chapter 4.
14. When Parliamentary time permits, the Government will modernise the definition of the areas of activity permitted to the Post Office to enable it to develop its business to keep well abreast of market changes. The definition will need to be sufficiently flexible to enable it to remain appropriate throughout the lifetime of the legislation (or means will be needed to permit updating of the definition without the need for primary legislation). Meanwhile, whenever the Post Office needs the consent of the Secretary of State to undertake new ventures in areas surrounding the traditional postal market, the Government intends to interpret powers conveyed by the 1969 Act broadly and will continue to be willing to give consent, when appropriate, under section 61 of the British Telecommunications Act 1981

to wholly owned subsidiaries of the Post Office engaging in activities beyond those in which the Post Office itself has power to engage.

Conversion of the Post Office into a plc under public ownership

15. At present, areas of responsibility and accountability are blurred between the Government and the Post Office Board. This cannot be allowed to persist if the Government is to ensure real commercial freedom for the Post Office within the public sector. Unless there is a transparent framework of accountability, within which the Post Office Board is clearly accountable for the commercial success of the business, it is difficult to see how things can be very much different than they have been in the past.
16. We propose that the Post Office remains a publicly owned business, but in order to make the accountability framework as clear as it possibly can be for a publicly owned business, the Government believes it is both necessary and desirable for the Post Office to become a public limited company under the Companies Acts.
17. The intention is to replace the current legal structure of the Post Office which is unclear with a form of structure which is more appropriate to a forward looking business; and which is clear and widely understood. The Post Office as a corporation is currently governed by legislation which is either unique to it or specific to nationalised industries. This legislation, which interweaves the regulatory and ownership powers of the Government, provides for intervention in the business which is no longer consistent with the Government's aim for clarity in the respective roles of the Government, Post Office and Regulator.
18. Transforming the Post Office into a public limited company will help establish the clear separation of the functions of ownership and management, whilst remaining under public ownership. As a public limited company the Post Office and its relationship with the Government (as owner) will be disciplined by the full range of company law. In particular it will make it absolutely clear that the Directors owe their duties to the company (not directly to the Government as owner) and will require the Government as owner to exercise its interests effectively.

19. In addition, and as a matter of practicality, plc status will enable the Government to receive a proper dividend, rather than the Post Office having to build up cash deposits on its balance sheet (see paragraph 28 below).
20. There are precedents throughout the world for a Government-owned plc. All the Nordic countries now use this model; as do Australia, New Zealand and Austria. A similar change to plc status for the Post Office will underline the accountability of the Directors and the new commercial status of the public sector organisation. Without it the public sector option will be much weaker.
21. It is intended to establish the publicly owned Post Office as a plc through primary legislation as soon as Parliamentary time permits. As was said in the statement to the House on 7 December, the Government does not rule out the possibility of introducing private share-holding into the Post Office - for example through the sale of a minority stake in it or an exchange of equity with other businesses - at a later stage. However at present wholesale privatisation would not be a realistic option.
22. Primary legislation will be necessary to convert the Post Office into a plc. The Government will propose that such legislation shall contain a commitment that if there is any proposal to sell or exchange shares, then there would need to be further approval of such a proposal by both Houses of Parliament.

FINANCIAL REGIME

23. The Post Office, as a public sector body, is subject to the Government's planning and control regime for public expenditure. In June 1998⁴ the Government announced a number of important changes to the public expenditure control framework to make it more consistent with the Government's fiscal rules and to promote longer-term planning. Whilst the Government made it clear that it will continue to apply its fiscal

⁴ Cm 3978 *Stability for Investment for the long term economic fiscal strategy* (ISBN 0-10-139782-8).

rules to the public sector, **including** public corporations,⁵ the reforms recognised that certain, largely self-funding public corporations (known as self-financing public corporations, SFPCs) – such as the Post Office – should be given more flexibility.

24. Traditionally, the control of each Nationalised Industry's expenditure has been through a limit on the body's requirement for external financing of its activities – the External Financing Limit (EFL). Because the Post Office has not had recourse to external financing in recent years (but has generated a cash surplus) it has instead had a *negative* EFL through which it has been obliged to invest a high proportion of the profits it has generated each year in non-redeemable gilt-edged stock or National Loan Fund deposits. Under the new framework the EFLs of SFPCs (including the Post Office) are no longer part of the spending limit for Departments and will be separately managed, and SFPCs have more flexibility to manage their spending between years, within agreed limits.
25. Further reform of the Post Office's financial regime builds on this more flexible framework. The Post Office has a good track record of profitability and has been a net contributor to the public finances over a long period. The Post Office needs a more commercially structured financial regime to enable it to retain a higher proportion of its earnings to modernise its operations and to raise finance when required to invest in the business.

Revised financial regime

26. The key features of the new financial regime will be:
- The Government will set a **profit target** for the whole of the Post Office business on the basis of the agreed Strategic Plan.
 - The Post Office will be expected to invest an equivalent of a **commercial dividend** each year. This will be set at 50 per cent of the Post Office's expected post-tax profits in 1999/00, and thereafter the level will be 40 per cent of post-tax profits each year. This will in effect mean more than halving the rate at which profits are removed from the business.

⁵ Note that, on national accounts definitions, borrowing by the Post Office scores within the Public Sector Net Cash Requirement (previously the Public Sector Borrowing Requirement) which is closely related to changes in Public Sector Net Debt.

- The Post Office will, in the light of being able to retain 60 per cent of its profits, be expected to **finance from retained earnings the capital expenditure** required to maintain and enhance its existing business.
- The Post Office will be allowed to **borrow for growth investments** including acquisitions and joint ventures where these cannot be funded from retained earnings, and subject to an approval process for larger investments.
- By 1 April 2002 the Post Office's **balance sheet will be restructured**.

Setting the profit target

27. In the past the Government has set a number of targets for the Post Office's individual businesses: return on capital employed and real unit cost reduction for Royal Mail, return on capital employed for Parcelforce Worldwide; and return on turnover for POCL. In future the Government will set only one annual financial target – the profit target for the whole Post Office – on the basis of the agreed Strategic Plan. It is essential for the Government to set a profit target to ensure that price regulation does not result in falling value. The Post Office's individual business targets will be consistent with the overall profit target. Whilst the overall Plan will be agreed by Ministers, specific business targets will be a matter for the Post Office management.

Commercial dividend

28. As indicated above, the Government will expect the Post Office each year to invest the equivalent of a commercial dividend in gilts or deposits with the NLF. However the proportion of post-tax profits mentioned above will be subject to a floor, which will be determined when the Strategic Plan is agreed. This will provide an incentive for the Post Office to ensure its Plan can and will be effectively implemented. It also gives some certainty to the Government as owner, in the same way that private companies aim to maintain dividends in the face of lower outturn profits. The expected dividend will be announced to Parliament once the Strategic Plan has been agreed. After the close of the financial year, the Government will inform Parliament of the outturn figure. The outturn External Financing Requirement (EFR) (which is the sum of the gilts

purchased/new NLF deposits less the new borrowings) will also be announced after the close of the financial year, at the same time as the Government's report (referred to in Chapter 5) and other financial information is published.

29. Once the Post Office has been established as a publicly owned plc, (as explained in paragraph 15) it will pay an annual dividend over to the Government, rather than invest in deposits.

Borrowing for further investment

30. The Post Office will be expected to finance investment in the core business from retained earnings. But this is unlikely to be sufficient to allow the Post Office to grow into new markets and provide new products. Borrowing will therefore be permitted for growth investment.
31. The details of the borrowing regime are:
- (a) for cases costing more than £75 million a fast track, but rigorous, Ministerial approval process will be required. Ministers will complete this process within 28 days of a full business case being received. The Government will approve Post Office requests for borrowing for investment cases which are consistent with the Strategic Plan, commercially robust, and pose no undue risk to the taxpayer;
 - (b) for cases costing £75 million or less there will be:
 - (i) timely notification to the DTI by the Post Office;
 - (ii) a need to go through the Ministerial approval process only where a satisfactory return is dependent on further linked investment being undertaken;
 - (c) borrowing under (b) will be limited to an annual limit of £75 million in each of the next five years.
32. In principle the Post Office has powers to borrow from either the Government (the National Loans Fund) or from the commercial markets. It has been argued that borrowing from the commercial markets would impose additional disciplines that could offset the additional cost. However the markets will regard such borrowing as being underwritten (at least implicitly) by Government, and so such borrowing is likely to

confer little, if any, additional discipline. The Government has therefore decided that any borrowing will be from the National Loans Fund, as this will be more cost-effective for the taxpayer. But in order to ensure that the Post Office competes fairly with other postal operators in the private sector; and to reinforce commercial disciplines, the Post Office will borrow at a rate which is broadly comparable to the rate it would be charged in the market without an implicit or explicit Government guarantee. The Government will seek independent advice on the appropriate rate.

Restructuring the balance sheet

33. The Post Office balance sheet currently shows over £1.8 billion invested in gilt-edged stock or deposited with the NLF. Much of this represents the accumulation of previous EFL surpluses. The Post Office does not, as a rule, have access to these surpluses (since they are, in effect, accumulated dividends which cannot be paid over to the Exchequer since the relevant legislation does not require the Post Office to do so) but it benefits from the interest payable, estimated to be £107 million in 1998/99. To place the Post Office on a more commercial footing, and one where it can be better benchmarked against its competitors, the balance sheet needs to be restructured. It is therefore proposed that the Post Office should cease to hold, and have access to interest from, the present level of accumulated EFL surpluses. To allow time to make the transition to this new situation, it is planned that the change will take effect on 1 April 2002. During this period the Government will consider with the help of professional advisers the appropriate shape of the balance sheet to give the Post Office both the incentive to perform and the financial scope to enhance its business.

Pay

34. The services the Post Office provides are for the most part, by their very nature, labour intensive. Pay therefore forms a high proportion of the organisation's costs (over 67 per cent in 1997). The quality, reliability and efficiency of post office services is very dependent on the work of the nearly 200,000 staff it employs – literally across the whole country.

35. The reforms set out in this White Paper, including the introduction of a profit target set by Government, and price regulation by the Regulator, all impose real disciplines on costs. The market place in which the Post Office is acting is increasingly competitive, and this too imposes real pressures to increase efficiency and cut costs.
36. In order to be able to respond to the commercial pressures, the Government believes it is right to allow the Post Office more flexibility within the necessary context of public sector pay policy, to increase the linkages between pay and productivity and performance. The Post Office already offers tailored productivity schemes to reward staff for their own particular contributions to more effective working. But in addition (following consideration of outline proposals from the Post Office), the Government and the Post Office will be looking at the possibility of developing a general framework of parameters for overall pay settlements, rather than requiring the Post Office to put forward each settlement for approval. They will also consider ways to share long term success of the business with staff, based on any increasing value of the organisation. These areas will be explored further over the next few months, with a view to implementation from 1 April 2000.

POTENTIAL FURTHER REFORMS

37. Events will continue to move rapidly in this constantly changing commercial environment and further changes may be required to enable the Post Office to grow and to meet customer needs, which are in the best interests of the Post Office and its staff. The Government does not rule out the possibility of making further changes to equip the Post Office for success.

Objective 5 – To support a viable network of post offices so as to ensure nationwide access to a range of public and private sector services

1. The Post Office counters' business poses a distinctive set of challenges. The network of nearly 19,000 post offices makes up Europe's largest single retail network and forms a familiar and valued part of the social and commercial infrastructure of the country. Although they provide an important point of access to the services of Royal Mail and Parcelforce Worldwide – and in so doing play an essential part in enabling the Post Office to fulfil its Universal Service Obligation – the key business conducted at post offices today is in the delivery of such Government services as the payment of pensions and other social security benefits and the issue (through selected post offices) of vehicle licences. Indeed POCL today relies on the work it carries out contractually for the Government and its agencies for more than half its income.
2. Technological progress is however increasing the number of options available to Government clients and their millions of customers for carrying out these transactions. Thus for example over 30 per cent of child benefit recipients have opted to have payments made directly into their bank accounts by automatic credit transfer (ACT) and more than 50 per cent of new pensioners are making a similar choice. It is of course right that customers should be free to exercise such choice, and it is also right in principle that POCL's Government clients should explore the channels of payment they believe will best meet the needs of their customers whilst striving for an acceptable balance of efficiency and security in the provision of such essential services to secure best value for the taxpayer.
3. The dilemma that this poses both for POCL management and for the Government lies in the underlying financial structure of the business.

In 1997/98 the business recorded an operating profit of only £33 million on a turnover of £1.1 billion representing a return on turnover of 3 per cent. But these figures tell only part of the story. Of the network of nearly 19,000 offices, only 600 are directly run and staffed by POCL (the Crown offices). The remainder are franchised or agency operations usually run in conjunction with another business. In rural areas this will typically be the village shop, whilst in urban and suburban areas the associated business is frequently a confectioner/tobacconist/newsagent or a convenience store. In recent years post offices have appeared in a number of large supermarkets, and examples of associations with petrol stations and a wide variety of other businesses can also be found.

Further development of the Post Office counters' network

4. It is primarily this sharing of overheads between combined businesses that make the franchised and agency network an economically efficient means of delivering Government and other services, compared with stand alone, directly operated post offices. For customers, the arrangement offers the convenience of a range of services under a single roof and often longer and more flexible opening hours than is normal with Crown post offices, and in rural or other areas access to cash and shopping not otherwise available nearby. For the franchisee or sub-postmaster, the attraction lies not only in the income derived from carrying out work for POCL, but also in the footfall generated by recipients collecting pensions and other benefits and those conducting postal business who then stop to make other purchases.
5. There are other valuable synergies within the counters' network (arising especially from the association with the Benefits Agency and Girobank). Many smaller businesses enjoy the convenience of depositing their takings at their local post office. POCL then pays out this cash in the form of pensions and other social security benefits. These matching inflows and outflows of cash represent an efficient recycling of some £40 billion cash circulating within the economy each year.
6. Despite its many strengths, the strong inter-dependency between post offices and the mostly small, retail sector also brings to the network

a particular vulnerability. If either side of a sub-postmaster's business underperforms or falls into decline, the sub-postmaster may decide to call it a day. In such circumstances POCL sometimes has difficulty in finding a replacement. Where, despite best efforts, one cannot be found, POCL will normally try to put in place some form of fall-back arrangement, for example a community office open for just a few hours a week, to ensure that the community is not left without service. Even so, the network is currently shrinking by some 200 offices a year. Most of these losses occur in rural areas and reflect changing social and demographic patterns.

7. It is clearly right that the network cannot be set in concrete and should have the flexibility to adapt to the needs of its customers. At the same time, the closure of a post office and its associated business can have a major adverse impact on a community, particularly where it represents the last remaining retail outlet. This can be as true of isolated housing estates as it is of rural villages with particular hardship caused to the less mobile sections of the community.
8. The key to sustaining the network lies in the confidence of individual sub-postmasters that they have an ongoing viable business and a large enough customer base to make a living. POCL already provides important underpinning of the most vulnerable offices by a system of payment which provides a guaranteed minimum level of income. A large majority of the rural network particularly benefits from these guaranteed floor payments. But clearly POCL can only sustain these financial transfers from the more profitable parts of the network if the profitability of the network as a whole is sufficient to accommodate them.
9. In recent years, POCL has made good progress in attracting new business such as bureaux de change, travel and other forms of basic insurance, and the National Lottery, to offset the gradual erosion of traditional benefit payment work, as increasing numbers of recipients choose to be paid through ACT. But this success needs to be seen in perspective. The cumulative value of new business represents only a fraction of the total value of POCL's work for Government agencies such

as the Benefits Agency (BA) and the Driver Vehicle Licensing Agency (DVLA). Any sudden withdrawal of this latter work would leave POCL with an unbridgeable revenue gap, compounded for sub-postmasters by a corresponding loss of footfall.

10. One element of the Government's help to sustain the nationwide network of post offices is to influence the rate of any migration of existing Government business so that it does not run too far ahead of POCL's ability to develop new sources of revenue to replace it.
11. A second element reflects and responds to POCL's need for a modern on-line IT platform to serve existing clients as effectively and efficiently as possible, as the basis for developing new business opportunities, and to provide better services and access to customers. The Government recently announced that agreement had been reached in principle with ICL about the continuation of the Horizon project to computerise the Post Office network and automate the payment of benefits.
12. The project initiated by the last administration, had suffered considerable delays and set-backs, and was running three years late. When these delays became apparent, the Government commissioned a major review of the project to decide the best route forward given its huge importance to the approximately 15 million people who collect their benefit cash from post offices, the 28 million customers of the Post Office, and 18,000 sub-postmasters and others who keep nearly 19,000 offices running.
13. Against the background of this delay all parties were concerned to review the project's future and find a positive way forward. This has now been completed, and new agreements have been signed by ICL and POCL.
14. The changes to the Horizon project are aimed to put it on a suitable footing for the future and allow the Post Office to move as quickly as possible to the computerisation of Post Office counters' services.

15. The main elements of the agreement are:

- First, the project to automate Post Office counters' services will be taken forward as planned as quickly as possible. For the first time ever, post offices will have an up-to-date automation platform, helping them to provide a better service to their customers, and representing a major investment in the future of the nationwide network of post offices.
- In agreement with ICL the magnetic strip benefit payment card will be removed from the project. Given the delays this is now an outdated concept and the banks among others are already moving away from magnetic strip in favour of the next generation technology – the smart card. For the future, the Government intends that the Benefits Agency will move from the traditional paper-based methods of payment to a more modern and efficient way of paying benefits, using the existing automated credit transfer system to make benefit payments into bank accounts accessible throughout the nationwide network of post offices. POCL and DSS/BA will be working together on plans to introduce the new arrangements in 2003. This will mean that all benefit recipients who wish to collect their benefits in cash at post offices will continue to be able to do so both before and after the change.
- In the interim, the Benefits Agency intends to use bar-coding on order books (as already operating successfully in some areas) to tackle benefit fraud. This should provide potential savings of around £100 million a year.
- The public sector parties and ICL are satisfied that the target of achieving the computerisation of every post office throughout the network by the end of 2001 is more realistic. This will give customers a better service and help to secure a viable future for the network of post offices.

This project represents a major investment in the future of the nationwide network of post offices. We will be looking to the Post Office to explore how it can build on this investment to earn new business and offer more cost-effective services, in partnership with the private sector.

16. A number of the Government's wider policy objectives represent potentially important new areas of business for POCL. The first is the universal availability of bank accounts and access to the accompanying range of financial services. The post office network has an unrivalled reach into both rural areas and urban deprived areas. Thus some 60 per cent of rural parishes have a post office whereas less than 10 per cent have a bank or building society. POCL has long associations with Girobank (which now forms part of the Alliance and Leicester group). It also provides banking facilities at post offices throughout the country on behalf of the Co-operative Bank and Lloyds TSB. POCL's ability to expand these services and develop new ones, eg based on smartcard technology, will be significantly enhanced by the agreement to press ahead with the Horizon platform.
17. Similarly, the unique reach of the counters' network, coupled with the Horizon platform, should mean that POCL is well placed to offer a major channel to deliver the Government's ambitions to interface with citizens in a modern, convenient, efficient and coherent manner through the increasing use of IT.
18. The Horizon platform, together with an increasing familiarity on the part of customers with simple computer technology, will offer to POCL the prospect over time to deliver a range of services to customers through a publicly accessible electronic network as an alternative or supplement to the physical network of post offices.
19. The Government has repeatedly made clear its wish to see a thriving nationwide network of post offices. There may be a difficult transition as demand for traditional services declines whilst new services and new ways of working may still be at an early stage of development. The Government stands ready to play its part in easing this transition with an eye in particular to supporting those post offices of special value to the local community. The Benefits Agency will continue to use the counters' network on the same basis as it does now until 2003, when the new arrangements for paying benefits by ACT will be introduced over a two year period. A number of other Government Departments and agencies

also use the counters' network for the delivery of their services. There is an understandable wish on the part of these Departments and Agencies to find the most cost-effective means of delivering their services to their customers and giving their customers a range of choices for accessing their services. But this needs to be balanced against the importance of avoiding too sudden a change in POCL's financial circumstances, with the damage that this would cause. The early progress with the Horizon platform now in prospect should enable POCL to offer substantial enhancements to the facilities they are able to offer these and other clients, which should in turn increase the attractiveness of POCL as compared to alternative delivery channels. POCL has recently signed a three year agreement with DVLA. The three years will provide POCL with the opportunity to offer the Horizon platform for at least part of this period to streamline services to DVLA.

20. The future of the Post Office counters' network lies above all in its continued attractiveness to clients and customers as a channel for accessing products and services and to sub-postmasters as a business proposition. If, for whatever reason, customers stay away from an individual post office, neither the Government, nor the Regulator, nor indeed Post Office management will in the end be able to prevent its closure. If local communities value the presence of a post office outlet, as so many clearly do, their best guarantee of retaining it lies in making full use of the facilities on both sides of the business.

Criteria for further development of the counters' network

21. Against that background, the Post Office will continue to maintain a nationwide network of outlets which will provide customers with convenient access to Post Office counters' services. It is recognised that the precise shape and configuration of the network must be responsive to commercial and social changes, and it must be a matter for Post Office management to determine how its commitment to a nationwide network is to be met. However, given the uneven distribution of population in the United Kingdom, it is also recognised that some reassurance may be required against a concern that the commitment could be met with

substantially reduced access compared with now in less populous areas. It is the aim of the Government and the Post Office to maintain access to counters' services in, for example, rural communities. POCL goes to great lengths to maintain post offices in these circumstances, setting them up in village halls, petrol stations, pubs and even domestic premises when no other solution can be found. In response to that concern the Government will for the first time set (as part of the Government's guidance to the Post Office and the Regulator on environmental and social issues) minimum criteria for access to Post Office counters' services, for example percentage of the population within a certain distance. POUNC will monitor and will be able to advise and make recommendations to the Regulator on the size and make up of the network. This further measure will ensure that any evolution of the network of post offices will take place with due regard to less populated areas, as well as to those of social deprivation. The Post Office will publish in its annual report information about how the network is evolving in continuing to meet these aims and, in doing so, will comment specifically on the network situation in rural and urban deprived areas. This will enable the Government to consider any potential problems that might arise, and examine whether any action can be taken.

Conversion of Crown post offices

22. The Post Office aims to bring the benefits of sharing of overheads to part of the network of the post offices which it owns and runs – the 'Crown post offices'. The conversion programme was suspended in 1997 in the light of concerns arising as a result of some of the early conversions. The Government has now agreed a strategy, which reflects proposals put by the Post Office to the trade unions, of retaining a core of modern, strategically well-positioned, directly owned and managed Crown offices that account for a significant value of the business done at post office counters. Such a network provides POCL with direct contact with the customer, and enables them to develop high standards of service and products which their customers need. For the foreseeable future the Post Office intends to manage the conversion programme so that at least 15 per cent of the total business transacted by the counters' network is

done at the remaining Crown offices. The strategy also recognises that some further conversions will be beneficial to customers and the business. The selection of offices for conversion will be driven by three prime factors:

- improvement of service delivery;
- cost effectiveness; and
- ability to manage related staff issues.

POCL, following consultation with POUNC, also intends to make changes to the public consultation process on conversions, aimed at providing customers with specific details of the services being proposed, to provide a more objective basis against which interested parties can evaluate a proposal. Such changes will be incorporated in the Code of Practice on the Network, agreed between the Post Office and POUNC.

CHAPTER EIGHT

Royal associations

1. The Royal associations are symbolic of the historic character of the Post Office and of the essential role which it continues to play. They are also an intrinsic part of the brand which the Post Office has built up over a period of many years.
2. The Government's reform plan will ensure that the Post Office will continue to have a unique role in British life as a dynamic, competitive business within the public sector. The Government is therefore pleased to report that Her Majesty The Queen has graciously agreed that, under the proposals for the Post Office set out in this White Paper, the traditional Royal connections should continue. In particular Her Majesty has consented that:
 - a depiction of Her head should continue to appear on all stamps issued by Royal Mail, the designs of which will be submitted to Her for approval; and
 - the Royal emblems, the Crown and the Cypher should continue to appear on such items as post boxes, vehicles and business premises.
3. The Royal connections, important to customers and to stamp collectors, will remain symbolic of the essential national role which the Post Office will continue to play.



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