House of Commons

Trade and Industry Committee

Royal Mail Group

Ninth Report of Session 2005–06

Volume II

HC 1556-II

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Oral and written evidence

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The Trade and Industry Committee

The Trade and Industry Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Trade and Industry.

Current membership

Peter Luff MP (*Conservative, Mid Worcestershire*) (Chairman)
Roger Berry MP (*Labour, Kingswood*)
Mr Brian Binley MP (*Conservative, Northampton South*)
Mr Peter Bone MP (*Conservative, Wellingborough*)
Mr Michael Clapham MP (*Labour, Barnsley West and Penistone*)
Mrs Claire Curtis-Thomas MP (*Labour, Crosby*)
Mr Lindsay Hoyle MP (*Labour, Chorley*)
Mr Mark Hunter MP (*Liberal Democrat, Cheadle*)
Miss Julie Kirkbride MP (*Conservative, Bromsgrove*)
Judy Mallaber MP (*Labour, Amber* Valley)
Rob Marris MP (*Labour, Wolverhampton South West*)
Anne Moffat MP (*Labour, East Lothian*)
Mr Mike Weir MP (*Scottish National Party, Angus*)
Mr Anthony Wright MP (*Labour, Great Yarmouth*)

Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.publications.parliament.uk/pa/cm/cmstords.htm

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at http://www.parliament.uk/parliamentary_committees/trade_and_industry.cfm.

Committee staff

The current staff of the Committee are Elizabeth Flood (Clerk), David Slater (Second Clerk), Robert Cope (Committee Specialist), Ian Townsend (Inquiry Manager), Clare Genis (Committee Assistant), Jim Hudson (Senior Office Clerk) and Joanne Larcombe (Secretary).

Contacts

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Witnesses

List of written evidence

Oral evidence

Taken before the Trade and Industry Committee

on Tuesday 18 July 2006

Members present:

Mr Peter Luff, in the Chair

Mr Brian Binley	Rob Marris
Mr Peter Bone	Anne Moffat
Mr Lindsay Hoyle	Mr Mike Weir
Miss Julie Kirkbride	Mr Anthony Wright

Witnesses: Mr Adam Crozier, Chief Executive, and Mr Allan Leighton, Chairman, **Royal Mail Group plc,** and Mr Alan Cook, Managing Director, Post Office Ltd, gave evidence.

Q1 Chairman: Gentlemen, can I welcome you to this evidence session on 'you', the Royal Mail Group. As always, can I begin by asking you to identify yourselves for the record?
Mr Leighton: Allan Leighton, Chairman of Royal Mail Group.
Mr Crozier: Adam Crozier, Group Chief Executive of the Royal Mail Group.
Mr Cook: Alan Cook, Managing Director, Post Office Limited.
Chairman: We do have quite a tight timetable this morning—we could have done this over more sessions, but the imminence of the recess meant we wanted to get this done and dusted—and so I am encouraging everybody to be as economical as they can with their words. Lindsay Hoyle.

Q2 Mr Hoyle: Thank you, Chairman. Obviously the big issue is about not being able to borrow money. The Government has set up some kind of rules and we believe, or I believe, they have even given you some money as well. Can you enlighten us on the position, your borrowing and what monies you have got or have not got?
Mr Crozier: As you know, when we met last time we went through the challenges that the business faced in terms of modernisation, the pension issue and some of the issues within Post Office Ltd itself. We were asked by the Government to put together an investment case which would cover how we would develop the businesses over the next five years and beyond, and as part of that investment case what modernisation money we needed, how we would try and solve the pensions issue that we faced and how we try to resolve the transformation of the Post Office. That investment case has been through a number of banks on our side, a number of banks on the Government side. It has been, in principle, accepted by the Government, just in principle. A key and integral part of that investment case is employee shares and, following that 'in principle' agreement, we spent the last few weeks, and no doubt the next few weeks, trying to agree with the Government how that will be taken forward but, as yet, that is not resolved and it is still outstanding.

Q3 Mr Hoyle: When do you expect to have it resolved?
Mr Crozier: That genuinely is difficult to say. I hope in the next few weeks, but, as always, there are issues on both sides.

Q4 Mr Hoyle: So presumably it is holding back the business plan?
Mr Crozier: It is, in the sense that we have spent nine months putting that together. Clearly, at a time when competition is rushing into the marketplace, this is precisely the time our foot should be firmly on the accelerator, and to certain extent we are on hold while we agree what funding there is there to take the business forward.

Q5 Mr Hoyle: Obviously that is key, but there is press speculation this week, and I do not know what the situation is, that Post Office managers are due on strike any day, in sunshine like this! Is there any truth in what the press are telling us?
Mr Crozier: I do not believe that is the case. We are still fully in talks with Amicus who represent our managers. Those talks are ongoing and I do not see any reason why they would not come to a satisfactory conclusion.

Q6 Mr Hoyle: What about CWU? Are they happy with you at the moment?
Mr Crozier: Allan and I met with the CWU, Dave Ward and Billy Hayes, two and a half weeks ago. We agreed an outline deal, in principle, and I believe, having worked on some of the details of how that will work, that goes before the union executive any time now.

Q7 Mr Hoyle: So you expect to be strike-free and there to be an amiable agreement between the unions and your good selves?
Mr Crozier: That is not to for me to say, but certainly I would hope so. For the good of our customers and for the good of all of our people, I would hope that would be the case, yes.

Q8 Mr Wright: You just mentioned the question of the pension deficit and obviously the modernisation. In your previous submission to us you did mention the fact that what you were seeking was an increase in the price of postage. This was to "ensure Royal Mail is in a position to fund its pension deficit". Postcomm has obviously agreed to allow that increase in their postal prices to invest over £1billion (I think was the figure that was quoted) in modernisation and also an average of £320 million a year towards the pension deficit. Given this, why has the Government also had to step in and act as guarantor for the monies for you?

Mr Crozier: As part of the package the Government would not be acting as guarantor. The Government would not do that. The whole funding package is, indeed, a package. It comes from some of the things that Postcomm are allowing us to do, the Government funding itself, our improvements in efficiency and some of the Government money there is to go into an escrow account to give the pension trustees some comfort that, were anything to ever go wrong with the company, they have some money to call on. What that allows us to do is to then, instead of, as is more normal, paying off the pension deficit over ten years, which we could not afford, we are able to potentially spread the payments over 17 years, but, clearly, our ability to do that deal with the pension trustees is dependent on the Government funding as a whole as an integral part of the package that will take the Royal Mail forward.

Q9 Mr Wright: So you are quite happy and content that the pension deficit will not be increased any more but will actually decrease year on year?

Mr Crozier: That is clearly something we are not entirely in control of because, like every company, we are dependent on what bond rates are, what happens with the stock market, all of those things. We have a pension deficit, as you know, as it currently stands of £5.6 billion. Unlike many companies who have yet to do it, we have done a review of mortality rates, which, as you will know from other companies, have gone up, and therefore that has added to the pension deficit, but at least we know where we are now, as of today. Clearly our intention is to clear that pension deficit over 17 years. We have come to, again, an 'in principle' agreement with our trustees to do that, but that in itself is on hold whilst we see if we can finalise the Government funding.

Q10 Mr Wright: Are you quite happy that you will not have to return to the Government or to Postcomm to ask for an increase in prices to cover the deficit? Are you quite happy with your strategy?

Mr Crozier: I am happy. If every single part of the package comes off, then we are comfortable that that is the right place for us to be to deal with the pension deficit and to modernise the business. Clearly, what we can predict is some of the things that are outside of our control, but obviously we will deal with them as they arise.

Mr Leighton: I think it is very important. I have heard all this stuff about government hand-outs and everything else. We never take hand-outs from anybody and we do not intend to. We have always run the company and taken it from a pretty perilous state to where it has been self-sufficient. We are like everybody else. We have made an investment case. The investment case is very straightforward: This is what we need to do with the company. You are the shareholder, you just have to deal with the Government not Schroders, and, therefore, if you want to support this we can give you a great return for it. It is an integral part; there are no separate bits. Like any investment case there is, you cannot take a bit and put that bit and invest behind that, it is an entity. Our view is that it is necessary for the company, it will enable us to grow the value of the organisation, it will enable us eventually to pay a dividend to a shareholder, which is what a shareholder would expect, but this whole fact that everybody thinks you are going to have to go and ask people for money, whether it is Postcomm or the Government, is incorrect and does not do justice to the people in the organisation who work as a commercial entity.

Mr Crozier: Clearly what we want is a modern Royal Mail that can compete in an open competitive marketplace. To go back to Lindsay's point, the competition are not sitting around waiting for us to finish this discussion, they are off, they are buying other companies, setting up operations all over the country, and the one thing that we lack at the minute is an agility and pace to get on with things and be competitive, and that is why we are so anxious to get on with this.

Q11 Chairman: If you were fully privatised in a fully competitive market, you would not be here today, of course.

Mr Leighton: Yes, but we are not. Somebody made the point yesterday, which is a very interesting way of thinking about it, that you can argue the Government privatised the mail industry and we are a public entity competing in what is now a completely privatised industry and did it in a completely different way to the way it has been done historically, i.e. market opened up, regulator put in place and off you go. But, as I say, we do not complain about it because there is no point complaining about it. We are as we are, so far so good, we have been able to compete, that is our intention.

Q12 Mr Bone: Your investment really breaks down into modernising your operation and the pension deficit. I would quite like to know what proportion of your investment to do those two things comes from hiking up the price of postage stamps, or income generated by the pension fund, or from the shareholders, or from efficiency savings. What are the proportions in relation to that investment?

Mr Crozier: There is certainly no income from the pension fund. We face 17 years of paying into the pension fund around £735 million a year.

Q13 Mr Bone: Can I just stop you, because there is something I do not quite understand on this. The pension funds have sometimes been in huge surplus, depending on the stock market. So, how can you say for certain what is going to happen over the next 17 years on the stock market? It could boom and you would no longer have a problem?
Mr Crozier: I think that would be terrific if that were to happen.

Q14 Mr Bone: So there is a possibility of money from the pension fund, but you put that in as zero?
Mr Leighton: When you say "money from the pension fund", what do you mean?

Q15 Mr Bone: From your investments. You are saying there is no growth there?
Mr Leighton: No growth in what?
Mr Bone: The pension fund.

Q16 Chairman: I think the suggestion was that if the pension fund might become fully funded at some stage in the next 17 years, you would get another pensions holiday again?
Mr Leighton: That is a possibility. There is nobody, I think, in the pensions world who is predicting that.

Q17 Mr Bone: So, it is zero at the moment?
Mr Crozier: Let us try and remember we have a company that has an asset base of £2.3 billion and a pension deficit of £5.6 billion, so we have negative equity, so we are not in a position to think about income from the pension fund at all. In terms of efficiency, to go back to your question, as part of the Postcomm price settlement we are charged with improving efficiency by 3% per annum after we have paid for any wage inflation. So, that is a 3% net improvement after any improvement in pay or anything else, and so that is a huge task for us going forward. In terms of price rises, again, although we have had a two pence price rise, let us not forget, we lose five pence on every first-class letter and eight pence on every second-class letter, so we are still not covering our costs on stamped mail. We have still got a long way to go on that.

Q18 Mr Bone: I do not think you attempted to answer the question that I asked. What proportion of that investment would come from each of the categories I asked you about?
Mr Crozier: I do not have that information to hand, but we can certainly send you that.

Q19 Mr Bone: You did not comment on the shareholder result, whether there will be any money from the shareholder. Your answer indicated to me that the monies would basically come from efficiency savings and increasing the price of a stamp?
Mr Crozier: No. You have got three main segments, if you like, of funding. It is assigning the Mail's reserve of about £850 million over to the company, there is a borrowing and credit facility of up to £900 million, which was sort of there before, and then there is the fully funding of whatever the solution that people agree to is on the Post Office itself. Those are the three main elements, if you like, of the funding package. Certainly percentage-wise, I am very happy to go away and break that down for you and send you that through.

Q20 Mr Bone: Would you? Is there anything I have missed? Is there any other financing method you could use to do this investment?
Mr Crozier: No. We are not allowed, without the express permission of the shareholder, to go outside for any funding.
Chairman: We will move on to the ownership questions, if we may. Rob Marris.

Q21 Rob Marris: My colleague, Brian Binley, is going to ask you something about the incentive side of things, but I wanted to ask you some quick questions, some of them may require yes or no answers. Have you formally or informally approached the Government with a share-ownership scheme to widen share ownership for the Royal Mail?
Mr Crozier: Formally.

Q22 Rob Marris: You have formally done so?
Mr Crozier: Absolutely, and have done a few months ago, yes.

Q23 Rob Marris: Could you outline the details of that formal programme, that is the package you put to the Government?
Mr Crozier: Again, to go back to Allan's point, it is very much part of the investment case as a whole, so it does not live out there to the side, it is part of the overall case. We recognise that the company is going to go through some fairly huge changes over the next few years and it is very important that as part of that we take our people with us and we motivate them to want to do a good job for us and for the customers. What we envisage is having assigned over to the company 20% of the shares of the organisation. Those would be allocated to people absolutely equally. Whether it is myself or Allan or frontline postmen and women, everyone would get exactly the same.

Q24 Rob Marris: To employees?
Mr Crozier: To employees. Those shares would have very small initial value, but as the company grows and achieves its target those shares would grow to hopefully provide people with around £5,000 each of equity value in the Royal Mail.

Q25 Rob Marris: How will this raise any money for the company? I can see that selling shares would raise money on the stock market, but how?
Mr Leighton: It does not.

Q26 Rob Marris: So why is it part of the overall finance package?
Mr Crozier: Because that is what helps to massively transform the performance of the company, which generates the profits, which allows you to reinvest in the organisation. We have got empirical evidence of how this works from all over the world and in the

UK. It is a pretty standard way of doing it. The shares scheme, the reason it is absolutely fundamentally not privatisation is the shares can only stay within the company in a trust that we would set up. If people decided after three years they want to cash in those shares, they can only sell them to the company and, if they wanted to, they could buy some extra, again through the trust. If you leave, either because you get another job or you are made redundant or you retire, you have to give the shares back. So the shares always stay within the Royal Mail itself. They never leave.

Q27 Rob Marris: When was this formally put to the Government?
Mr Crozier: I cannot remember. It was a few months ago. Again, I can get you the exact date if you would like, Chairman.
Mr Leighton: So, your point, it was part of the overall—. It goes back to the same thing. It is all part of a business case which covers all the aspects of what should be required to modernise the company.

Q28 Rob Marris: What are the views of the main trade unions on this. Presumably you consulted them on the overall financing, including this aspect thereof?
Mr Crozier: We consulted with our people, and within the space, first of all, of about two weeks we had 80,000 replies from people saying that they thought this was a good idea.

Q29 Rob Marris: You talk about "our people", that means your staff directly?
Mr Crozier: That is right, yes.

Q30 Rob Marris: What about consulting with the trade unions, which is what I was asking?
Mr Crozier: We understand from the trade unions that they are against it. We understand from our people that they are for it.

Q31 Rob Marris: So do I, but did you consult the trade unions on this?
Mr Crozier: We have certainly spoken to the trade unions on a number of occasions, myself and Allan with Billy and Dave. I know the Government have spoken to the trade unions, initially through Alan Johnson when he was Secretary of State. We understand that philosophically they are opposed to it. We take a different view and we believe our people take a different view, and, in the end, our job is to do what is right for the business and right for our people, because there is a huge transformation that needs to take place.

Q32 Rob Marris: When you say you consulted "our people", you did a survey or you wrote to them?
Mr Crozier: We wrote to all of our people asking them to let us know whether they were interested in this, starting with whether they thought it was a good idea, and we received, I think, 85,000 replies in the space of two weeks saying, "Yes."

Q33 Rob Marris: And to a total staff complement of?
Mr Crozier: Of around about 150,000, but then again on most of our ballots that would be an enormous response. We very rarely get a response like that.[1]

Q34 Rob Marris: What part of your Memorandum and Articles of Association permit you to spend Post Office resources in that way?
Mr Leighton: In what way?

Q35 Rob Marris: In terms of sending out letters to staff and surveying them on share ownership and that kind of thing?
Mr Leighton: As far as I am concerned, the ability of the management to talk to their people and consult their people at any time is absolutely open to anybody in the organisation, and we do not consult a Memorandum or Articles of Association, we are a plc, we are a commercial entity, we engage with our people, we are interested in what our people think and that is why we do it.
Mr Crozier: I cannot think of another company that does not talk to its own people.

Q36 Rob Marris: I am asking just a simple question. Which part of your Memorandum or Articles of Association enables you to do that. I am not suggesting that it does not; I am simply asking which part of it allows you so to do.
Mr Crozier: None. Management has the ability to talk to its people at any time, full stop.

Q37 Rob Marris: About anything?
Mr Crozier: About anything.

Q38 Rob Marris: About what colour car they might like?
Mr Crozier: Absolutely.
Mr Leighton: Whatever you want to do.

Q39 Rob Marris: Could you send us a copy of the relevant part of the Memorandum or Articles of Association?
Mr Leighton: If there is one, we will send it to you with pleasure; if there is not one, there is not one.

Q40 Rob Marris: Perhaps you could let us know if there is not one?
Mr Leighton: Absolutely.

Q41 Rob Marris: There must be a Memorandum and Articles of Association?
Mr Leighton: There is for the company. Whether it deals with whether you can talk to your people and ask them things, I am not too sure. I think that is just commonsense, good management.

Q42 Chairman: Would it be possible to see a copy of the letter you sent to your staff about the scheme?
Mr Leighton: Absolutely.

[1] In total Royal Mail Group wrote to 208,000 employees and 91,703 returns were received.

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Q43 Chairman: That would give us some background information that some of would like to know about.
Mr Leighton: Absolutely. No problem.

Q44 Mr Binley: I am beginning to lose touch with reality, quite frankly. I do not wish to trivialise what is a very big business, but I am a businessman and it seems like we are playing Monopoly. You have a situation where we have found little evidence that employer share schemes incentive employees to improve productivity. Only 37% of your employees have expressed an interest in share ownership, there is no measure of normal accountability that there would be in a business with a share scheme and, finally, you are trading insolvently, because you have got assets of £2 billion and you have got debts of £5 billion. This concerns me enormously. I do not like playing games with a big thing like the Post Office, and I am sure you feel uneasy too. Exactly how much factual evidence do you have that your proposed model of employee share ownership would be advantageous to the UK consumer, and, as Royal Mail is a public sector organisation, how would your company's ultimate shareholders, the UK population, be compensated in all these Ruritanian machinations?
Mr Leighton: Brilliant! That was a hell of a speech. Two things. Number one, a lot of it is Monopoly money, I think you are absolutely right, and your issue about the assets of the business and the work of the business is absolutely right too. You have to ask yourself: how did that happen? We inherited this mess and our job is not to reflect on that, our job is to put it right, and the whole issue about this investment case starts to do that, and actually, touch wood, so far we never asked the great British public for anything in this process. Along the way, which has been a very painful process for the people in the company, it is worth reminding everybody that this business, which is the way we tend to look at it, has just delivered, in very difficult circumstances, the best quality of service ever in the history of the Royal Mail and the best profit ever delivered in the history of the Royal Mail. That is something to be applauded, not something to be jumped up and down about and trivialised, because to do that in this market with that amount of people in the circumstances we have got is a pretty significant achievement.

Q45 Mr Binley: Profit and stable business are two different things. I understand where you have been, and we applaud that, but my question still remains relevant without that sort of comment, quite frankly.
Mr Leighton: But it is a very important comment, because when you talk about Ruritania and Monopoly, all I am saying is that this is a serious business, it does serious work, employs lots of people and actually the majority of those people do a fantastic piece of work, and this business, the Royal Mail, is still the envy of most of the postal services of the world. The fact that it has got to where it is is one hell of an achievement. What we are talking about now is how do you move on, and how do you move on in an environment where no longer are we a monopoly? Even when we were a monopoly and we could determine exactly what our revenue was, we could not make money. If you cannot make money when you can determine exactly what your revenue is, you have got a pretty big problem down the track.

Q46 Mr Binley: Can I remind you of the two questions I asked you?
Mr Leighton: Yes. We can give you empirical evidence that shares for employees works. That was part of our submission. We will give you that with pleasure.

Q47 Chairman: Shares traded on the stock exchange, no doubt at all. This model is what the question is.
Mr Leighton: And we have got stuff that can demonstrate on this model. The other way to look at it is, like us or not, we have got some experience in running companies, and generally a pretty good track record in running companies, and actually, so far, a pretty good track record in running this company, and to a degree that should count. We are not in the game of doing things just because we think it is a good idea. We are in the game of doing things because it is part of an overall investment case that says: if you do all of these things, if you modernise, if you put more efficiency in, if you invest back into the business, if we involve people in the company and (the way I think about it is a rhetorical question really) do you believe that people participate more and do more and actually feel more for an organisation where they own part of it? My view is that it is exactly same as every individual around this table. Stuff that we own or that we part own plays more of a part in our lives, and so the empirical evidence happens in every day of every man and every woman in the street, so a lot of it is commonsense.

Q48 Mr Binley: You did congratulate me on my speech. I congratulate you on yours. That was pretty good too. Can I come back to this final point that you did not touch on. How would your company's ultimate shareholders, the UK population, be compensated? How do you see that connect, bearing in mind there is no direct accountability in terms of what a normal company would classify as accountability?
Mr Crozier: You also touched on the need for a stable company. Most of the issues that face the Royal Mail are actually issues of legacy. The three most synonymous ones are the pension deficit itself, which is clearly huge the fact that the company has not been invested in for the last 20 or 30 years, which means therefore it is completely unmodernised compared to all our competitors and, thirdly, the fact that government income into the Post Office will have gone from 60% of the Post Office's income four or five years ago to less than 10% in a couple of years' time. So we are dealing with three huge legacy issues plus the future one of an open competitive market. So, although the companies perform very well today, it has got those issues to cope with. Clearly,

in part of the investment case, the taxpayer ought to be saying, "We are quite prepared to stand behind the Royal Mail and to invest some money, but if we are going to do that, we want to make sure it is going to work." That is the important thing. If you put money in, it works and you get a return and you get a great quality of service. The share scheme is all about motivating our people, taking our people with us so that we can go on this journey together and make this work. The end benefits to the taxpayers are that, as we get more efficient, we give them better value in the sense of (1) more cost-effective prices, (2) better quality of service and (3) eventually returning to a position, like a normal company, where we give our shareholder a dividend based on our performance, and that has got to be good for the taxpayer because it means we are putting something back into the economy. If you go back three years when we were losing £1.7 billion over two years, that is when the taxpayer should have been very upset because the Royal Mail was an absolute drain on the taxpayer. So, that is what they get out of it. Over time, as we become more efficient, they get a modern Royal Mail which is absolutely vital to every business in this country who relies on us, because we are the link with their customer, every household that relies on us, and over time, as we get more efficient, they get better prices, they get better quality of service and we start to put something back in. That is the plan and the thinking.

Q49 Mr Weir: I have listened carefully to what you have said, and it all seems very nice, but taking the optimistic scenario of your success where the Royal Mail becomes highly successful, do you not feel that under this model you are going to face increasing pressure from your employee shareholders to make the shares fully tradable? Do you not think that in the end it will be privatisation through the back door?
Mr Crozier: Absolutely not, because as far as they are concerned they are fully tradable, they are just fully tradable within the Royal Mail, so there is no need or requirement for them to wish to go outside it.

Q50 Mr Weir: If the company becomes highly successful, presumably the shares would have a tradable value which may be greater outwith the small group that can trade them, and so there will be pressure building up to make them tradable on the London markets?
Mr Leighton: It does not work like that. This is very straightforward. This is exactly the same. The shares in the company go up with the value of the company, in the same way that the shares on the Stock Exchange go up with the performance of the company, and actually it is exactly the same. They are all traded within the trust, so as far as our people are concerned it is exactly the same as being outside but for our purposes it is totally inside, it is within the trust, it can never be sold outside the trust and can only be held for our people, and they get a dividend too, so they get exactly the same benefits. That is why—it is quite interesting listening to everybody—this is so simple it is untrue. Actually, if you go to the public they get it in one, they absolutely understand it: "It is exactly the same as if I own a share anywhere else, they are just traded within the company and I get a dividend. I understand that. I get that." That is why it is very potent.

Q51 Chairman: A 'dividend' I understand, but how do you value these shares because they are not being traded?
Mr Leighton: In the same way as you value the company. What happens is that, over a period of time, if the company performs, as any other company performs, you can determine a value for the company. The whole idea of this is for the value of the company to increase because of its performance, and there is a very simple piece of methodology, which is exactly the same as you would use in how you value shares in the marketplace, which gives you a value.

Q52 Chairman: Different shares have wildly different "P" ratios on the Stock Exchange?
Mr Leighton: It does not matter.

Q53 Chairman: But how you chose that ratio will determine the value of the company?
Mr Leighton: Yes, but you get somebody outside, an independent, to do the valuation, in the way as happens in the Stock Exchange.

Q54 Chairman: Yes, but the markets have a way of attaching sentiment to valuation as well. This can be a very mechanical process which will mean a there will be a lot of challenge, will it not?
Mr Leighton: You say that, but the thing about our markets, interestingly, is they might be wrong in any one day, they might be wrong in any one week, but generally over time they are right. So, sentiment counts for a period of time, performance counts all of the time.

Q55 Chairman: If you make a loss in any one year, what happens then to your employees and their shares?
Mr Leighton: Exactly the same thing. If you make a loss or your value does not go up, then clearly the price of the shares goes down; so it is exactly same.

Q56 Chairman: That is the incentive value you see for your staff?
Mr Leighton: Absolutely. We are not planning on making a loss.

Q57 Mr Hoyle: But there is no liability?
Mr Leighton: Not at all. The one piece of difference in this is there is no liability.

Q58 Chairman: Let us move on to the other whole area. I would like to explore this at great length. It fascinates me. I am not yet persuaded, but you might yet persuade me. Let us move on to post offices. Tell us some factual stuff first of all. How many post offices are there today in the network?
Mr Cook: 14,500.

Q59 Chairman: How many have you said you would need to run a commercially viable network?
Mr Cook: A commercially viable network would be around 4,000.

Q60 Chairman: So you could actually do without over 10,000 of the current Post Office network to run a commercially viable network?
Mr Cook: I do not have an aspiration to run a network on 4,000, but if you wanted the optimum commercially viable network, it would be 4,000.

Q61 Chairman: By the way, your timing was not perfect. I received this in the post this morning, the pricing and proportion document. I suspect we are going to need a lot more post offices out there to advise your customers on what they have got to pay for everything when they see the complexity of this nightmare of a pricing scheme. You might need more than 4,000 then, I suspect. Do you think it is going to be useful, this pricing proportion?
Mr Cook: We shall make sure we provide additional support in the opening weeks for customers, but I think people will adjust to the change quite quickly.

Q62 Chairman: I find it very difficult to understand.
Mr Cook: We will make sure we have someone in your local post office!

Q63 Chairman: I have a very good sub-post office down the road, which I want to keep very much, thank you, which leads me on to the main thrust of my question. The Government has told us it will not be renewing the Post Office Card Account after 2010. What impact is that going to have on both the urban and rural Post Office network?
Mr Cook: The impact is huge in terms of income. This year we will earn around £195 million from the Card Account. Clearly, if that is not renewed in 2010, that income will go to zero. If one steps back a moment, the whole role and purpose of post office branches for many years has been twofold, (1) to act as the front office, if you like, for the Royal Mail in terms of the delivery and parcels business, and (2) it has been a business that has got the right amount of cash in the right town on the right day of the week so people can collect benefits, and that second part of the whole purpose of the Post Office is rapidly disappearing, and we are going to need to adjust the business model to cope with that significant challenge, but we were earning £400 million a year on benefits income very recently, and that is going to drop to zero.

Q64 Chairman: Before we look in more detail at some of the questions about the implications of the loss of the Post Office Card Account, can I ask you to put this in context for me. First of all, how many post offices do you currently expect to have to close over the next few years?
Mr Cook: That is really for government to determine. It is really clear that they have to decide exactly what scale of network, or, if you like, community provision they would feel appropriate.

Q65 Chairman: Is it the case that up until now the Post Office network, in my view quite reasonably, (it is not a criticism) has been 'subsidised' or funded (perhaps a better, more neutral word) in large part by the benefit system and also by a range of other public sector contractors with you as well, I think television licensing and DVLA. How important have those been in financing the network?
Mr Cook: They have all been payment for services rendered. I would not call them a subsidy or funding, I think they are tasks that are performed on behalf of government in contact with its citizens. If those tasks are taken away from post offices, the two you mentioned in particular, the Card Account and the BBC TV licences, have a particularly adverse effect on the income and, ultimately, therefore affect the underlying profitability.

Q66 Chairman: The TV licence is more important than the DVLA were because every sub-post office has issued licences, whereas car licensing has been more specific to larger offices?
Mr Cook: Correct. Yes, 4,000.
Mr Crozier: I made the point earlier that if you go back three or four years, something like 60% of the Post Office's total income was effectively front-facing government services, if you like. Within the next three years that will go down to less than 10%, and in many ways I think that is partly the reason why the Government has set up this Miscellaneous 33 Committee, because I think what people are starting to understand is that there needs to be a kind of joined-up approach to this. As part of the overall investment case, what government has signed up to do is to fund the Post Office going forward, but what they have recognised is that if they are taking away with one hand (i.e. all the accounts you have mentioned like the DVLA, the BBC TV and the Card Account), it only increases the amount of subsidy they need to give on the other side, and therefore what they need to have is a joined-up view of what the Government wants from the Post Office. The reason this is important is because you rightly ask us the question of what would a commercial network look like. We have often answered that it is in and around 4,000 branches. We have never suggested that that is the right answer. There is an answer that lies somewhere between that and the current set-up, and in a large part that has to be determined by what the Government wants to use it for. I thought it might be helpful for the Committee to give you one or two facts around the Post Office, because I think it is a very emotional issue, but sometimes a few facts help focus the mind a bit. The Post Office last year lost £2 million every week. This current year, because of the withdrawal of the pension benefits, that will rise to losing £4 million a week. So, there is an instant effect of a decision. As you know, of the 14,500 only 500 are actually owned by us, so the issue is that is 14,000 businessmen losing their own money when they lose money. You have got the fact that we have got 1,600 branches serving less than 100 customers, and every time one of those customers does a transaction we lose eight pounds. So there is a fact that just focuses the mind

a little bit. 90% of our customers are actually concentrating, in a living sense, around 50% of our branches, so you start to see the clusters of where people live, and in rural areas there are twice as many branches per head of population as urban areas.

Q67 Chairman: Only twice as much.
Mr Crozier: Yes. So we have got a really skewed network there with some really in-built issues, and all of this withdrawal of business counts. Another important thing that people tend to forget is, if the Post Office loses the footfall of people going in to do that kind of business, then clearly when these people were visiting post offices they were also spending money on other things whilst they were there. We are very happy to send you a note of some of these facts, because sometimes they are quite helpful in getting people to understand the reality of that part of the organisation.

Q68 Chairman: We do understand quite a lot of that. The bottom line is historically the nation has enjoyed the experience of sub-post offices, often in very remote, rural locations, because of the wide range of services the state chose to put through those post offices?
Mr Crozier: Yes.

Q69 Chairman: The state is now withdrawing those services from the post offices. If we want those post offices to continue, there must be a more explicit funding mechanism for those offices to endure?
Mr Crozier: Absolutely, and that is effectively what we are agreeing with the Government. The next part is for them to decide what they want from the Post Office.
Chairman: We do feel a bit sore about the Post Office Card Account though, and we are going to pursue that in a little more detail, if we may, with you now. Mike Weir.

Q70 Mr Weir: When many of us have asked the Government about the withdrawal of the Post Office Card Account, we have been assured that there was never any intention of extending the contract after 2010, but I remember the Minister waving a copy of the contract at one debate saying, "It is all in the original contract", but we were never allowed to see it. Can you tell us whether you were sufficiently aware that the contract would not be renewed post 2010 when it was signed in March 2002?
Mr Cook: All contracts have an expiry date, first off. Obviously the contract was for a ten-year period and action would need to be taken at the end of the ten years. I think our organisation had an expectation that there would be a continuing need for a method of providing benefit payment to individuals who do not have a bank account. My belief is that whilst this contract will end in 2010, there will still be a continuing need, maybe not on the same scale, for individuals to receive their benefit payment in cash in some mechanism, and my understanding is that the Department for Work and Pensions, who I am working with quite closely now, will probably put out to tender for that work, which inevitably I intend to bid for in a robust way.

Q71 Mr Weir: Do I take it from that that your original view was that, although the contract was for 2010, you had a reasonable expectation it would be extended beyond that with that or a similar contract?
Mr Cook: In the sense that there is a certain logic that individuals do who do not have a bank account have got to get their benefit in some way, yes, but I think the DWP's view would be that is a separate arrangement and a separate contract that requires us to tender for separately.

Q72 Mr Weir: But there is not an organisation equivalent to the Post Office to deliver that service through a branch network?
Mr Cook: I should enlist you in helping me write my tender!

Q73 Mr Weir: The profit was not just the Post Office, the banks and building societies are also part of it to some extent. Do you know if they were aware of the end date of the contract of 2010?
Mr Cook: Again, they would have been aware that there was an end date to the contract because you would not necessarily expect anybody to sign an open-ended contact that runs *ad infinitum*, but again, I would assume, and it is for them to comment, that they would anticipate that some form of payment provision was going to be required. One could imagine it diminishing over time as bank accounts become more acceptable and people become more financially astute and more prepared to hold a current account and have payments credited to it.

Q74 Mr Weir: But Mr Crozier has just told us, and you told us as well, about the numbers of post offices and the optimum level. I appreciate you are not saying we ought to go down to that optimum level. You talk about banks as an alternative, but those of us who represent rural areas know that most of the banks have closed down in rural areas as well and are in a position where, if your network closes, there is effectively nothing in many rural areas, a bank or a post office?
Mr Cook: Correct. I am involved in quite detailed conversations now with DWP to find the best method of both securing that individuals receive their benefits in the way they want to receive them, meeting the DWP's cost aspirations, but also meeting my own needs to make sure that we make the business model that underpins the Post Office Limited as viable as possible. There are two ways individuals could receive benefits going forward. One is through a successor account for individuals who do not have a bank account, but even where individuals do have a bank account, there are opportunities for the Post Office to play a significant role. The top million customers, for example, that hold Card Accounts currently have sitting in those Card Accounts the best part of £750 million worth of balances. The current specification for the Card

Account does not result in those individuals being paid any interest for that. Certainly one of the suggestions that I have made, and we are now investigating jointly, is that we create a new entry level savings account as a Post Office product where individuals then would have their benefit paid into that entry level savings account and I would pay them interest. The remuneration would be nowhere near as significant as I am getting today, because I would then just be running it as a savings account and earning a margin on the difference between the money I have got in the bank and the money that I pay the individual in terms of interest, but that would retain the footfall and it would retain some level of income.

Mr Crozier: Two points. One is we have 4.3 million customers who are very happy customers, so this is not a customer-driven issue. The second is that when the Government Committee looks at the Government response across the Post Office, it will also, as I understand it, consider things like financial inclusion, because it is not just about the numbers of post offices. Those post offices provide a valuable role in terms of getting people money that would not otherwise be able to get it. So, there is quite a lot to think about in the government response; it is not just about numbers.

Q75 Mr Weir: We see you have got 4.3 million happy customers. I am sure you do, but if a large part of these 14,000 post offices go, there could be very unhappy customers?

Mr Leighton: I think that is the issue. With all due respect, the issue is straightforward. When the Government revenue was 65%—the Government revenue is 10%—that is £500 million of revenue, so there is £500 million that was going in there that is not going in there any more. We have got a couple of choices. Replace the £500 million, which is what we are trying to do, which is pretty big for a retail outlet. Again, if you think about the scale of what we are having to do here, I do not know any retail business in the world that loses half of its turnover, but this one has, so replacing it is a pretty big deal, and if you talk to the sub-postmasters, that is what we are all about here: how we are replacing half the revenue. So, you have got two issues. We have got an issue with the sub-postmasters—they have lost half their revenue, how are we going to find that back—and that is a pretty big deal because we are very dependent on them having some degree of living to keep the things open, otherwise we are going to have to pay them just for keeping it open.

Chairman: You are up against your deadline, I know, but I think we are agreed about this. I am asking a detailed question that we must pursue with you.

Q76 Anne Moffat: You have answered most of what I was going to ask about the Card Account, but can you explain to me why it costs the Government and, ultimately, the taxpayer £1 each time a benefit is paid into the Card Account, whereas if it was an ordinary bank or building society it would be something like a penny? Is there anything we can do about that?

Mr Cook: The penny is correct. The numbers that you are quoting are how much it costs the Department for Work and Pensions. I can assure you, it does not cost the banking industry a penny to make a payment out. If the money is credited to a current account and the customer comes in every week and clears the account down to zero, that is costing a darn sight more than a penny to the bank when that customer comes in, but all it has cost the DWP is the cost of the transmission to the bank account. Effectively, what has happened is the administrative burden has been transferred from government to the banking industry. The payment that we currently receive seems to me to be pretty fair recompense for what actually goes on. These are high transaction accounts that are not attractive to the banking industry, and it is for them to make their own comments, but no balance is typically held on them. I have talked about the group at the top that do hold a balance, but the vast majority (3.3 million of them) clear down to zero every week because it is just a mechanism for paying out benefits, it is not a savings account, and that is the difference.

Mr Crozier: There is a really important point that goes with that as well, which is that, as each government account is taken away, the cost of the network still remains and, therefore, each time you pitch for a new piece of business you are advertising that cost against fewer and fewer pieces of business, so in effect it becomes self-fulfilling that you are uncompetitive, and again this is something that we have given the Committee to look at because you end up going down a spiral.

Q77 Mr Hoyle: There is something rather absurd, is there not? Whether it is TV licences, whether it is benefits, whether it is driving licences, this is taxpayer's money, so taxpayers money should go into a Post Office that is owned by the taxpayer so any profits then go back to the taxpayer. This way, if the business goes elsewhere, it goes to private shareholders. It seems an absolutely absurd way of thinking. Do you really believe the Government knows that it is shafting the Post Office? Do you think it is deliberate or do you think it is just bad management?

Mr Leighton: We will just agree.

Q78 Mr Hoyle: The second quick point we have not got down on the questions is that I understand that the cities are now opening up: we are going to see people in maybe brown uniforms with nice shiny buttons delivering mail. Allan, you are the face of capitalism, but is this the unacceptable face of capitalism when these people in the brown uniforms have hard to deliver addresses, addresses that cannot be found, suddenly turn up on your doorstep, and say: "Here you are, you can deliver the hard to find, we will only take the easy business"?

Mr Leighton: All I can say, Lindsay, we have been dealt what we have been dealt, and the fact of the matter is, as I say, the industry was privatised, the Royal Mail was left public, the whole regulatory system and everything was set up in a completely different way to the way it was set up before. There is no point moaning about it. I genuinely believe that with the investment case that we have got, if we are sensible and we continue to do the right thing, then I think we can still compete in this marketplace. The Royal Mail has great assets, it has got great plans, it has got some very good people, we have been at it for 200 years and, if we do what we are supposed to be doing, then we can compete. The reality is that those people are going to come, they are going to try and steal all our business mail, but we are going to have to learn to compete, and I am sure that we can.

Q79 Chairman: I know that you are up against the clock, and so are we, so I think we will call an end there. You promised us a copy of a note you sent to your staff about owned share schemes, also some more information about the Post Office's network. It would be helpful if you could classify as much as possible where those post offices are, because there all different types of post offices, some are stand-alone, some are in-store and some the post office is the main feature and there is a small shop attached to them. As much of an understanding about the nature of the network as possible would be very helpful.

Mr Crozier: We will break that down for you.

Chairman: That is very helpful. Gentlemen, thank you very much indeed.

Witnesses: Mr Billy Hayes, General Secretary, Mr Andy Furey, National Officer for Post Office Counters, and Mr Jeremy Baugh, Head of Research, **Communication Workers Union** (CWU), gave evidence.

Q80 Chairman: Gentlemen, thank you very much indeed. We are very grateful to you for coming. Can I, as always, begin by asking you to introduce yourselves for the record.

Mr Hayes: Can I just apologise for Dave Ward. He was going to be part of the team. He is the General Deputy Secretary. He cannot be here this morning. My name is Billy Hayes, I am the General Secretary of the Communication Workers Union, on my right is Andy Furey, who is the National Officer for Post Office Counters, and on my left is Jeremy Baugh, who is the Head of Research.

Chairman: Thank you very much indeed. Anne Moffat.

Q81 Anne Moffat: Good morning. The pension deficit is now £5.6 billion. Just how worried are you and your members about this?

Mr Hayes: Obviously, we are clearly concerned in terms of the deficit because our members have paid into the pension scheme, and what we also have to remember when we talk about the pension fund deficit is that for 13 years the Government had a pension fund holiday, and doing a fag packet type calculation, we estimate that somewhere in the region of a £4 billion holiday in terms of contributions, so we are really worried but, obviously, the deal the Government has done with Royal Mail is a real step forward. The commitment to pay in £750 million over 17 years is a big step forward and it does begin to ease our concerns about the pension fund.

Q82 Anne Moffat: Are you concerned that the famous gap salary scheme will go as a result to help with the deficit?

Mr Hayes: We are concerned in the sense that it seems to be the fashion at the moment, but the deal done between Royal Mail and the Government allays our concerns. Our concerns are more about the generalities as opposed to specifics.

Q83 Anne Moffat: We heard evidence earlier from the Royal Mail that they have consulted with "their people" directly, and they did not do that through you. How do you feel about that?

Mr Hayes: That is part of Royal Mail's style, and it may be historical in terms of managers coming in from outside of the company and having a particular style, but the fact is we still represent 98% of the workforce and we speak with authority on behalf of them and we would like them to speak more to us. We have been doing some work on that and we are beginning to understand each other's language.

Chairman: We will test that a little bit later on. Peter Bone.

Q84 Mr Bone: I think, Chairman, you might have already answered the first part of my question, which is that you seem reasonably happy with the Government's decision about the funding of the pension deficit and you think it will it be acceptable to your members?

Mr Hayes: We think it is a big step in the right direction. Obviously there is lots going on and things could change, but it is certainly a step forward, yes.

Q85 Mr Bone: Do you have faith in the trustees and that the pension deficit will go down rather than up?

Mr Hayes: Again, just to reiterate the point, it is a step in the right direction and we are reasonably confident that things are going to move along in terms of the pension fund.

Q86 Mr Bone: I am tempted to say, Chairman, you seem in very reasonable form, because I think I might have been hitting the Government over the head a bit more about that £4 billion pension holiday, but you are quite content that this will solve the problem in the long run?

Mr Hayes: What I am saying is that I think it is a step in the right direction. It is a move forward, clearly. The deal that has been put on offer to the Royal Mail is clearly a step in the right direction. It begins to allay fears. Obviously, anything can happen in the future, but at this present time it is a real step in the right direction.

Q87 Chairman: The Government's pension holiday, which is often referred to, they could not actually make a contribution then because the scheme was fully funded, but, of course, there is nothing to stop them being generous since now it is not fully funded and make those contributions belatedly. That is right, is not?
Mr Hayes: Yes.
Mr Baugh: I would add one *caveat* to that whole discussion. As the union we have not seen the final detailed proposals on the escrow account and on the whole investment package. We have seen bits of it but no-one, either in government or Royal Mail, has presented us with the full detailed picture of what that investment package is going to do, exactly where the money is going to be spent and how the escrow account will work in detailed practice. So, we reserve our judgment until we see the final detail.
Chairman: You are giving such splendid answers I am not entirely sure Brian Binley has any questions left to ask, have you Brian, but I have. Can I preface the question that Brian was going to ask, because we have been talking about pensions, pensions, pensions, but, of course, the financing framework is also about investment, so I think Brian does still have a question to ask you because it is both halves of the equation, is it not?

Q88 Mr Binley: I have a general question which is related to the question I asked the management of the Post Office. I am concerned because, if I were investing in a business, I would be frightened to death, quite frankly, to invest in the Post Office after what I have heard this morning. My concern is how you feel about that: because your membership has a massive investment in this whole business and yet I am not sure I got the answers that made me feel it was a secure business with a long-term future. I want it to be, we all want it to be, but we have got to be realistic. Can I ask whether you have been consulted in those terms to the level you want, because it seems to me that that would be pretty important? I think I have got the answer, but I just want that confirmed.
Mr Hayes: In terms of the investment, we are talking about?

Q89 Mr Binley: Yes.
Mr Hayes: In terms of the Government's decision to invest, we have been told about it, we have not been consulted by government and we have not been fully consulted by Royal Mail, but do we think the investments of the Government allowing the company to invest is a positive step forward? It was the CWU five years ago who was the only organisation calling for investment, quite patently it needs investment, so it is big step forward and we welcome the investment. Our concern is that people see investment just in terms of plant and machinery and not the workforce. The key issue was obviously investing in the workforce. When you are in a heavily labour-intensive industry, which the post office is all around the world, it is not particularly unique to the UK, getting the workforce on side is a key issue and investing in the workforce as well as plant and machinery is important to us.

Q90 Mr Binley: It sounds to me like your workforce is not that confident because their reaction to the share scheme, for instance, is really not very positive.
Mr Hayes: I think we are talking about something different here, are we not?

Q91 Mr Binley: I was talking about the whole financial policy?
Mr Hayes: Okay. The share scheme, for example—

Q92 Chairman: We will deal with the share scheme separately later.
Mr Hayes: Okay, Chairman. The investment, as long as it is not just seen as plant and machinery and it is also in the workforce, because, despite what people may say, it is still a labour intensive industry and is likely to be so. There is nobody going to be replacing post women or postmen for the foreseeable future. In terms of the sector, contrary to popular belief, the mail sector is a growing sector. It has grown at a greater rate than GDP for the last 25 years. Actually, in terms of the communications revolution it becomes a virtuous circle. A simple example: Sky Television, whatever you think about Sky, it is a marvellous platform, Sky Digital is fantastic, technology into the sky, beamed down across the UK. It is still a post woman that delivers Sky Magazine to your front door. So, the potential for growth is enormous. The concern is that Royal Mail will not catch up, will not deal with the competition, and one of the things we think about dealing with the competition is it cannot simply be just what it is now, it has to expand its services, and one of the disappointments that we felt in terms of its investments, in terms of its overall strategy, it is not looking to develop new products. For example, the UK has the largest number of small businesses in the OECD. I think there is about 3 million. We do not think they are catered for in some of Royal Mail plans, and the joke, "The cheque is in the post", is not a joke to a small business person because people still send cheques when they are dealing with small business because (1) it stays in their account longer and (2) it is harder to blame the Post Office, if you like, in terms of delivery. So, there is tremendous potential. Our concern is the investment is not just directed directly to the latest gizmo or gadget.
Mr Baugh: I would just stress that on the investment plan, again we have not been fully consulted about that in the sense of having a meaningful exchange with a view to perhaps changing the outcome. We have literally just been informed about what the global figures and the general plans are and we are not happy about that. Royal Mail have presented their five-year business plan to the Government, including the question of shares, but we have not seen that full business plan. We have seen bits of it, but other bits have been excised and the question of shares has not been put to us at all. Our position on investment, we need the investment, we welcome the

money, but there is still a job of work to do to find out exactly how that is going to be introduced and spent and we are in that process as we speak.

Q93 Chairman: I hope I am not repeating something you have said already, but how confident are you that the level of investment promised and the way in which the investment money is going to be spent, leaving on one side the people, but the physical infrastructure and the business, how confident are you that that is being done in the right way?

Mr Hayes: Well, in the absence of firm details, it is difficult to speculate, but I think overall in terms of, for example, the fact that in the UK currently the machines sort 55% of the mail, whereas with the Dutch Post Office it is about 95%, clearly you need to invest in machinery to pre-sort mail so that instead of the postman sorting before he or she goes out, it actually replicates what happens in Germany or Holland. That seems a clear strategy. In terms of investment in the workforce, we have had some evidence that we have made some progress in the last few years in terms of that, but we have still got a long way to go, so optimistic, but we still need to be convinced about the fine detail.

Q94 Mr Wright: One of the issues which really concerns me in terms of the pension deficit and the ability for them to reduce it, is the fact that when we have investment, invariably it means job losses and it is one of the concerns when we are talking about thousands of job losses. Ultimately, it could also mean that if people lose their jobs, there are fewer people actually contributing to the pension fund. Are you concerned, as I am, that when you have that reduction in jobs, that will actually add to the burden of the pension deficit rather than seeing the reverse?

Mr Hayes: It also relates to the earnings, does it not? If the earnings of the industry go up, there is the same argument in terms of pension generally, and if the economy expands, there are more contributions being made in terms of the growth of the economy. The same is true of the Post Office. If we kept the wages right for the people who do the work, then that would deal with some of the problems. We are concerned about the level of job losses, but we are not convinced of the level of job losses for one example, that if we do expand out to the East Thames corridor, there is talk about a million extra homes where you are going to need more postal workers to do the jobs, and not forgetting the growth in the company if the company grows as well, so we are obviously concerned, but we are still in an expanding sector, so it all has to be balanced up.

Q95 Mr Wright: So your expectation is then a growth in the workforce rather than what the perception may well be, a reduction, because of the need to modernise the industry?

Mr Hayes: No, I am not saying there will not be job reductions. It is patently obvious that there will be job reductions, but the level of job reductions is dependent on the business expanding. That is my point.

Chairman: We will move now to the ownership question.

Q96 Rob Marris: Before you arrived, Adam Crozier unsuccessfully tried to sidestep my question as to whether the trade unions are being consulted; and you have confirmed this morning that indeed you were not consulted on the employee share ownership scheme. Has the position of the CWU changed since you were last before the Committee in terms of your being opposed to the sorts of proposals which were then being talked about and have now been formally put to the Government?

Mr Hayes: We use as our lodestar the Government's Manifesto commitment which was a promise to the British people that they had no plans to privatise it. To suggest that the release of £1 billion of equity to private individuals is not privatisation is just an insult, we believe. In terms of the consultation, the company did consult, as they see it, in terms of offering free shares which is a bit like offering free money and they get back 37% interest of the overall workforce, which is quite low, as far as we are concerned—

Q97 Mr Wright: Can you pause there because Crozier indicated it was over 50%. He indicated, I think, that there were something like 85,000 expressions of interest out of a total workforce which he cited at around, from memory, 150,000, which is a lot more than 37%.

Mr Hayes: Well, on our calculations, and Jeremy can come in here, and even on his own figures, it is not a great rate of return in terms of expression of interest. I think it is wrong anyway for a public servant to consult on an ownership issue. To me, it is very, very dodgy for a public servant to consult on an ownership issue.

Q98 Mr Wright: Do you think that they had legal authority to do so—

Mr Hayes: I would question it, to be honest with you.

Q99 Mr Wright:—in terms of the powers of the company?

Mr Hayes: Yes, I would question it on this basis: that both the Chairman and the Chief Executive are public employees. The people who determine public policy in this country, as far as I am aware, are politicians. The Government gives a Manifesto commitment. For a company chairman—

Q100 Mr Wright: That is the theory, Billy!

Mr Hayes: Well, I am looking to you people to say yes, but politicians nonetheless determine public policy, so we would question that. That was done in response to our poll actually. We did a poll of the workforce, but we were stopped at every stage of the way in terms of consulting and we were told that our ballot was a political ballot because we mentioned privatisation, but their poll or their letter was not a ballot and it was not political because it did not mention privatisation, it only mentioned shares. Now, I am sure that the dormouse in *Alice in*

Wonderland would be very impressed with that kind of logic, but we went round and we were blocked every step of the way. I refer to what you said at your Committee at the very end in terms of privatisation. You said, "If Royal Mail management still wish to pursue commercial ways of motivating their employees, we believe there are less controversial ways to do this, such as the current profit share scheme". We are up—

Q101 Mr Wright: I did want to ask you about that, or perhaps Jeremy who is the research person. Adam Crozier this morning, I think, was fairly clear and so was Allan Leighton that they have all kinds of, what they call, empirical research, totally empirical, in terms of the man on the top of the Clapham omnibus. I do not know if Crozier has got better stuff about how employee share ownership schemes around the world incentivise people, blah, blah, blah, I hope they will send us that evidence, but I wondered what evidence the CWU had got comparing employee share ownership schemes as an incentive mechanism for improved performance in contradistinction to profit-related pay schemes or bonus schemes. You have already got a bonus scheme, I think, though I do not know if it is profit related, but you have already got a bonus scheme. Has the union done any comparative work on the share model or the bonus model as incentives?
Mr Baugh: The evidence is patchy. Like you, my ears pricked up when I heard there was going to be clear, empirical evidence because I do not think there is any. It is very hard to draw any direct correlation between any pay input and an outcome to the performance of the business. It is a notoriously difficult area and with shares it is even more difficult because it is an even more roundabout way of incentivising. The bottom line is that we are the recognised trade union and if they want to talk about incentivising and rewarding staff, talk to us and we can come up with an agreement. We have got proposals which are less costly than the share scheme being proposed. The shares will not do anything for pensions, will not do anything for investment and it is questionable whether they will incentivise staff, so why throw £1 billion in that direction? If you have got that amount of money to spend, we can really make some progress in agreeing schemes that will be agreed with the union, agreed with the staff and can incentivise. The bottom line is just improving quality of service—

Q102 Mr Wright: I understand that, but just to oversimplify something, which is what happens in these committees, I am afraid, can you explain in two or three sentences what your proposals are on incentives?
Mr Baugh: We have said that if they want an incentive scheme, they should adapt the current share in success scheme which is a straightforward profit-sharing scheme. We would actually propose that, in addition to that, they could include other factors, such as quality of service measures which would help trigger the payments which would add another level of performance improvement, so we think there is a far more straightforward, less costly and agreeable way of moving forward without this great share scheme with all the costs and the problems that come with it.

Q103 Mr Wright: Have you got any evidence that your proposal would be more effective than their share ownership proposal?
Mr Hayes: I think from other companies we have.

Q104 Mr Wright: Yes, I am looking for comparative work.
Mr Hayes: Yes, do we have evidence based on real events?

Q105 Mr Wright: Yes.
Mr Hayes: Other companies, and I have not got this to hand, but other companies that we negotiate with, because we negotiate with somewhere in the region of 40 companies now, we have evidence that profit-related schemes have actually improved the performance of the company, yes, we have. That is why it is tried and tested and we can dig that out, the point being whether it incentivises the workforce. The thing about the share scheme and linking it to quality, I do not think the public want to know about how profitable the company is or the Post Office is; they want to know how healthy it is in terms of the service it delivers and getting the workforce keyed in on quality, because it matters both to us, to the people we represent and to the people who do the job, so it really matters, so getting people focused in on the quality of the service, not on a rate of return for the company, is a key thing for us.

Q106 Mr Wright: Could you perhaps send us some abstract of the research to which you have access on the efficacy or otherwise of a kind of bonus scheme in contradistinction to the efficacy or otherwise of a share ownership scheme and I do not mean necessarily in your sector.
Mr Hayes: Perhaps I can just give you one off the top of my head. In the 1980s the Monopolies and Mergers Commission went into London to look at quality of service and bonus schemes, and the productivity and quality of service went up almost, not literally, but almost overnight. We have stuff on that as well even within the Post Office which we can send you.
Mr Baugh: Just a final point I would make is that we have got chronically low basic pay rates. Our members receive £80 a week below the national average. If you want to incentivise people, pay them a decent basic wage and a decent pension. I think that is the best incentive that you could possibly provide.

Q107 Anne Moffat: Would you consider a joint consultation with your proposal and their proposal going directly to the members?
Mr Hayes: Why would we want to do that when we have a commitment from Her Majesty's Government which says they will not privatise the Post Office? The Government said it would not

privatise the Post Office, so why would we test the issue of privatisation with the workforce? I cannot see why we would do that?

Q108 Anne Moffat: Would you not be convinced though that your scheme would be best and could you not sell that to the members? Is that not a better positioning than anyone proposing a new share scheme which they are going down the route to do?
Mr Hayes: Allan Leighton has done his poll and we have done our poll and he got 37% and we got 95%. We have got a Government commitment on the Manifesto and I would go back to the point I made earlier, that I do not think it is for public servants to determine government policy.

Q109 Chairman: You keep on using this 37% figure and I am very interested in getting the facts right. I have just done the mental arithmetic. He tells us 60–65%, on my rough working, say yes to their scheme, so what is this 37%? They say 85,000 responded saying they wanted it.
Mr Baugh: The total workforce is just over 210,000, so 80,000-odd out of 210,000 and let us not forget as well that they extended the ballot deadline for a week because they did not get the right number of returns in and they included post office managers and we also believe they may have included subpostmasters as well, so it is a much greater constituency.

Q110 Chairman: So that is 85,000 out of 210,000?
Mr Baugh: Which is about one in three.

Q111 Rob Marris: Are you saying that Adam Crozier, who is your Chief Executive, only realises 75% of the workers that there actually are in round terms, that he thinks there are 150,000 and there are 200,000 in round terms? Am I understanding you correctly on that?
Mr Baugh: You will have to ask Adam Crozier how he gets his figures.
Rob Marris: But he is your Chief Executive, is he not?

Q112 Chairman: We will seek clarification on that.
Mr Hayes: The simple thing, Chairman, is if we give you our figures rather than like a betting shop, working out odds and percentages.

Q113 Chairman: I cannot resist asking this question. From where I sit, as a wicked old Tory, I would rather see this as a Tony Benn-ite sort of cooperative that Allan Leighton is trying to impose upon you rather than privatisation. Why is it not a Benn-ite cooperative?
Mr Hayes: I do not know whether you are being rude to Allan Leighton or Tony Benn! They might like to portray it as a benign socialist paradise, but I am not so sure it will be. The danger is that people trade shares and eventually those shares will be sold on and it will lead to the break-up of the company.
Mr Baugh: Also employee ownership is often associated with greater degrees of employee involvement, seats on the board, a whole measure of representative things for the union and the employees, but there is nothing in the proposals to do with increasing employee involvement or representation.

Q114 Chairman: It is not the John Lewis Partnership, is it?
Mr Hayes: It is not. It is far, far from it.

Q115 Mr Weir: Moving on to the Post Office Card Account, you have also expressed your concern about the Government's, the DWP's decision to withdraw when the current contract expires. First of all, were you aware in the first instance that it was due to expire in 2010 and it was not going to be renewed after that?
Mr Furey: Simply, no, we were not. The Post Office Card Account came into being in 2003 and was only fully rolled out to the whole of the UK from April 2005, as there was a two-year migration programme, so in reality it has only been up and running for just over a year. Our belief was that it was going to be extended beyond the life of the contract.

Q116 Mr Weir: How do you believe the withdrawal will impact on the urban and rural post office networks?
Mr Furey: I think it will have a devastating effect on the whole of the network holistically. It will certainly have a detrimental effect on the rural communities, society in general in the rural areas, and also in urban deprived areas because much of the work that goes across post office counters, the Crown post offices which I represent or my union represent are in such urban deprived areas and to lose that volume of traffic, footfall, revenue and income will be devastating.

Q117 Mr Weir: How do you react to the suggestion that the banks will take up the slack in this, if you like, that people can go to the bank rather than to the post office?
Mr Furey: Well, it is about choice and the one thing the DWP is not giving is choice to these 4.5 million people or 4.3 million people. These people have chosen deliberately to have their state money paid into the Post Office Card Account, so they had the choice previously to have their money paid into banks and building societies and they chose not to. They made a conscious decision to say, "I want to collect my money at the post office via the Post Office Card Account", so I do not think the banks and building societies will be able to do this work.

Q118 Mr Weir: From your own experience, you have talked about rural areas and deprived areas, and are these not the very areas the banks that have moved out of as well and is that going to cause a problem from your point of view in people accessing the services?
Mr Furey: Absolutely. Postcomm's latest annual report on the network actually says that customers living in a village or a more rural area are less likely to withdraw their benefits from a cashpoint or a bank or building society and they are more likely to withdraw their cash over the counter at post offices.

The stats are that just 4% of rural areas have a bank, whereas 60% of rural areas have a post office, so it is a given that people in rural communities will draw their money at the post office.

Q119 Mr Weir: Have the Government or have Royal Mail suggested to you that there will be any type of assistance for post offices after the withdrawal of POCA and, if so, what is it?
Mr Furey: First and foremost, nothing has been discussed with the CWU from either the Post Office, the Royal Mail Group or the Government on this issue. Our concern is that these decisions have been made by the DWP without having joined-up government thinking in terms of the DTI. We have a major concern here that one decision by one government body is actually impacting detrimentally on another government body, so the bottom line is that we have not been consulted on this.

Q120 Mr Weir: We are hearing later obviously from the National Federation of SubPostmasters, and we heard earlier that there were some 14,500 post offices, but how many of those would have your members in them?
Mr Furey: We have approximately 500, declining daily. Three offices have been announced for franchising today in various parts of the UK. Out of the 500 Crown offices, the businesses that are directly managed, but they have historically been known as 'Crowns', they transact between 20 and 25% of the actual volume and traffic on a weekly basis, so 80% less and less is transacted by 14,000 offices and only 500 offices do 20% plus, so you can see that we are talking about the major flagship offices where the footfall is quite heavy.

Q121 Mr Weir: So your members would be considered as in Crown post offices rather than the smaller sub-post offices?
Mr Furey: They would be, but we do have a big concern about closures of rural sub-offices and sub-offices in urban areas as well because our members collect mail and deliver mail, a lot of our members actually work out of these sub-offices in the rural areas and they sort their mail in these offices. We see it as a holistic issue, we see it as integral to the whole of the post office network, and, whether they are run privately or whether they are run as Crown offices with people employed directly by the Post Office, they are all vitally important to the state and the nation.

Q122 Chairman: We are out of time because the Minister is outside and we want to have the Minister in to challenge him on some of these issues.
Mr Hayes: If I can make a final point, Number Ten a few years ago, its Performance and Innovation Unit did some work on Post Office Counters. This Post Office Card Account and what has happened with Post Office Counters really is a lack of joined-up government, but the Performance and Innovation Unit did a major piece of work for Number Ten which has not been acted upon.

Q123 Mr Hoyle: Obviously with the pattern of decline of Crown post offices, which I think is an important fabric of any town centre, I am very concerned about this deal which is being done with WH Smith. Have you got a view on this?
Mr Furey: We are opposed to that deal with WH Smith. We are very, very worried that one of the non-executive directors of Royal Mail actually was the former Chairman of WH Smith. That worries us no end. We have not been consulted on it and indeed our members have not been offered TUPE to go and work in WH Smith.

Q124 Mr Hoyle: Really? That is absolutely absurd.
Mr Furey: Absolutely.

Q125 Chairman: I once had a very bad experience of running the constituency office from a Crown office, but we got it back as a Crown office again and I am well pleased. Just before you go, what is your relationship with the Royal Mail at present and can we look forward to a strike-free summer and autumn?
Mr Hayes: First of all, the relationship at senior level is quite good. At the middle rank it is a bit more troublesome. It takes two to tango. We are on the dance floor and it looks like we might have a tango this summer.

Q126 Chairman: I think that was encouraging, but I am not quite sure. I will reflect on what is in the transcript.
Mr Hayes: We are optimistic, Chairman.
Chairman: Thank you very much indeed for coming.

Witnesses: Jim Fitzpatrick, a Member of the House, Under-Secretary of State for Employment Relations and Postal Services, Ms Elizabeth Baker, Director, Shareholder Executive, and Mr Stephen Lovegrove, Director, Shareholder Executive, **Department of Trade and Industry**, gave evidence.

Q127 Chairman: Minister, you have come with some added and surprise bonuses, so can I ask you to introduce yourself and your two colleagues for the record.
Jim Fitzpatrick: If you will forgive me, I will ask them to introduce themselves as the titles that they have, I am not entirely familiar with. I am Jim Fitzpatrick, Minister for Postal Services, amongst other responsibilities, at the Department of Trade and Industry.
Ms Baker: I am Liz Baker. I am a Director in the Shareholder Executive of the Department of Trade and Industry.
Mr Lovegrove: I am Stephen Lovegrove, also a Director in the Shareholder Executive at the Department of Trade and Industry.

Q128 Mr Hoyle: Obviously the big issue is about the new financing framework that you have brought in. Now that you have allowed Royal Mail to borrow

funds and obviously hopefully it is going to move the business forward, could you tell us a little about the offer, how you believe it will work and will this be enough to allow Royal Mail not only to modernise, but actually to compete with the other business that will be entering the market, whether it is Deutschepost or whether it is the Dutch. Obviously the market is going to open up, so do you really see that there is a future with the financial package that they are allowed to use?
Jim Fitzpatrick: There are essentially three elements of the framework and obviously we are in a position whereby in 2002 Royal Mail were losing £1 million a day and obviously that situation has completely transformed itself and this is about, as you say, Mr Hoyle, the future. The three elements of the framework, as we see them, are, firstly, that the reserves of the Royal Mail Letters business which total £850 million would be transferred to a pension Escrow which can be drawn upon to fund the pension fund in the unlikely event that the company were to fail. This gives the pension trustees additional comfort in respect of the pension deficit and, assuming the funds are not used for the pension fund, they will be returned to the Government when the pension fund is more stable. The second element is that the Government is to extend the existing debt facilities, such that £900 million is available for use by Royal Mail on commercial terms. This will be available for the company to use so that it can transform its effectiveness, secure the efficiency improvements required under the regulatory settlement and successfully compete in a newly liberalised market, and that essentially is the money that you describe that will allow the company to move forward and ensure that it continues with its progress. The third element of Post Office Limited's funding needs—including the Social Network Payments for the next two years and any funding after 2008, will in future be met by the Government rather than Royal Mail reserves. The level of any support after 2000—will depend on decisions on the future of the post office network, which I am sure we will come to later. Together, these measures allow the company to stabilise the pension deficit and it allows them the funds they need to be able to continue to transform the business. The details of the framework will be set out in legal documentation currently being prepared by the Government and the company's commercial advisers and this work is still under way.

Q129 Mr Hoyle: So do you envisage further assistance and will this be enough of an assistance that it will allow them, one, to modernise and, two, to compete with the highly competitive competitors and with the sheer volume of investment which has already taken place to compete with Royal Mail? What do you see? Do you think the future is going to be good, do you think you are going to have to give them more money and do you really think they will have modernised enough to allow them to have an equal playing field which is a total disadvantage to them at the moment because we have gone ahead of the rest of Europe, so we are already on an unlevel playing field to begin with?
Jim Fitzpatrick: In discussions with the company, we are confident that this amount of reserves to draw upon and confidence-building in the allocation of the pension Escrow will be enough for the company to be able to plan confidently for the future and to allow it to compete within the liberalised market, so we do not see the need to return to renegotiate any additional package. This is a package which we think is adequate, and we believe the company are confident this is adequate as well, so we do not envisage any further assistance. We believe that the examination that is under way at the moment of the framework to validate it will justify that in due course.

Q130 Mr Hoyle: So what you are saying is that they have got enough money to modernise and to compete with new equipment which is capable of competing with anybody else in the world. Are you sure that is the case because they have got a lot of outdated machinery in outdated sites which makes them struggle to keep up with the rest of the business? Are you sure that they will be financially able to do that?
Jim Fitzpatrick: I think your assessment is fair, but the progress which has been made in recent years has demonstrated that the company has the wherewithal to be able to improve its performance within the market. It is confident that it can further compete, further modernise, further improve its performance within the market and we are confident that the settlement which we have arrived at and the agreement which we have arrived at is adequate.

Q131 Mr Hoyle: So it is not just about taking a headcount out to get the wage bill down, it is actually about real investment in modern equipment?
Jim Fitzpatrick: Indeed.

Q132 Mr Weir: You mentioned there that when you started the Post Office was losing £1 million a day, I think you said, which now has been transformed, but I note that Mr Crozier told us last year that the Post Office was losing £2 million per week and this year it had gone up to £4 million and that was before, as I understood it, the full impact of the withdrawal of POCA, the withdrawal of TV licensing and the other impacts on the post office network, so is your new framework taking into account what seems to be the Post Office going backwards in terms of profitability?
Jim Fitzpatrick: If you will forgive me, Mr Weir, we are talking about two different sides of the business. Royal Mail was losing £1 million a day and it has now posted profits and I will get the figures for you later in respect of last year. Post Office Limited and the Counter service is losing between £2–4 million per week. It was £2 million last year and Mr Crozier, you have advised me, is quoting £4 million this week.

Our estimate was certainly £3 million and he obviously is in receipt of the latest figures, but that is Post Office Limited and certainly the POCA situation impacts on that, but that is a separate part of the business from Royal Mail. If you want me to talk about Post Office Counters, I am happy to and if you want me to continue talking about Royal Mail, but they are two separate business plans.

Q133 Mr Bone: The Government, in response to Postcomm, said that, "the unavoidable costs of servicing the pension fund deficit are inherited costs of the business and as such should be borne over a suitable period by the postal service customers, not by taxpayers". I understand that means hike up the cost of the stamp and make people who use the post pay for the pension fund deficit, but, as the taxpayer is the shareholder from which the business inherited this deficit, why does the Government think that way?

Jim Fitzpatrick: Well, the pension fund transferred, along with other property rights and liability, from the Post Office Corporation to Royal Mail Holdings plc and then Insignia in 2001. This is how the costs, as I understand it, associated with the pension fund were inherited by the current public limited company. It is accepted that the Government acts as shareholder obviously on behalf of the taxpayer and that the customers are the taxpayers and this is all somewhat circular. The point here, however, is that it is normal for the costs of a business to be met through the prices it charges for its products. In this case, the customers would contribute to the pension fund costs through the price of a stamp. We believe that this is right rather than the Government providing the company with large sums of money from the public purse to reduce the deficit. Royal Mail has agreed with the pension fund trustees to reduce the deficit over 17 years with contributions of some £750 million per annum. This money will be raised through the revenues. The pension fund Escrow account will only be drawn on if necessary and this is thought unlikely.

Q134 Mr Bone: That is all well and good comparing it with a private company. If you are a private company, first of all, you are not in a monopoly situation where you can just stick the price of your goods up and know that it has to be paid because there is nowhere else to go. What would happen in reality is that that company would have to look at its reserves and probably would not have got itself in the mess in the first place, but bearing in mind that the taxpayer, who is the shareholder, had a pension holiday for many, many years, it seems absolutely disgraceful that you are handing this off away from the taxpayers to the people who have to buy the stamps. It seems to me that this is just an effort by the Government or the Chancellor not to pay money and to put it on to the poor person who has to pay, the poor old aged pensioner who has to post his or her letter and stick it up. It really is outrageous, is it not?

Jim Fitzpatrick: Well, I think it is fair to say that customers have benefited from low prices in the UK. Prices here remain amongst the lowest in Europe and I think it is reasonable and I certainly do not think it is unreasonable now to expect that there is an additional, legitimate and unavoidable cost to the company and that this ought to be passed on to the customer. The customer has benefited for a number of years and continues to do so, and I think it is important also to acknowledge that Postcomm recognise this. Of course the company will want to minimise price increases so that it can remain competitive, as the discussion I was having with Mr Hoyle a moment ago, but I do not think it is unreasonable to pass a certain proportion of the costs on because when you look at the prices in the UK compared to the rest of the European market, they are still very low and in that instance the UK customer has benefited, so for the UK customer to be asked to pay part of the price I do not think is unreasonable.

Mr Bone: I think, Chairman, we have heard a major change of policy here because for years under Conservative and Labour Governments, the policy was to keep the cost of the stamp at a fairly low level. We are now hearing from the Government that we should be moving towards the European level of postage, and I think that is a major change, and it is very welcome to have that evidence.

Q135 Chairman: You are putting up the price of the stamp to meet this deficit. Who is to blame? That is what I really want to understand. I really wonder who is to blame for this. How did it happen? My colleague Rob Marris thinks it is all the actuaries who got it wrong. Who do you think got it wrong? Where did this mess come from?

Jim Fitzpatrick: The pension deficit from where I sit, as I understand it, has arisen because of market changes in the value of pension fund assets, the equities, life expectancy obviously of members of the scheme has created a complete change and the way in which pensions are reported in company balance sheets under internationally agreed accounting standards again makes an alteration. Less than five years ago the pension fund was over £700 million in surplus and of course it is not only Royal Mail which has a pension deficit; we see that happening in a number of private sector companies, like BT and Rolls-Royce, who have experienced similar problems. I do not believe that the deficit is the Government's or the company's fault or down simply to the pension holiday that was taken earlier. In 2001 the fund was some 105% funded and the deficit is due, in our opinion, to market changes, revised assumptions of life expectancy and a new accounting standard, so I think there were a variety of impacts on the pension fund which were outside the control of the Government and outside the control of the company and, in that instance, I do not think we can actually point the finger at any individual or individuals.

Q136 Mr Bone: I was very interested in the new evidence that we heard, but you talk, Minister, about this pension holiday which I believe was equivalent to about £4 billion, so if the Government had the benefit of not putting that £4 billion in for whatever reason, why is it not right that when there is a shortfall they put at least that £4 billion back in? That just seems to be fair and that is, I think, what would actually happen if it was a public company, that you would use your reserves to do it.

Jim Fitzpatrick: I think I have explained a moment ago and obviously not to your satisfaction, Mr Bone, but it is our assessment and clearly Postcomm's that the company's prices are such that the UK customer has benefited over the years and, therefore, it is not unreasonable to expect the UK customer to make the contribution that we are suggesting that we ought to. I have to say, I do not recognise the £4 billion figure. It is a new figure to me. I have not read it in any of my briefings over the past eight weeks.

Q137 Chairman: But there was a pensions holiday and clearly there was a significant short-term gain to the Exchequer.

Jim Fitzpatrick: Sure, although obviously the pension holiday calculation was made on the basis that there was not a deficit and that the fund was in balance well enough to be able to deal with its liabilities.

Q138 Mr Bone: Can I just stop you a minute. That is exactly the point, that is quite correct, but when you then have a shortfall, do you not then have to say, "Well, you've got to put that money back in"? That is how any commercial company would look at it. You could not then just stick your prices up to cover it. That just is not possible in the normal marketplace.

Jim Fitzpatrick: Well, if you will allow me, I will ask Stephen to make a point as he has far more technical knowledge in this area than I do.

Mr Lovegrove: The pension fund holiday, you are right, did last for about 12 years. That broadly took the form of forgone dividends the Government did not take out of the business. Those dividends then were kept on the balance sheet of Royal Mail in the Royal Mail reserve and indeed it is releasing some of the restrictions around the Royal Mail reserve which is effectively meaning that the pension fund is being stabilised at the moment.

Q139 Chairman: I am probably being very dense, you must excuse me, but are you saying that the holiday took the form of dividends?

Mr Lovegrove: No. Clearly the company was making profits throughout that period. Those profits could have been utilised to over-invest the pension fund which at the time was more than 100% invested. In fact actually the Government did not take any money out of the business at that point. What it did was leave that money on the balance sheet of the Royal Mail.

Q140 Chairman: For the whole of the period that there was a pension holiday, the Government did not take its dividend? If it is true, it is not what I understood the position to be.

Mr Lovegrove: Can I get a note back to you on that, but certainly the £2.8 billion—

Q141 Chairman: For years and years under successive governments, one of the problems with the Post Office has been that governments have taken too much money out of it, they are treated as a cash cow and they were not allowed to invest and upgrade.

Mr Lovegrove: Could I provide you with a note on exactly what the Government has taken out, but it is certainly the case that the Royal Mail reserve was built as a result of the money that the Government did not take out of the Royal Mail and that is money which is effectively now going to support the financial framework which will give the pension fund trustees confidence that the pension fund situation will be regularised.

Mr Bone: I understand that you have got the fallback guarantee and that bit is quite good, but what you are actually saying is, "No, we are not going to use that money, we are going to put the price of stamps up to cover the pension deficit" and that is what I think is outrageous and cannot possibly be justified.

Chairman: I think that is a rhetorical question. You have tried to answer that but obviously not to Peter's satisfaction. I think a third attempt is probably futile, Peter.

Q142 Miss Kirkbride: I have two quick questions. First of all on the business of whether or not the government took a dividend from the Post Office. Is not the whole point of the Post Office that because it is in public ownership and it is not free to borrow money as normal private companies would that the government has always cut a deal on whether or not it takes a dividend because if it did take all its dividend all the time then there would be no money for the Post Office to invest? Therefore, you sitting there saying "That is really about the pension fund" is trying to mix apples with pears, it is not really good enough.

Mr Lovegrove: It is typical for a shareholder clearly to look at the cash flows which come out of a business that it owns, and we all know the taxpayer owns Royal Mail, and to decide what the best way of deploying those cash flows might be.

Q143 Miss Kirkbride: For investment.

Mr Lovegrove: In some instances it may be investment, in some instances those monies might be repatriated to the shareholder.

Q144 Miss Kirkbride: It seems to me what you have just said is those monies that the state allowed the Post Office to retain for investment purposes you are now double-counting, so that is actually about the pension deficit. It cannot be both. It was either to do new machinery and make the business more competitive or it was to fund the pensions, it cannot be both. You cannot have it both ways.

Mr Lovegrove: The financial framework that we are negotiating at the moment is basically to allow the company to use its own cash flows to make the investment in machinery alongside renegotiated debt facilities and also to release some of the restrictions on the Royal Mail reserves in order to regularise the pension position.

Jim Fitzpatrick: If I can make the point, Chairman, the price increases are agreed with the regulator and not the government. The Postal Services Act, going back to the question about stamp prices, says the Universal Service Obligation, which includes stamp prices, must be at a uniform and affordable rate and that remains unchanged. The cost of first class stamps still remains amongst the lowest in Europe. In respect of the point that you made in terms of money that government has or has not committed, certainly since 1999 this Government has put around about £2 billion into the Post Office to demonstrate our commitment to Royal Mail and to the Post Office, which I am sure we can break down for you later on when we get to other questions.

Q145 Miss Kirkbride: Given that you have been clear to this Committee that the way we are going to get over the pension deficit is to increase the price of stamps, do you think it is a good time to do it when the Government is rightfully opening up the Post Office to competition but at the same time nobbling it by forcing it to charge much higher prices when competition is going to take a lot of its business away?

Jim Fitzpatrick: As I say, it is the regulator who agrees price increases, not government. Liberalising the market is a fact of life. We believe that the Post Office Royal Mail is equipped to compete within the liberalised market. We think Royal Mail is demonstrating that and Post Office Limited is perhaps not best placed to compete in an open commercial market. I am sure you have had evidence this morning in respect of the nature of the numbers of outlets that Post Office Limited has and its ability to compete and, indeed, Mr Weir has already made mention of the £2 million to £4 million a week that Post Office Limited is—

Miss Kirkbride: I am talking about Letters here.

Chairman: We need to move on quite quickly given the time.

Q146 Mr Hoyle: I think we need to go back to where we were talking and the fact that for 12 years the government took money out. You are suggesting they did not. In fact, most companies are allowed to keep balances and what you were suggesting was all the money was left in balances, but I do not believe that is the case. I believe during those 12 years the government accessed the milk cow, they milked it fairly well dry but allowed it to keep some investment, some headroom, within there, and that I do not disagree with, but I would like a note to know how much was taken out over the 12 years. The fact that somehow the Minister is suggesting it is very generous of the government to put £2 billion in, I think the Minister ought to recognise it is not his generosity, it is his liability. He is the shareholder, it is his company, and it is his responsibility to ensure that this business continues. You cannot get away with talking as though it is some generous donation to a charity. This is something that during the great summer days you have done very well from, you have reaped the hay from the harvest, so therefore when there is a downturn the government has to put something back in. I think we ought to recognise that it is not the generosity of the government, it is right that government should ensure, as a shareholder and as a business it owns, that it has got to put the money in that is needed. The fact is we would like to know during the 12 years how much was taken out and how much of the pension fund it ensured in the holiday period. I think we have been misled slightly. I do not think it was deliberate, it is not quite knowing the history.

Jim Fitzpatrick: My apologies if I gave any impression that we were being overgenerous. What I was trying to say in response to a comment from the Chairman was that we have had a period of investment by the Government. How generous or otherwise that is is a matter of judgement but certainly there has been an investment by the Government since 1999. That was the point I was trying to make.

Q147 Chairman: Before we move on to the ownership questions can I ask one thing about the pension deficit. Do you know the works of Stanley Holloway at all, *The Lion and Albert*? You remind me of the judge at the end, who gave his opinion that no-one was really to blame. Surely one of the factors you listed there was the direct responsibility of government and the changes to the accountancy rules have a direct impact and that is a government decision.

Jim Fitzpatrick: I am sorry, your question?

Q148 Chairman: On the pension deficit, one of the factors you said was out of government's control was a decision that you could have controlled.

Jim Fitzpatrick: Sorry, what I said was there were a number of factors and that was among them. I would accept if the rules are changing because of legislation then that would be partly government's responsibility.

Chairman: That is helpful, thank you very much. We will move on to ownership, a less contentious issue possibly.

Q149 Anne Moffat: We gave a manifesto commitment that we would not be privatising the Royal Mail but the Royal Mail are now proposing a scheme to make employees have a share in the business. Do you consider that as privatisation?

Jim Fitzpatrick: We have obviously received the proposal from the company that that is the way they want to go. That suggestion, that proposal, is being given close examination at the moment. It is not my understanding that we would agree that the best description for that would be privatisation. Given that were we to agree the shares would be contained within the framework of the company and be for staff and an incentivisation scheme we do not agree that that is an appropriate description. No, we do not think that is part or full privatisation.

Q150 Anne Moffat: What factual evidence have you got that a scheme like this would actually incentivise the workforce or the organisation?
Jim Fitzpatrick: There are academic studies which have indicated that this is the case. There is the example of Eircom where a similar scheme has been introduced. There are organisations which promote share schemes as incentives for workforces. We think there is quite a lot of evidence out there that can be drawn upon to validate or otherwise the suggestion that this scheme would be useful for the Royal Mail and would serve its purpose.

Q151 Anne Moffat: Would you be surprised, as I was, because I heard both from the Royal Mail and the CWU this morning, that the Royal Mail decided to consult with their people, as they called them, directly and did not do that through consultation and negotiation with the union? Do you consider that to be best practice?
Jim Fitzpatrick: I would have thought it is good practice for employers to be in close contact with their workforce through whatever measures they think are appropriate and obviously different companies, different corporations, have got different ways of doing that. I do not think it would be inappropriate.

Q152 Chairman: So you would encourage them to bypass the union basically?
Jim Fitzpatrick: I am not saying it is bypassing the union. I am saying in terms of contacting staff there are different ways of being able to demonstrate that one is in touch with the feelings of one's staff and trade unions are clearly a very important way to do that. There is a recognised structure within Royal Mail Holdings which clearly the CWU have a very central and pivotal place in but I do not see the company speaking directly to staff as necessarily bypassing the union, it is an additional way to speak to staff.

Q153 Chairman: But they frustrated the union's own consultation with their members.
Jim Fitzpatrick: I think the union clearly demonstrated that it had a point of view that it wanted to demonstrate and therefore it wanted to canvass its members to be able to show that it had support for its point of view.

Q154 Chairman: That was made difficult by the Royal Mail. They sought to frustrate that process. They objected to the use of the word "privatisation" in the question that was being asked and therefore sought to do their best to stop it happening.
Jim Fitzpatrick: As I say, I think the question of privatisation is a matter of opinion, a matter of judgment. I do not recognise and do not agree that a share incentive scheme, such as that proposed by Royal Mail for its staff, is necessarily privatisation, therefore if you have two different opinions then obviously there is going to be—

Q155 Chairman: I agree there is a matter of definition but it is not a matter of dispute that the Royal Mail consulted direct with its employees and sought to frustrate the union doing the same thing, so you approve of the fact that the Royal Mail sought to bypass the union.
Jim Fitzpatrick: No. We approve of good communications between management and staff through every appropriate measure that is available to them. We are trying to encourage an inclusive workplace. We have changed the regulations on information and consultation. We think it is appropriate that managers are in touch with the feelings of staff in a whole number of different ways and the normal, conventional trade union structures are clearly very important but they are not exclusive.

Q156 Mr Binley: I really am concerned because the whole of this share ownership is being lauded by the Government and being seen as a major part of modernising the Post Office generally, Royal Mail and so forth. You are the major shareholders on behalf of the British people. We have a situation where you are told on this sizeably important subject that discussions with the unions have not taken place. You are the major shareholders, should you not be saying "I am horrified, I need to get in there and do something about this"?
Jim Fitzpatrick: No, I do not think it is our role to interfere in how the company is doing its business. We have seen the reports that I think you are referring to, Mr Binley, that the Government is in support of this scheme. We have not pronounced on this scheme as yet. We are still studying and considering the scheme and in due course we will come forward with a view. As I said a moment ago, we do not consider it as privatisation, we do not recognise that as an appropriate definition of that which is being proposed even were we to go along with it in due course.

Q157 Mr Binley: Nor do I consider it privatisation, I am a capitalist, for God's sake. My concern is this is still to all intents and purposes a nationalised industry. You might have put some fancy titles around it but the Government is the major shareholder. Quite frankly, I am horrified at the cavalier attitude that I feel I am getting from you, I am sad to say, Minister, with regard to the formal negotiating structures over a scheme that is so important to your modernisation issue.
Jim Fitzpatrick: I am sorry if I gave the impression that we were being cavalier over the structures, that is not what I tried nor wanted to convey. What I said was that management have an obligation to keep in touch with their staff. How they do that is very much up to them. The conventional trade union structures and the recognition agreement that they have with the CWU would be a very important part of that but would not necessarily be exclusive.

Q158 Miss Kirkbride: I just wonder whether you could explain, Minister, given that this Government has already privatised some of the nuclear industry and Air Traffic Control, amongst others, why not the Post Office?
Jim Fitzpatrick: We gave a manifesto commitment in 2005 that we would not do that and we are holding to that manifesto commitment.

Q159 Miss Kirkbride: But what is the rationale behind that, or should there not be a rationale behind it? Should I not expect a rationale behind—why not?
Jim Fitzpatrick: I think it is a fair question whether or not manifesto commitments and policies should not be revisited and reviewed because time marches on and conditions change. Our perception, our view, our considered judgment at this time, is that the manifesto commitment that we would not go down the route of privatisation still holds true and it is not our intention to privatise Royal Mail or the Post Office.
Miss Kirkbride: But you have not told me why not. It may be a manifesto commitment but tell me, given this brave new world we live in under New Labour, and given there is the regulator and competition and everything else, why not privatisation? Why does the dog not bark?
Mr Hoyle: Are you barking?

Q160 Miss Kirkbride: No, but the Minister's answers so far seem to be!
Jim Fitzpatrick: It is our assessment that the duty that Royal Mail and Post Office are under is being fulfilled and we do not see any need to go down the route of privatisation. The commitment we gave to the electorate in 2005 still holds. The company on the Royal Mail side is performing much better than it was in those days. The performance of Post Office Letters and Post Office Counters is a different matter and obviously we want to look at that very closely.
Chairman: I would love to pursue this with the Minister at greater length, having been a special adviser in the DTI when the Conservatives tried to privatise the Post Office, but I will not. I think Lindsay has got a detailed point.
Mr Hoyle: I hope the manifesto pledge was not the same one as top-up fees because I would worry.
Miss Kirkbride: I thought it rather was actually.

Q161 Mr Hoyle: Allowing for that, Minister, obviously the question is what is the percentage that is being considered to be offered to the Post Office employees? That is Royal Mail, who then give it to the employees.
Jim Fitzpatrick: My understanding is that the proposal from Royal Mail is for a 20% share and that is what is being examined at the moment.

Q162 Mr Hoyle: If I remember rightly, would I be right in saying as a state-owned company you have to own at least 95%, therefore if you gave 20% away it would no longer be a state-owned company or a nationalised industry, so would that not class itself as privatisation in fairness?
Jim Fitzpatrick: As I mentioned before, it is not our view that this would constitute privatisation because the shares would not be—
Chairman: We know your view but it is a matter of legal definition.

Q163 Mr Hoyle: How much do you have to own for it to be a nationalised industry?
Jim Fitzpatrick: You will have to forgive me but I do not have that information myself. I would be happy to research that for you.

Q164 Mr Hoyle: Obviously if it was at a certain level it may be that it would then be classed as privatisation.
Jim Fitzpatrick: I would need to check that out for you, Mr Hoyle.
Mr Hoyle: If you could let us have a note on that.

Q165 Chairman: Let us move on to an even less contentious area, the Post Office Card Account. When the predecessor Committee took evidence in the last Parliament we were led to believe that the Post Office Card Account would replace the business that would be lost through the change in benefit payments arrangements and there was no suggestion it was temporary. What changed?
Jim Fitzpatrick: I do not think anything changed. The contracts that were signed and agreed were of seven year duration and those contracts are due to expire in 2010, therefore they have to be renewed, revisited or altered.

Q166 Chairman: But they are not being renewed or revisited, they are being scrapped.
Jim Fitzpatrick: Certainly it is clear that the amount of money that is being spent at the moment does not constitute value for money for the taxpayer in our view because, as was mentioned previously, Post Office Limited is losing up to £4 million a week and POCA is a big part of its business. Clearly there has been an examination going on since the arrival of POCA and if we can arrive at an alternative which meets the purposes of the requirement to make sure that anybody can get their benefits and cash at a post office then obviously we need to do that.

Q167 Chairman: So your only test now for the Post Office Network is value for money, you are not interested in social obligations or social responsibilities. In the past the government used those post offices to reach out to populations, to provide services, greatly valued services, not just in remote rural communities but also in deprived urban communities. You are saying now it is just about money.
Jim Fitzpatrick: No, forgive me. You are quite right to correct me, Chairman, we have a community obligation as well as a commercial obligation and that is what is being examined at the moment. The network of some 14,500 post offices far exceeds the largest network of any of the banks, which I think is 2,500, and the largest retail network of any of the major stores, which I think is around 2,000. I think I am correct in saying that there are 800 sub-post

offices which have less than 20 customer visits per week and 1,200 which have less than 50 customer visits per week and we know in situations like that—

Q168 Chairman: They could be very important visits.
Jim Fitzpatrick: They are making important business and what we need to work out is whether or not that business can be provided by a near sub-post office neighbour or by an alternative method because there is a community requirement, an obligation, on Post Office, on Government, to make sure the service is there.

Q169 Chairman: My colleagues want to explore some of these issues in more detail, I must not pre-empt all their questions. Just one final question from me before I move on to Mike Weir. Parliament did not realise the contract would not be renewed, we thought it was going to be renewed. It is perfectly reasonable to have a contract, look at the terms again and get it going again. We did not realise it was not going to be renewed. I consider myself misled, very badly misled. What about the commercial partners in Post Office Card Account, did they realise it would not be renewed and how do they feel about it?
Jim Fitzpatrick: I am not sure what every individual Member of Parliament felt. Certainly, the contracts that were signed were signed until 2010; we gave an assurance in the 1999 White Paper that individual citizens would be able, regardless, to be able to collect their benefits at a post office or a sub post office, and we are holding to that.

Q170 Chairman: What about the commercial partners, did the commercial partners know that the contracts would not be renewed?
Jim Fitzpatrick: Yes, they signed the agreements, they signed the deals.

Q171 Chairman: They knew that the contract would not be renewed; the banks understood it was just seven years and then it was a complete new sheet of paper.
Jim Fitzpatrick: The banks and DWP with POL signed up to a seven-year deal.

Q172 Chairman: That is not the question I am asking, Minister, I am asking did those commercial partners have a reasonable expectation that the contract terms would be renegotiated in 2010 or for 2010, but would be renewed, or did they expect this to be a one-off, short term experiment which then dies?
Jim Fitzpatrick: I will have to check on the detail of that, sir—

Q173 Chairman: It is a very important question. It is not a detail, Minister, this is the heart of the political argument.
Jim Fitzpatrick: I would have to check because I was not privy to the negotiations at the time between the banks and Post Office Limited. I will need to find out what the details of those agreements were. Certainly the agreements that were signed were all for a seven year duration, so I would have thought it would have been logical, for anybody signing up for a deal like that, to ask the question is this a one-off or is this going to be renewable, or is this going to be renegotiated over the course of the next seven years.

Q174 Chairman: Frankly, you have come before this Committee today and have not been able to answer the single most important question, which is was that contract likely to continue in another form, yes or no, and you cannot answer that question.
Jim Fitzpatrick: What I said is that for the citizen, for whom we are required to provide cashable benefits, there will be an opportunity to be able to do that after 2010.
Chairman: I will bring in Mike Weir because he wants to ask about that, it is not fair for me to put the question.

Q175 Mr Weir: We touched on earlier, Minister, that the Post Office losses have now gone up to £4 million a week; and we were talking about the sub-post office network, I think you said. We also heard from Mr Crozier that 60% of sub-post offices' business came from the Government three years ago, it is dropping to 10%. The Post Office is losing business from the issuing of passports, TV licences and DVLA; I have to ask you, is the Government simply giving up on the Post Office Network?
Jim Fitzpatrick: I do not think the Government is giving up on the Post Office Network. I referred earlier on to the commitment that the Government has demonstrated since 1999 where we have committed some £2 billion to the Post Office: £500 million helped fund the Horizon IT infrastructure which has had a direct effect on POL's ability to secure and expand new business such as online banking facilities, We and the E-top-up market which has generated revenue to POL of £340 million, we have committed £150 million per year, as you know, to support the rural network, we have spent £210 million to support the urban re-invention network and some £30 million of investment to modernise branches, as well as £25 million into pilots to examine how we can best deliver services in a different way to rural areas which might not be able to support and sustain their own sub-post office.

Q176 Mr Weir: That is all very well, Minister, and you have made this point several times, but you also said in a separate answer that POCA was not value for money. You talked about the £2 billion that the Government has put into the Post Office but part of the reason the Post Office is losing more money is because of the withdrawal of Government services. I have to ask where is the joined-up thinking in this between the DTI and the DWP? The DWP are undermining the Post Office by removing benefits, removing POCA; the DTI have to put money in to keep the network going. It is taxpayers' money going round in a circle, it makes absolutely no sense. Where is the joined-up thinking, where is the vision for the future of the Post Office Network in all this?

Jim Fitzpatrick: We are examining the future of the network at this very point. We know that we have got time-limited support for the rural network because we have committed ourselves to £150 million to 2008; we are of the opinion that that cannot continue. We have given Post Office Limited the support that we have to allow it to be able to grow into new activities such as banking and insurance. There is an element of movement from Government, just as there is an element of movement from individuals, people just are not using the post offices and the sub-post offices.

Q177 Mr Weir: Because the services are going from them.

Jim Fitzpatrick: People just are not using the sub-post office and the post office as they used to previously. There is a whole variety of different ways for people to be able to access services, and that is not to criticise, this is a modern age, we have got to equip the post office with the ability to go out into the market to provide services. Sadly, I do not think it is sustainable to be able to continue with 14,500 sub-post offices across the country.

Q178 Mr Weir: Mr Crozier or one of the Royal Mail Witnesses said that the optimum level was about 4,000 to keep a network going; what does the Government think the optimum level of post offices is, how many do you see closing in 2008 when the Government stops the subsidy for rural post offices?

Jim Fitzpatrick: This goes back to the question that the Chairman asked initially and at this point in time I have not got a figure to be able to put to the Committee today. We have spent £25 million in the past—I believe 12 months, maybe slightly longer, forgive me if I am wrong—to look at pilot schemes to determine the best way to provide services that sub-post offices are providing. We are examining the numbers that we have at the moment, we clearly have the evidence from Post Office Limited and from Mr Crozier who says that a commercial network would be 4,000 strong, my response to Mr Luff earlier—he nodded—was that there is a community responsibility on Government, not just a commercial responsibility, and we have to look at this as Government across departments, identifying the need of each department and the role that it will play in being able to potentially assist the network and being able to survive, whether that is financially or with resources or with tasks or with contracts. We are in a very commercial world and some of the services that sub-post offices and post offices have been providing previously have gone, simply because they have not won the contract.

Chairman: That is interesting, but Brian Binley has a question which Mike has already half asked.

Q179 Mr Binley: I am getting mixed messages and the people out there are getting mixed messages and particularly in rural areas that is a very important concern, it really is. I know how difficult your job is, Minister, because I know that plans are evolving at this very moment. I recognise that, but you did say that you were not giving up on the Post Office Network, so that part of the message gave me confidence. You then go on to say that you recognise the Royal Mail saying that we are going to have to cut 10,000 offices down to 4,000, as I understand it, through the network—sub offices and so forth. Can I ask what your preliminary view would be of how many you will have by the year 2010?

Jim Fitzpatrick: Can I say just to correct, in case I misheard you, we have not agreed that 4,000—

Q180 Mr Binley: No, I said the Post Office have said that.

Jim Fitzpatrick: The Post Office has said hypothetically that were they go into an exclusively commercial market, how many could they sustain, and they said they think around 4,000.

Q181 Mr Binley: That is right.

Jim Fitzpatrick: Therefore we know that we have a starting point of at least 4,000 which would be able to survive in the hard-faced commercial world. The difficulty I have got, sir—and, forgive me, I would love to be more helpful—is if I were to put a figure anywhere between 4,000 and 14,500 to the Committee today that would almost automatically become Government policy and a Government statement and give everybody something to go and campaign about during the summer recess. We are not in a position where we have arrived at that conclusion because we are still studying the results of the £25 million pilot schemes. I have only just concluded bilateral meetings with ministers, your colleagues, from all the departments which have a role or responsibility or rely on post office services; there is a Cabinet sub-committee which I know has been reported in the press as being set up, which will be looking at this particular issue.

Q182 Chairman: That is a formal Cabinet sub-committee is it?

Jim Fitzpatrick: Misc. 33, sir, yes, which has been set up and will be formally bringing Government departments together to examine the issue and to be able to set out what patterns and be able to identify the figure that you want me to say which, I am sorry, I am not in a position to say today.

Mr Binley: Just between you and me you could not say, Minister?

Chairman: We have given the Minister a chance to give an answer to that question. Lindsay Hoyle.

Q183 Mr Hoyle: Obviously, Minister, I can understand that you are being the honest broker, DTI are saying we want to do the best by the Post Office, but at the same time you are being undermined by other parts of Government because, we have to say, this at the moment is death by a thousand cuts. We have lost the TV licences: five million people visited the post office to collect their TV licence, it has been taken away. The fact is the DVLA are considering taking their business away, the fact is that the Passport Agency is considering taking their business away, what on earth is going on within government when at the end of it, whatever we might think, this is taxpayers' money, these are

taxpayers' facilities. Surely we ought not to be putting this work out to the private sector, to a private shareholder; something has gone seriously wrong, what are we going to do to get a grip of it? It is no use saying that Miscellaneous Committee 33 is going to be chaired and the Cabinet look at it, it will be too late. It is action now to stop government departments giving the work to other people; we need to see the work retained. We are either serious about the future of Royal Mail, whether it is rural, urban or town centre post offices; if we are serious we have got to keep the work in-house. Whatever we do, the best thing we can do now is get those government departments to make a stand and say we will support the Post Office Network. We need you to do that, you are the honest broker, please get on with it and please save the Post Office Network.
Jim Fitzpatrick: I am very grateful for your description as the honest broker. I can assure you that I do find that in my role I have a dual purpose: in one sense I obviously represent the taxpayer and the shareholder and want to get the best deal possible, but in the other sense I am the postal services minister and my job is to protect the Post Office and Royal Mail. Therefore, one of the reasons why my officials are doing as much as they have been and I have been doing as much as I have—and I am grateful that we do have a Cabinet sub-committee Misc. 33 which has been set up—is to hopefully help to do the job exactly as you have described, Mr Hoyle.

Q184 Mr Hoyle: When does it report back though, Minister? We know it is set up, but when does it report back? Is it 12 months, 18 months, two years, three years? The cuts are taking place now, the Post Office is being shafted by government departments: we have to stop it now. When does the committee report back, Miscellaneous 33?
Jim Fitzpatrick: We have not got a date for formal reporting back but clearly with the SNP, the Social Network Payment—
Mr Hoyle: I thought you meant the Scottish National Party.

Q185 Mr Weir: Please do not blame us for that.
Jim Fitzpatrick: Were that possible, Mr Weir, you can be assured that we would! Given that the SNP runs out in 2008 we clearly have a backstop. We do have the pilot evidence, which was only completed in March of this year, which is being examined, and we do have the commitment to a further consultation period because we are not going to make an announcement and say that is the conclusion, we are going to allow people the opportunity to express a view, it is somewhere in between the two. I do not have a date by which we are required to report back to Cabinet.
Mr Hoyle: Can you stop the work going out from the Post Office?

Q186 Chairman: There is another quick question I really do want to ask you actually, which relates directly to what Lindsay has been asking about. In your memorandum to us you actually say that the Shareholder Executive has sought to increase Royal Mail's accountability and its objectives are "the delivery of government and other services effectively through an efficient and fit for purpose"—God, I hate that phrase fit for purpose—"Post Office branch network which offers maximum access as needed." Which government services will be provided through this Post Office Network that you are trying to keep there to provide these services?
Jim Fitzpatrick: Again, I am sorry, but I am not in a position to give a definitive response to that because we are looking at the services that are being provided and those that we may be able to provide in the future. I have to say I agree entirely, I was irked when I saw the phrase "fit for purpose" in a memorandum that was coming out from DTI.

Q187 Chairman: Do not worry so much about fit for purpose, the point is your memorandum to this inquiry, given to us a few weeks ago, says that it is your objective to provide government services through the Post Office Network, so which services?
Jim Fitzpatrick: The basic position is that obviously there is a commercial dimension to this.

Q188 Chairman: Which government services?
Jim Fitzpatrick: Certainly the baseline service which we are committed to in the 1999 White Paper is the ability of individuals to be able to receive their benefits in cash at the post office, that is an absolute given.

Q189 Chairman: You remain totally committed to providing benefits in some form through the Post Office Network?
Jim Fitzpatrick: We are.
Chairman: That is helpful.

Q190 Miss Kirkbride: Just on that I would very much agree with the Government's objectives on all of this because there is a social policy attached to the maintenance of the Post Office Network and sub-post offices. Could you not at least give this Committee an undertaking to go away and ask government departments to stop farming out the business, to put a stop to DVLA pursuing a tender for its business, to stop the other organisations and be prepared to condemn the BBC for going away with the TV licence now, because if all this business goes and you do not stop it now, it does not matter what you decide in 2008, there will not be a viable business.
Jim Fitzpatrick: I am sorry, I am not in a position to condemn the BBC—
Mr Bone: Shame, go on.
Mr Hoyle: Go on, kick them.

Q191 Miss Kirkbride: Let the BBC go on this one; the DVLA?
Jim Fitzpatrick: We might mention it in Parliament tomorrow morning if that were to be the case. What I have tried to demonstrate in explaining the degree and the intensity of work that officials have been undertaking with colleagues, both with the Post Office and with other government departments, the

bilaterals that I have been having with every relevant government department which have now concluded with the setting up of the Cabinet sub-committee, is that there is a degree of awareness that this is an issue which we have to look at in the round and is not something which can be looked at separately.

Q192 Chairman: Minister, we have given you quite a tough time but this is a very important issue indeed.
Jim Fitzpatrick: Of course.

Q193 Chairman: We all attach, around this table, value to the post offices that serve our constituencies. There was a consensus ruling in this country for many years that the government would provide its services through the Post Office Network; this hard commercial edge which New Labour has brought to the Post Office Network is something quite new. Now that consensus has gone, only value for money counts in terms of delivery of services but we still think that post offices are important to the communities they serve. Is it not time to have a major public consultation about the social role of post offices and to agree explicitly how that is funded? The cross-subsidy effect that was there has gone, that consensus has been shattered by this Government; we need a new method to protect the social role of post offices, do we not need a big public debate to agree what that role actually is and how it should be funded?
Jim Fitzpatrick: I mentioned a few moments ago that we are committed to further consultation which may very well be full, formal consultation. I cannot give that commitment this morning because we have already undertaken quite a bit of consultation over recent years and, therefore, if there was a need to be able to arrive at quicker decisions then we may short-circuit the full formal consultative period of 12 weeks, but there will be an opportunity for the public to express their point of view. I know that the National Federation of SubPostmasters and Mistresses, with whom I also have met recently, and whom I believe you are taking evidence from next, have had their own public consultation and have some three or four million signatures that they are going to bring to Downing Street some time later on this year I anticipate; they will be ready to engage whenever we have that consultation, as well as honourable and right honourable Members right across the House because I obviously do get quite a bit of correspondence from colleagues. I am seeing the all party group at 4.30 later on today, I am meeting Labour colleagues at six o'clock today and that is on exactly the same issues that we have been covering this morning, Chairman.
Chairman: We cannot put this to you because we have not had the evidence yet–we are running late as it is–but I think we will hear from the subpostmasters that there is already pressure from DWP on customers to abandon the Post Office Card Account now, not even 2010. At least I hope the message you will take away from this meeting, I think my colleagues would agree, is please ask your colleagues in DWP to stop that pressure; at least let the contract run its course.
Mr Hoyle: And have been given incentives to actually change their account; great pressure is being put on people who use the Post Office Card Account.
Chairman: We will take that evidence next, Minister, but the situation is grim and we look to you to act. Thank you very much indeed.

Witnesses: Mr Colin Baker, General Secretary, Mr John Peberdy, NFSP Executive Council member, Chairman of NFSP Executive Council's Negotiating Committee, and Mrs Sally Reeves, National President, **National Federation of SubPostmasters** gave evidence.

Q194 Chairman: I do apologise for keeping you waiting so long, but we did think that last session was quite an important one, and I hope you share that view. We will have to slightly curtail the time we have with you as a result, for which I apologise, but I still want to get all the points you want to make on the record. Can I begin by asking you to introduce yourselves?
Mr Baker: Yes, you can, thank you, Chairman. My name is Colin Baker, I am the general secretary of the National Federation of SubPostmasters; on my left is Sally Reeves, who is the national president of the National Federation of SubPostmasters; on my right is John Peberdy who is the chairman of the Federation's Negotiating Committee.

Q195 Anne Moffat: You have been here for the evidence so my questions on ownership and the share options that the Royal Mail want to put to their staff, how do you feel about that?
Mr Baker: We feel as though ownership is secondary to survival, frankly, and the Post Office Limited side of the business is in a pretty dire state as we have heard this morning, so the ownership point is not an issue that we are concerned with, but the share option one is one where we have suggested to our members that they register an interest. We believe that it is by no means a done deal and so there is no harm in registering an interest; in fact, if you think about subpostmasters we would love to be debating the pension fund with you because subpostmasters do not get a pension, their pension is invested in their businesses; therefore, the £2 billion of subpostmasters' money is invested in the Post Office and Royal Mail Group, so if there are any shares given out to anyone it is absolutely unbelievable to think that those shares could be dispensed without involving subpostmasters. What we have said is register an interest, let us see what happens, but there is no harm in doing this at this stage. Most certainly, privatisation and ownership issues of that nature are quite secondary because the problems of the business surmount all that stuff.

Q196 Chairman: Mr Baker, you have heard the questions we put to the Minister; do you believe that we overstated the concern about the abolition of the Post Office Card Account?

Mr Baker: Not at all, Chairman, you hit the nail on the head. The meter is running on the Post Office Limited—I am not going to use emotive phrases but most certainly it is a difficult time for us and, you are quite right, you can forget 2010, it has started now. The intention is that there will be nothing left in 2010, there will be no cliff-edge in 2010, they are working towards the demise now, and if you think about it from the subpostmasters' point of view, every customer that they lose now they will lose the payment for, they do not retain the payment until 2010. There is an urgency and we do welcome this Misc. 33 because it is a joined-up government issue, we have pleaded to have a joined-up government look at this and it is time for a whole new look at the sub-post office and the network. One of the recommendations you could make is, firstly, that they meet and, secondly, that they meet with us.

Q197 Chairman: Has the Government given you any clue at all about what kind of package might be in place to support the rural and urban sub-post office network after the loss of the Post Office Card Account?
Mr Baker: No, Chairman, they have not at this stage. All we know is that in 2008 the existing Social Network Payment ceases and they have not given us any indication yet as to what happens after that.

Q198 Chairman: When in 2008 does that payment run out, what time of the year?
Mr Baker: I believe it is 31 March.

Q199 Chairman: It is actually significantly less than two years.
Mr Baker: Yes.
Chairman: It is not a long time when you are doing a proper business plan, for instance. Mike Weir.

Q200 Mr Weir: On the POCA, were you aware when the POCA was set up that it was just 2010 and it was intended to end there? Were your members aware of that and do you think that Post Office Limited and the banks and building societies were aware of that?
Mr Baker: I will start off and I will ask Mr Peberdy to follow on with this one. The reason for that is that myself and Mr Peberdy actually had monthly meetings with the Department of Work and Pensions and Post Office Limited, drawing up the Post Office Card Account. As you know, we were promised universal banking at the post office, not the Post Office Card Account, and we spent several months with the DWP and Post Office Limited working up this proposition that we could support. You can imagine how we felt in January this year to hear that it was ending in 2010, because we had not seen the contract, we were not told that it was going to end in 2010 and, in fact, it is worse than that because that contract includes a phrase that says the subpostmasters will migrate their customers onto the banks between 2003 and 2010. I ask you, Mr Weir, do you think that we would sit and have a contract like that? We did not sign it, we were not asked to sign it, we did not see it, we were rightly very annoyed. Mr Peberdy.
Mr Peberdy: The other thing, Mr Weir, is that as you so rightly say, nor was anybody else. As you know, the customers had to sign up, although it was a convoluted process to sign up for a Post Office Card Account. None of those opened that card account thinking it was going to end in 2010, not a piece of mention was in that literature. You do not go and open a bank account, for example, and think the banks are going to close the account down, do you?

Q201 Mr Weir: Are you finding that your customers are leaving the Post Office Card Account as a result of what is happening now?
Mr Baker: I will ask Mrs Reeves to come in on this one because Mrs Reeves has got a good, rural constituency.
Mrs Reeves: Thank you. There have been some trial areas that have been going on, some pilot areas, and the indication seemed to be that some of these areas saw customers moving away. In my own patch, customers who have Post Office Card Accounts have actually been getting phone calls from DWP officials at six o'clock at night; elderly people living on their own, pressurising them and asking them for details of their accounts, and they are being put in a situation that they should not have to be put in. They have made their decision, they have made their choice, so whilst they have made their choice and they are left alone they are fine, they are content, they have made their choice and they are happy with what they are, it is the continuing invidious pressure that they are being put under, and of course they are now hearing the end of the Post Office Card Account in 2010 and it is beginning to worry them and they do not know where they are going. For a lot of people in my constituency they do not have a bank to go to if they do not have a bank account that they can access at the post office; many of them do not have bank accounts at all, they have been living in their working life by getting cash at the end of the week as their wage, they never had a bank account and have chosen not to. For them it is a very scary time.

Q202 Chairman: The pilots you are talking about, they are being conducted by who?
Mrs Reeves: The DWP.

Q203 Chairman: What sort of spread do these trial areas have, do you know?
Mrs Reeves: Some of them I understand—I am sure Mr Baker can correct me if I am wrong—were in the North East, and they were in specific patches, probably to monitor what would happen in a geographical area.

Q204 Mr Weir: Can I come in on that? You say specific trials, but in my area which is not a trial area there is a private company called Action for Employment, I believe, who are writing to customers, trying to get them to move to direct payments. Have you come across that happening in other areas as well?
Mr Baker: Oh yes we have, Mr Weir. We know AforE well and they tell us—we have met with them in fact, which is the style that we adopt, we try to

meet with people to see how we can work things through—that their script includes the Post Office Card Account but the feedback that we get from customers is somewhat different.
Mr Weir: I am interested to hear that, because I have had that experience in my area as well.

Q205 Chairman: I just want to be clear I have understood this correctly, the contract between the Government and the Post Office enabled a migration from the Post Office Card Account to bank accounts, that is what you are saying, but you were not aware of that provision in the contract?
Mr Baker: Correct. It did more than enabled, with respect, it advocated it.

Q206 Chairman: Encouraged it. Does this suggest that the banks themselves were aware that 2010 was a pretty final date and were looking to use the Post Office Card Account as a transitional arrangement to bring more customers into the banking network?
Mr Baker: Forgive me, I really cannot speak for what the banks knew at the time. The people I have spoken to since seem to be taken aback by the fact that it all ceased by 2010 because one much appears to say by 2010—

Q207 Chairman: Which people?
Mr Baker: The British Bankers Association.

Q208 Chairman: They are taken aback by it all?
Mr Baker: They were, yes. I believe that everyone thought, even those that knew that this contract was for a term—and I suppose if we had thought about it we would have expected that all contracts are for a term and do not last forever—there was an expectation on everyone's part that during the period between 2003 and 2010 we would be working together to find the 2010 equivalent of the Post Office Card Account, but in fact what happened, as we know, is less than a year after the last order book was cashed the account was called time on, which I think took everyone by surprise.

Q209 Mr Weir: You heard the Minister earlier say that POCA was not value for money and quoted figures for the cost. We are told it costs the Government an average of £1 to make a benefit payment into a POCA compared to one penny for a similar transaction to a bank or building society account. Can you tell us first of all why there should be such a huge disparity and also what fee do your members receive for each new POCA opened?
Mr Peberdy: I will try and help. The Post Office, we are led to understand, have got a ratecard for their services to banks *et cetera*, and their rate is something in the region of £45 per year to the DWP for the Post Office Card Account. This figure has become loosely equated to being, with some minor additions to that which they might call VAT *et cetera*, around £52 a year, hence £1 a week. The one penny, I am led to understand, is the BACS cost of a transfer through any BACS system, and of course the banks then pick it up or the customer, of course, if they get into difficulties or if they are paying direct debits out or whatever else at their particular end. Going to your latter point about what do subpostmasters get, there is an initial payment—or was an initial payment because there are not very many of them being opened these days—where a sub postmaster gets the equivalent of £2.60 for every account that is actually opened as a one-off payment, and currently subpostmasters are paid 15p per £100 for monies drawn out of that card account.

Q210 Mr Weir: Can I be perfectly clear about this £1 then; what you are saying is that the Post Office charges the DWP on an annual basis this £45 that comes up to £52 or whatever, so this average of £1 to make a benefit payment is on the basis that it is paid once a week or something like that, and it is not actually a payment for each transaction.
Mr Baker: No.

Q211 Mr Bone: My question really follows on from that. You said in your submission that you would be happy to work with the Government and Royal Mail to have a replacement for the Post Office Card Account, which seems sensible, but how would you feel if you had this new card account or whatever it was but you only received the cost as you would for a normal bank account? It sounds to me that that would be ridiculous, because it sounds as though you would only get a penny.
Mr Baker: To respond to that one, I do not think the penny is the full cost. If we are looking at the cost in a bank branch, for example, there is the double whammy that there is the actual withdrawing of the cash and then there is the clerk sitting there waiting to serve people, so I think the charge of a penny is the one that the DWP pay and then the banks take the rest of it. To answer your question, yes, we will work with the DWP, with the Post Office and with Government to find a replacement to the Post Office Card Account and more because, as you say, we now have in Shoreham over two million signatures on a petition, well over two million, and that is likely to hit a much higher figure before very much longer. There is an Early Day Motion which has got 381 signatures—the most signed Early Day Motion this term of Parliament—people are rightly upset by this and the people coming into post offices are more upset, but you do not hear them like we hear them unless you are in your constituencies and your surgeries. We hear them all the time and what we want—it is an easy thing to ask for though it may be difficult to get—is a tiered approach to this so that the people who want to continue to go to the post office for a very stripped-down account like the Post Office Card Account can continue to do so. Then we want to build a tier of banking products on top of that, similar in fact to what Alan Cook was saying this morning, where people can elect to go to the post office to do a different sort of banking, which will mean getting the banks and building societies on board that are not on board at the moment, but if we believe in the post office, and I am sure we do, then there is a way of doing this and we are prepared to

talk to anybody about it. Let me just come back tothe Post Office Card Account; this is what makes me passionate about the post office and the role that the post office fills and why we are so resentful of what is happening to our customers. This is not me, this is not the National Federation of SubPostmasters, but if I may be permitted to read two short extracts from a Citizens Advice Bureau document?

Q212 Chairman: Please.
Mr Baker: "The Humberside CAB reported that a lone parent who is expecting another baby was shocked to discover that £400 of her social fund maternity grant had been transferred out of her bank account to pay other debts, leaving her with about £30 to live on. The bank told her that even though they had accepted her offer of repayment towards the debts, they would check her account regularly and take any money they found in it. As a result Charlie could not buy anything for her unborn child." The other one: "CAB in Nottinghamshire reported that a client with schizophrenia and in receipt of income support and disability allowance went to a bank to open an account in order to receive benefit payments from the DWP because they were told to. The client was granted an account but was also offered a £2,000 loan, a £6,000 overdraft and the use of a credit card."

Q213 Mr Bone: That is most enlightening, but just go back to my point I guess how this sort of thing comes about is the government says to the DWP that you have to save X amount of money. They say we can save money by only paying a penny for doing this, when it costs more through the post office. Basically it is comparing apples and pears and there does not seem to be this joined-up thinking in Government about the whole thing. Do you think that is how it has come about?
Mr Baker: It is absolutely how it came about. We went to No. 10 in March and we were hoping that some of the things we said then might have influenced—I almost said resurrection of this committee then but it was never there before, was it—the creation of this committee, but I just hope that they will get on with it. That saving , we have the latest MORI research which we will make available to the Committee as this is very informative stuff. The Post Office Card Account is the second highest earner for subpostmasters, second only to postage work. We have figures in here that will frighten you: the average sub postmaster's drawings from his business are less than £1,000 a month, £948 a month; the saving that the state is making is being paid for by subpostmasters who are running their businesses with their pensions, based on their savings, and that is what is happening. The sands of time are running out, there is an urgency about this and we would implore you to generate as much pressure as you can on the people necessary.

Q214 Mr Hoyle: You are absolutely right. I believe that the Post Office Network is absolutely critical to the country, because you provide not only a valuable service but you are at the heart of most communities where people pay and stay and can discuss with the postmaster or mistress, so I am absolutely committed to it. There is an issue, however: the truth of the matter is that how much new business you get each year from people retiring is declining because people already have bank accounts. People who may, for one reason or another, suddenly become unemployed, already have bank accounts, so the problem is the Government is speeding up the effect but the reality is it is a sliding scale downwards. What I want to know is what can we do or what pressure can we put on the Government to ensure that the Post Office Network continues, what business do you believe can be brought in and, obviously, I am like you, I am a little bit bothered that this committee Miscellaneous 33 is there, but it is no good if it talks for two years because you have already lost business in other areas. What can we do to ensure that there is a bright future for post offices, what business can be put in there and what can we do to help you get there?
Mr Baker: I will start off and ask Mrs Reeves to sweep up on that one. There is a critical issue at the moment, but you are quite right, it is a sliding scale because people do start to walk away from the post office. Currently there is an issue because a competitive network has taken some of our work, it has outbid us for the work, the TV licence work and it has gone to a competitive network. We need a cheaper way, a more competitive way, of getting these contracts back, we have to tender more competitively; in order to do that we need new equipment. The Post Office, because of its perilous financial position, cannot afford to put that new equipment in: it can afford to put it into some post offices but not all, creating a network within a network if you like. That just means that we cannot compete because we have not got the funds to compete. We do not want money to live on, what we want is to work for a living and you know the saying, you can give a man a fish and he will eat for a day, give him a fishing rod and teach him how to use it and he will eat for the rest of his life. We want that fishing rod and teach us how to use it, that is what you can do; you can give us the start-up that we need in order to be able to compete with our competitors who have got smaller equipment. They only do what they do and they do it well; we have a whole range of services that we provide and because of that it is quite an expensive thing. Sally, do you want to add to that?
Mrs Reeves: You spoke about the banking scenario and you spoke about the new people coming in and having bank accounts and accessing their pensions through the bank accounts. The problem is that in a huge amount of the rural network they have not got bank facilities to access, and the post office is in exactly the right place for people to be able to access their funds however.

Q215 Mr Hoyle: Can I just stop you there; we are on the same side, but I live in a rural area and I have people who live in rural areas, the fact is that they have just retired from work but they do not say

I want it paid at my post office account. Unfortunately, even if they have to wait a month it does not matter to them, the reason is they want it paid directly into their bank account and that does not tempt them to the post office. How do we get those kinds of people into the post office and what can we do? My view—and it may help—is I believe we ought to have a new rural bank rolled out through every post office so that the local milkman who collects his money on a Friday can pay it in on a Saturday morning, the local garage can pay cash in, I would love to see you becoming the new rural bank to compete with the high street banks who I believe that people would have more trust in. That to me would be the real answer.

Mrs Reeves: That would be a wonderful answer and would bring a lot of work back into the rural network, because at the moment the rural network can only give free access to cash to about 40% of those people who have joint stock bank accounts, there are 60% who cannot access it through us. So a facility in some way to be able to get everybody in my village to be able to access their money through my post office would be wonderful, because those who have the joint stock bank accounts do use us and use us for other things. Also, those people who use us keep that money generated within the village, they keep the other enterprises in the village going—the butcher, the hairdresser, everybody else, so you make a sustainable community. Making us a central access point for banking is primary to going forward for the future.

Q216 Chairman: Thank you very much indeed. We have had a slightly truncated session with you but we have covered all the ground we want to; is there anything else you want to say to us before we conclude this session?

Mr Peberdy: Can I just add to what Mr Hoyle has just said in questioning what you can do? I know you have partially covered it with others today, but definitely, because it is something that we are advocating, the Government have got to start to think of its departments (a) in a joined-up manner and (b) to some degree think Post Office first. It is an absolute no-brainer as you have already said, they are paying out money with one hand to keep the network going and taking the means of earning a living away with the other—the DVLA *et cetera*. That is something that has got to happen, and some of the uncertainties have got to happen. The DTI, having had this report on the rural network with them for nearly nine months, have got to get on and come out and say what they are going to do so that it helps us to know which way we are going, what we can do for our members and how those subpostmasters feel out in that rural network in particular.

Mr Baker: I would just like to thank you, Chairman, for letting us give this evidence; I hope it was helpful to you, and the one word is uncertainty. We have heard it all morning, so anything you can do to help us with that uncertainty we would be very grateful for, but as you say the sands of time are running.

Chairman: Thank you very much indeed.

APPENDIX 1

Memorandum by Amicus CMA

The Communication Managers Association (CMA) sector represents some 16,000 managers and professional staff within the Royal Mail Group. The CMA is a section within the trade union Amicus which is the UK's second largest trade union with 1.2 million members across the private and public sectors.

Introduction

1. Amicus is always pleased to respond to requests for written evidence and to comment fully on proposals put forward. However this Consultation, which will focus on the refinancing of Royal Mail and the structure of the shares scheme, has proved challenging.

2. Amicus is disappointed in the lack of consultation with the trade unions on the proposal for both the reinvestment package and the share scheme within the Royal Mail Group. From what we know of the proposals it would appear to be a fundamental shift in the direction of Royal Mail and one which Amicus fears could lead to the privatisation of the postal service, to which we are opposed.

Investment

3. Whilst Amicus welcomes the investment it remains unclear to the union exactly what areas this will cover. Despite requests to Royal Mail we have not been involved in any detailed discussion with the company about their plans. Nevertheless in the meantime the redundancy programme continues to roll out with another 700+ job losses announced within the managers group during the first two weeks of June.

4. Amicus is also fully aware that other postal competitors are more advanced technologically than Royal Mail and that there are benefits to be gained through investment in updated technology. We want to engage in that dialogue. At the moment the information is at best patchy.

5. As an example Royal Mail engineering has suggested that with minimal investment the existing equipment may have an extended lifetime. Elsewhere we are aware that Royal Mail has decided to purchase some 1,000 walk sequencing machines. This would result in new ways of working in delivery offices and have an effect on the timing of deliveries to customers if Royal Mail is to sweat that asset. But our knowledge of this has again not been achieved through direct dealings with Royal Mail rather a number of trial machines have been introduced without consultation and agreement with the union.

6. This continual failure to consult through the established union/management channels indicates a blatant disregard for constructive dialogue. Royal Mail appears to prefer focus groups, employee surveys, and one-to-one communications from the top to communicate. But in the longer run that is no substitute for meaningful dialogue with the recognised trade unions. At the same time the staff are subject to endless speculation from the media about what the future holds. This uncertainty and the pressure it places on managers and other employees is causing serious problems in terms of stress and loss of morale.

Pensions

7. Amicus welcomes the Escrow arrangements which secure the funding to underwrite the pensions arrangements. We also welcome the commitment by Royal Mail to fund over the next 17 years increased pension contributions in an effort to resolve the current deficit and would see this as a significant step forward in the funding arrangements.

8. However as the refinancing package appears to be tied in with the restructuring plans for the company which could potentially lead to job losses, we will continue to be cautious until we see full details of how this will be achieved. It should be stated however that Amicus are firmly opposed to the refinancing of the Royal Mail pension scheme based on a restructuring programme which will lead to job losses.

Shares Scheme

9. One must challenge Royal Mail management on the confidence they have in their own proposals when they appear reluctant to reveal how the shares scheme will work or what percentage of the equity would be available for employees. Until Amicus sees the full proposals for the refinancing of the postal service and the structure of the share scheme we can only hazard a guess at how this would work and we may in fact find that the devil is in the detail.

10. Furthermore, there is no evidence that share distribution would necessarily contribute to improved relationships or productivity within the organisation and the potential wide distribution of equity would not give employees any real say in the future direction of the business. Our concern is that the share option would be the sliding slope to an eventual full privatisation and ultimately the possible transference of the more profitable parts of the business into foreign hands.

11. Amicus believes that the share scheme is a blatant diversion from what is actually required to deliver a postal service fit for the 21st century, namely, a no strings attached, financial and technological investment in the industry.

12. In summary, Amicus is uncertain exactly where Royal Mail wishes to invest but are aware that newer technology exists within the postal industry. We are also aware that investment in Royal Mail has been lacking for some years and that this has resulted in poor working environments for employees particularly in delivery offices where a number of offices are not fit for the purpose for which they are used.

13. Amicus members have made it clear that they do not want a privatised postal service. Nor do they want information on the future of their company which is based on rumour and hearsay. They do want an efficient, effective, productive and well managed universal service where management work with employees to ensure this is delivered. Not management decisions by diktat.

14. Unless Royal Mail put the rumours to rest by publishing full details of their plans for the company, then morale and productivity among the workforce will inevitably suffer.

June 2006

APPENDIX 2

Memorandum by the Citizens Advice Bureau

Summary

Citizens Advice Bureaux (CABx) developed a great deal of experience helping clients move to direct payment of benefits into bank accounts, and have helped many people choose the most appropriate method of payment for their circumstances during the migration from benefit books to direct payment.

We are extremely concerned about the lack of clarity on the future of the Post Office card account (POCA) when the current contract runs out in 2010, and are frustrated about the lack of clear information given by the Department for Work and Pensions (DWP) about its plans for the POCA. This frustration extends to

the lack of consultation about the brief pilots that were run by DWP to test methods of encouraging POCA holders to migrate to bank accounts. We are disappointed that the report of the results from the pilots has only just been laid before parliament (20 July 2006) and fear that the timing of its publication may limit the level of Parliamentary scrutiny which it receives.

While up to 70% of people with POCAs also possess some type of bank account, those without bank accounts—who are likely to be among the most financially excluded and vulnerable—must not be forgotten when the POCA is phased out. We understand that DWP is considering the provision of some form of functional account for these people, and would encourage them to ensure that this meets the needs of this group and is in place well before 2010. Operation of this account will rightly be determined by competitive tender, but we see great value in Post Office Limited bidding to run the account since this may help to minimise disruption while also allowing vulnerable customers to benefit from the extensive Post Office network.

It seems likely that DWP will be keen to migrate as many people who currently have POCAs to open bank accounts. Citizens Advice considers that any proposals to migrate people to bank accounts should only go ahead if a number of conditions are met:

1. There must be significant investment in the process of migration since it is necessary to make sure people are offered appropriate accounts, that the accounts allow people to access their money at the most convenient location, and that people receive the support that they require when making any transition. DWP should make sure that its submission to HM Treasury as part of the Comprehensive Spending Review takes account of this.

2. It is imperative that the process of opening basic bank accounts is made much easier. This must include the need for greater flexibility over acceptable identification documents and access to accounts for people in debt or undischarged bankrupts.

3. People should be able to open basic bank accounts in post office branches, and all current account holders should be able to withdraw cash over the counter at Post Offices.

1. Introduction

1.1 The Citizens Advice Bureaux (CAB) network is the largest independent network of free advice centres in Europe, providing advice from over 3,200 outlets, ranging from GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particular dispersed groups.

1.2 The service has two equal aims:

— to ensure that individuals do not suffer through lack of knowledge of their rights and responsibilities or of the services available to them, or through an inability to express their needs effectively;

— and equally, to exercise a responsible influence on the development of social policies and services, both locally and nationally.

1.3 In 2004–05 the CAB service dealt with 5.2 million new enquiries. Of these enquiries nearly 1.2 million were debt or finance-related. Between January and June 2006, 116 bureaux submitting detailed statistics to Citizens Advice reported that almost a third of their enquiries about bank accounts and post office card accounts—and by far the largest number—related to problems with access.

1.4 CAB clients are likely to be on low incomes. Recent research for Citizens Advice by MORI shows that CAB clients are predominantly in social groups DE and more likely to be tenants of social housing than the population as a whole.[1]

2. General Comments

2.1 The Trade and Industry Committee's inquiry into the Royal Mail Group focuses on three areas:

— the extent to which the refinancing package announced by the Government will help Royal Mail to pay for modernisation and deal with its pension fund deficit;

— the structure of the "shares" scheme proposed by Royal Mail managers, and its implications for the future of Royal Mail Group; and

— the future of the Post Office Card Account and the effects on the Post Office network.

2.2 Our comments are confined to the third area, namely the future of the Post Office Card Account and the effects on the Post Office network.

2.3 Citizens Advice Bureaux (CABx) have a great deal of experience helping clients move to direct payment of benefits into bank accounts, and have helped many people choose the most appropriate method of payment for their circumstances during the migration from benefit books to direct payment.

[1] *Unmet need for Citizens Advice Bureaux,* MORI, September 2004.

2.4 We have serious concerns about the lack of clarity on the future of the Post Office card account (POCA) when the current contract runs out in 2010, and are frustrated about the lack of clear information given by the Department for Work and Pensions (DWP) about its plans for the POCA.

2.5 Whilst the POCA offers very limited functionality, over 4.7 million POCAs had been opened for the receipt of benefits, pensions and tax credits (accounting for approximately 40% of benefit claimants invited to convert to direct payment). Evidence from Citizens Advice Bureaux shows that the POCA is popular with our clients because:

— People with POCAs can use their local post office to receive their benefit and pension; and

— Many of our clients find it difficult to open, access and operate bank accounts, including basic bank accounts. These problems are detailed in our recent evidence report, *Banking benefits.*[2]

2.6 Citizens Advice recognises that the POCA fulfils a useful role for many people, but its limited functionality renders it of limited use in fostering real financial inclusion. For instance, it offers no overdraft, direct debit or standing order facilities and can only accept electronic payment of state benefits, pensions and tax credits.

2.7 We understand that DWP is currently considering replacing the POCA with an account targeted at those people who may not feel confident enough to operate a bank account. We recommend that any such account must feature attributes that have been designed with the needs of those on low income or benefits in mind.

2.8 DWP is also likely to want to encourage as many POCA holders as possible to migrate across to use bank accounts. For this mass migration to be successful, a number of conditions must be met:

— the process of opening basic bank accounts should be made easier (including greater flexibility over ID);

— basic bank accounts should be made more suitable for people on benefits or low incomes;

— all bank accounts should be accessible free of charge at post office counters; and

— support should be available for people to open and use bank accounts. The CAB service would be happy to play a role in the delivery of this support but it will be essential that DWP factors the need—and costs—of such support into his submission to HM Treasury as part of the Comprehensive Spending Review.

2.9 Finally, if the contract for the POCA is not renewed after 2010 it will remove another important revenue stream for subpostmasters. This change will threaten the profitability of certain Post Office branches, particularly those in rural or urban deprived areas, at a time when the future of the subsidy for rural post offices is under review, and where the threat of a wave of branch closures cannot be ruled out.

3. Take-up of POCA

3.1 The POCA has very limited functionality: it offers no overdraft, direct debit or standing order facilities and can only accept electronic payment of state benefits, pensions and tax credits. Moreover, the process for opening a POCA was so convoluted that it might have put some people off applying. Yet POCAs proved to be very popular, with over 4.7 million having been opened for the receipt of benefits, pensions and tax credits (accounting for approximately 40% of benefit claimants invited to convert to direct payment).

3.2 Evidence from Citizens Advice Bureaux shows that the POCA is popular with our clients for two main reasons. Firstly, many people open a POCA because it allows them to use their local post office to receive their benefit and pension, and this is much more convenient for many people due to the respective size and reach of the networks: only four per cent of villages now have a bank or building society whereas 60% currently have a post office.[3] DWP figures suggest that roughly 70% of POCA holders also possess a bank account but may be signalling their preference for the Post Office over banks in receiving benefits payments into their POCA.

3.3 Secondly, many of our clients find it difficult to open, access and operate bank accounts, including basic bank accounts. These problems, detailed in our recent evidence report *Banking benefits*, include: use of credit scoring to determine eligibility to bank accounts; problems providing acceptable identification documents; long delays in opening accounts; and banks taking money out of accounts to pay other debts to the bank without checking the customer's circumstances first.

3.4 Despite the popularity of the POCA, the government has signalled its intention not to renew the contract with the Post Office to offer POCAs. The main driver for this is almost certainly financial, given that the cost per transaction to government for payments into a POCA is apparently £1 whereas payments into bank accounts cost just 1p.[4]

[2] *Banking benefits*—CAB evidence on payment of benefits into bank accounts is available at: http://www.citizensadvice.org.uk

[3] House of Commons Treasury Select Committee, Cash Machine Charges—Fifth Report of Session 2004–05, p 46.

[4] "It costs us £1 for every *Post Office card account* transaction; it costs us a penny for every bank transfer." Uncorrected evidence from Rt Hon John Hutton MP, Secretary of State for Work and Pensions, Work and Pensions Select Committee hearing, 3 July 2006. Available at http://www.publications.parliament.uk/pa/cm200506/cmselect/cmworpen/uc1389-i/uc138901.htm

3.5 Citizens Advice recognises that the POCA offers limited functionality, but notes take-up of the POCA has far exceeded DWP's initial estimates, with over 4.7 million people now possessing a POCA. We understand that DWP is currently considering replacing the POCA with an account targeted solely at those people who may not feel confident enough to operate a bank account. We recommend that any such account must feature attributes that have been designed with the needs of those on low income or benefits in mind, and would be happy to contribute to the design of such an account. It will also be imperative that such an account is available well in advance of 2010 when the POCA contract is to end in order to ensure a more measured transition.

4. Migrating POCA Holders to Basic Bank Accounts

4.1 It appears that many people who currently have their benefits payments paid into a POCA will in future be encouraged by DWP to receive their payments into a bank account.

4.2 For this to be successful, it is essential that the basic bank account product meets the needs of its potential users, and that the process of migration is carefully managed. There needs to be significant investment in the process of migration because it is necessary to make sure people are offered appropriate accounts, that the accounts allow people to access their money at the most convenient location, and that people receive the support that they require when making the transition. It will be essential that DWP factors the need—and costs—of such support into his submission to HM Treasury as part of the Comprehensive Spending Review.

4.3 Here are a few cases that demonstrate the difficulties faced in opening basic bank accounts, and the support that can be required:

> A CAB in Lancashire (Blackpool) reported that it took a whole day for an elderly vulnerable woman to open a bank account for payment of her pension credit and Local Housing Allowance entitlements. The client was entitled to a substantial amount in backdated benefits, which could not be paid until a bank account had been opened. The CAB adviser had arranged to go with the client to open a basic account at a local building society branch and had organised an appointment. However the client had gone to the local DWP office instead to pick up a girocheque for some of the benefit owed to her.
>
> A Sussex CAB reported that their client, an asylum seeker in his early 70s, attempted to open a basic bank account but was turned down by numerous banks and building societies on the grounds that his ID was not suitable. Following intervention from the local CAB one of the building societies agreed to accept his documents proving ID (which included passport, solicitor's letter and letter of entitlement from DWP).

4.4 Switching bank accounts remains rare even among people who have mainstream financial products, so in this setting—where many financially inexperienced people may be forced to move to an account that offers much greater functionality—it will be incredibly stressful, and require substantial support services. The CAB service would be happy to play a role in the delivery of this support.

4.5 If this support is not forthcoming, there is a real risk that many people who are forced to use a bank account for the first time may encounter difficulties in managing the added functions attached to their account—for example they may end up incurring bank charges of up to £39 for unpaid direct debits. Such charges can represent a significant proportion of a benefit recipient's income and can engender strong resistance to efforts to promote use of financial products and services. We urge DWP to provide assistance to POCA holders not just in opening accounts but also in operating the accounts successfully. We are concerned that this issue does not yet seem to have been fully grasped by DWP.[5]

4.6 Given our willingness to assist with any process of migration it was particularly disappointing that DWP officials did not consult with Citizens Advice, or with other organisations that have a strong interest in this area, when they devised and ran three short-scale pilots which were intended to encourage POCA holders to migrate to bank accounts and to inform DWP's future policy proposals.

4.7 We are disappointed that the DWP's report into the pilot activity has been published immediately prior to the Summer Recess, and we fear that this may mean that it does not receive the Parliamentary scrutiny that it deserves. We urge the Trade and Industry Committee to make sure that this does not happen.

5. Cheque Payments

5.1 Benefit recipients who are unable to manage a bank account or POCA themselves—perhaps because they have become housebound or have experienced mental health difficulties—have a number of options open to them in order to maintain receipt of benefits payments.

[5] "Customers who have managed to open and operate a *Post Office card* account should be able to do the same with at least a basic bank account. As we have done in the past, support could, where appropriate, include helping customers complete an application form to open a bank account and obtaining the required documents to prove their identity." The Parliamentary Under-Secretary of State, Department for Work and Pensions (Lord Hunt of Kings Heath): 6 July 2006: Column WA75.

5.2 If they have a current account they can give Power of Attorney to a friend or relative who can then operate the account on their behalf. Meanwhile POCA holders are able to nominate a second person to receive a card and PIN number for their account. However, basic bank account customers have neither option open to them, since they must rely on pin pads or ATMs to access their money and sharing PIN numbers is actively discouraged since the account holder is personally liable for any losses incurred because they have given their PIN to someone else.

5.3 If none of these options is appropriate, perhaps because of illness or disability, or because the person concerned relies on different carers to collect their money for them, then payment is made by cheque which can be cashed at post office branches (provided it is for less than £450). This facility provides a vital lifeline for many of the most isolated, vulnerable or housebound people.

5.4 Currently, over 700,000 people receive their benefits payments by cheque (equivalent to 4% of benefit recipients).[6] It costs DWP £1.70 to make a payment by cheque, compared to £1 to make a payment into a POCA and just 1p to make a payment into a bank account.[7]

5.5 DWP's plans to end the POCA contract appear, at least in part, to be driven by the potential to cut expenditure. Citizens Advice is concerned that as part of the process of migrating people from POCAs to bank accounts DWP may look to make additional savings by reducing the number of people paid by cheque. While we are supportive of efforts to increase levels of financial inclusion we do not wish to see people forced to open bank accounts where these are clearly not suitable.

5.6 People who have chosen to receive their benefits by cheque have clearly indicated their preference for this payment method and efforts to move them to open some form of account must be handled sensitively, paying attention to their needs, including the facility to nominate a second person to use the account on their behalf. If it is clear that cheque payment remains the most suitable method, and payment into a bank account would be likely to cause difficulties, then cheque payment should continue.

6. Access to Basic Bank Accounts

6.1 In terms of access to bank accounts, it is imperative that the process of opening the accounts is made much easier. This must include the need for greater flexibility over acceptable identification documents. Citizens Advice's report, *Banking benefits*, found that bank staff are frequently not willing to be flexible in the type of documents they are willing to accept. This was a significant issue reported by bureaux, with nearly a third of the case studies used to compile the report concerning problems with banks not regarding customers' documents as suitable or sufficient to prove identity and address. The impact of this can be substantial:

> A Somerset CAB's client had been offered a job and so needed to open a bank account to receive his wages. However, as he was homeless this proved impossible. The client found himself caught in a vicious circle in which he was unable to open a bank account without an address, he could not find a place to live without one month's rent and deposit, and yet could not start work without opening a bank account to receive his wages.

6.2 Since most banks refuse to offer basic bank accounts to people who are in debt or who are undischarged bankrupts[8] there is a significant risk that migration from POCAs (which have no restrictions on who can open an account as long as they are in receipt of a state pension or benefit) to bank accounts may create a new underclass of unbanked people. Banks' refusal to open basic accounts for those in debt seems to stem from their use of credit scoring but is unwarranted since these accounts offer no credit. To counter this, full credit scoring should not be used to determine access to a basic bank account.

> A CAB in Cumbria recommended that their client open a basic bank account. However, he was only allowed to open a savings account. When the bureau called to query this, they were informed that the bank submits all applications to credit scoring and credit reference agency checks.

> A CAB in Wiltshire had a client who was experiencing debt problems so was given advice to open a basic bank account. However, he was refused an account as he had a bad credit history. This meant that the client was unable to take steps to deal with his debt—he did not wish to make payments to his existing account as the bank would use them to pay off his non-priority debts to the bank, at the expense of paying his other, more pressing creditors.

> A Surrey CAB reported that a man who was too ill to work needed to claim incapacity benefit when he had used up all his savings. The Jobcentre told him to open a new basic account for payment of his benefits. The client sought advice when he was turned down by two banks because of a poor credit record.

[6] http://www.publications.parliament.uk/pa/cm200506/cmhansrd/cm050704/text/50704w19.htm

[7] http://www.publications.parliament.uk/pa/cm200506/cmhansrd/cm060227/text/60227w67.htm#60227w67.html—sbhd3

[8] For details, see Basic bank accounts—your questions answered, FSA, October 2005.

6.3 A key factor in people's decision to opt for a POCA instead of a bank account has been the ability to withdraw one's benefit payment over the counter at a Post Office branch. DWP maintain that customers will still be able to collect their benefit or pension at the Post Office by using their bank or building society account there but at present some of the big banks—notably HSBC, HBOS and RBS group—do not offer this facility, meaning that about 60% of personal bank accounts are not accessible at the Post Office.

6.4 Enabling all bank customers to withdraw their money from the Post Office would not only provide greater convenience for bank customers but would potentially throw a lifeline to rural post office branches that have seen a major reduction in their business following the introduction of direct payment.[9] Those that are offered this facility place great value on it: in research carried out for PostComm by Hall and Partners Europe Ltd, partner bank customers were asked whether they believed that the cash withdrawal service at the Post Office was a good thing, and "89% were positive about the service; 48% said the Post Office was more convenient than using a bank branch; 38% said it was more convenient as they were using the Post Office for other reasons anyway; 36% said that the Post Office is closer."[10]

6.5 Citizens Advice recommends that people should be able to open basic bank accounts in post office branches, and that all current account holders should be able to withdraw cash over the counter at Post Offices. It appears that individual banks are unwilling to reach an agreement with Post Office Ltd to allow their customers to withdraw cash from the post office network, and Post Office Ltd's application to join the LINK network in order to achieve this by another means to enable this to happen. The income generated from this venture could help to make a significant contribution towards sustaining the network of rural post offices, which are a valuable community resource.

6.6 One of the principal reasons given by banks that do not enable their current account holders to access their accounts at Post Office branches is that the Post Office must be viewed as a competitor since it now offers a range of financial products.[11] This follows the Post Office's move into the provision of financial services as part of an attempt to provide alternative income streams to replace the income lost by cashing benefit order books and girocheques.

6.7 However, recent research from the National Federation of SubPostmasters seems to call this decision into question. The NFSP's research reveals that sales of Post Office financial services including personal loans, credit cards, instant saver accounts, guaranteed equity bonds, growth bonds, child trust fund, car insurance and home insurance generated an average of just £7 per month income for subpostmasters, while 58% of subpostmasters received no income whatsoever from such sales.[12] Citizens Advice notes that the Post Office is still a fairly new entrant into the provision of financial services products, but we are concerned that this policy seems to be impeding progress in allowing all bank account holders to access their cash for free at Post Offices, without providing significant benefits to subpostmasters and by extension the Post Office network.

6.8 In 2000 the Performance and Innovation Unit's report "Counter Revolution—Modernising the Post Office Network" noted "although virtually everyone uses a post office from time to time, post offices' most frequent customers are older and poorer people."[13] Citizens Advice considers that this remains the case, and that such people are also likely to be most reliant on their PO branch. We are therefore unconvinced by POL's strategy of mimicking other providers' products and offering an increasing range of financial services products targeted at the middle-income market. In our opinion, POL may be better served in considering more innovative ways in which to tackle financial exclusion and serve its most loyal customers, notably the elderly and those on low incomes.

7. Free Access to Cash

7.1 The ability to withdraw cash over PO counters provides one important method by which people can withdraw their cash without incurring any fees. Another way is through using free cash machines, and here the Post Office network has a unique opportunity to provide an alternative means of free access to money for low-income consumers, reducing the reliance on charging machines. In particular, the Post Office network boasts:

— a large network of over 14,000 branches, which means that over 93% of people in the UK live within a mile of a Post Office;

— a large existing customer base, with over 28 million customers using the Post Office each year; and

[9] The National Federation of Subpostmasters/MORI research on subpostmasters' pay showed that before the introduction of direct payments around 40% of Post Office business had previously derived from benefits and pensions. "Building a viable network—fourth annual report on the network of post offices 2003–04", Postcomm, October 2004, p 55.

[10] Building a viable network—fourth annual report on the network of post offices 2003–04, Postcomm, October 2004, p 28.

[11] For example, Sir Fred Goodwin, RBS recently stated "The Post Office is in active competition with us . . . the Post Office is a competitor in the same way as the people here are competitors, so I do not like to put in place arrangements for our customers to use their counters either". Uncorrected transcript of Oral Evidence taken before Treasury Committee's inquiry into Financial Inclusion, 18 May 2006.

[12] SubPostmaster Income—Wave 3, Research Study Conducted by Ipsos/MORI for The National Federation of SubPostmasters, February–March 2006.

[13] Counter Revolution—Modernising the Post Office Network, PIU Report, June 2000, p 22.

— extensive representation in rural locations—while only 4% of villages have a bank branch, 60% have a post office branch.

7.2 In this context, it was extremely disappointing that a large number of PO branches previously installed fee-charging cash machines, which charged £1.50 on average to withdraw money. Citizens Advice's recent report, *Out of pocket*, drew attention to large numbers of "free cash machine deserts"—areas without any access to free cash machines.[14] In many of the "free cash machine deserts" there is a Post Office branch which has an ATM that charges a fee.

7.3 We are pleased to note that recent announcements from POL's have committed them to reverse the installation of fee-charging machines and to roll out 1,500 free cash machines in PO branches. However, of the 2,500 ATMs currently in use across the Post Office network, 72% remain fee-charging. We urge POL to roll out the free ATMs as promptly as possible, with preference given to areas of financial deprivation where there are no other free ATMs at present.

8. Impact on Post Office Network

8.1 Finally, if the contract for the POCA is not renewed after 2010 it will remove another important revenue stream for subpostmasters. The NFSP's research found that POCA transactions brought in an average of £249 income for subpostmasters per month, which amounts to 10% of their net pay. Subpostmasters in urban deprived areas are most dependent on card accounts as a source of income, as POCAs bring them an average of £403.[15]

8.2 The removal of the POCA will therefore threaten the profitability of certain Post Office branches, particularly those in rural or urban deprived areas, at a time when the future of the subsidy for rural post offices is under review, and where the threat of a wave of branch closures cannot be ruled out. The impact of PO branch closure can be severe, as the cases below demonstrate:

> A rural CAB in East Sussex reported that the closure of a local post office branch meant that their client—an 86 year old widower who looked after her semi-housebound sister, aged 91—would have to travel over one mile to her nearest post office or banking facilities. The difficulty in accessing basic services was causing the client great inconvenience, worry and stress.
>
> A CAB in Mid-Wales' client found that following the closure of the village post office there was a severe downturn in passing trade at her discount store, so she had to close the business. As a result of this, the client had to go bankrupt and is now unemployed and in receipt of incapacity benefit.

8.3 Citizens Advice recommends that the future of the POCA, and the revenue streams it generates for subpostmasters, must be considered in any discussion of the future of the Post Office network.

July 2006

APPENDIX 3

Memorandum by the Communication Workers Union

1. The Communication Workers Union represents 250,000 employees in the postal, telecoms and related industries. It is the recognised union in Royal Mail for all non-management grades, including those responsible for the collection, sortation and delivery of letters and parcels.

Background

2. In June 2006, the Trade and Industry Committee announced plans to hold a follow up to previous enquiries into the Royal Mail Group. The committee said it intended to follow up the inquiry into Royal Mail after liberalisation by concentrating on three key areas:

(i) the extent to which the refinancing package announced by the Government will help Royal Mail to pay for modernisation and deal with the pension fund deficit;

(ii) the structure of the "shares" scheme proposed by Royal Mail managers, and its implications for the future of the Royal Mail Group; and

(iii) the future of the Post Office Card Account and the effects on the Post Office Network.

3. The Committee has asked for view on these issues in advance of the oral hearing scheduled for Tuesday 18 July 2006.

[14] Out of pocket—CAB evidence on the impact of fee-charging cash machines, July 2006.

[15] SubPostmaster Income—Wave 3, Research Study Conducted by Ipsos/MORI for The National Federation of SubPostmasters, February–March 2006.

REFINANCING PACKAGE

4. The CWU have consistently argued that the question of investment is by far and away the most important issue facing the industry. All commentators and industry stakeholders recognise that (whatever happens in relation to competition) we will still need a healthy, viable Royal Mail if the UK is to have an effective national postal service in the future and that means tackling the legacy of chronic underinvestment.

5. Throughout Postcomm's consultation on the 2006 price control[16] the CWU pressed the case for concrete action to correct the years of underinvestment, address the underlying problems of the company's ageing infrastructure and to permanently raise the status and value of postal workers' jobs.[17] Accordingly we argued for an RPI + Y allowance for further defined investment that would deliver the necessary corrective investment in facilities, machinery and the workforce.

6. We therefore strongly opposed Postcomm's original price control ruling of RPI minus 3% which would have required Royal Mail to substantially reduce its overall prices for stamped products despite the fact we continue to enjoy among the cheapest postal prices in Europe.

7. While we welcomed Postcomm's revised price control formula (RPI—0.1%)[18] we still believe this fell short of delivering the extra investment Royal Mail needs. We therefore welcomed the Government's announcement of £1.75 billion investment in Royal Mail to finance its modernisation plans and deal with the deficit in the pension scheme.[19] The Government made a commitment in its election manifesto to make Royal Mail a success in the public sector and we believe the refinancing package is an important first step in that direction.

8. However, the CWU still need to see the full details of the investment package to establish exactly where the money will be spent and be sure that any proposals do not have a detrimental impact on the pensions of existing or future employees.

9. Against the backdrop of an expanding postal industry, investment is critical to enable the business to meet the expected growth in mail volumes and delivery points and to improve quality of service. Royal Mail must look to expand the industry and introduce the new products and services the major mail users have consistently said they would like to see introduced. Examples include evening re-deliveries and same day and timed delivery services.

10. As well as modernising and improving Royal Mail's product portfolio and service standards, new investment must also be directed at Royal Mail's "greatest asset"—its workforce. In our recent membership consultative ballot, over 95% said they supported the union's vision to raise the status and value of a postal worker's job. That means tackling low basic pay rates (which are currently £80 pw below the UK average of £395.60), improving training and development arrangements (to enhance the security and integrity of mail), providing more modern offices and equipment and defending our members' final salary pension scheme. The CWU are therefore keen to understand the precise details of Royal Mail's spending plans and ensure the company works with the union in agreeing the timetable and framework for future change within Royal Mail and ensuring it spends the money wisely so we can deliver improvements for both customers and staff. However we are concerned that the process of modernisation could lead to the loss of up to 40,000 jobs and a sharp deterioration in service standards.

11. In relation to pensions, the size of the Royal Mail pension fund deficit is clearly a matter for concern for the CWU. Pensions in payment are deferred wages and form an integral element of the remuneration package. The well-being of the company's employees once they retire is dependent on the ongoing viability of the pension fund. It is also absolutely apparent that addressing the deficit is key to securing Royal Mail's own future and in particular its ongoing ability to meet its universal service obligation. We therefore welcome the additional refinancing to deal with the deficit which includes the release of £850 million of the Royal Mail Reserve for the company to transfer into a pension escrow account that may be drawn on by the pension trustees in the event the company should fail.

12. While the CWU welcomes this additional provision, it is important to remember that the Government took billions of pounds out of Royal Mail over the past 40 years and the company took a lengthy pension contribution holiday. We therefore believe that Government and Royal Mail have a moral obligation to deal with the deficit.

13. The CWU also notes the recent deal struck between Royal Mail and the pension fund trustees in which Royal Mail will pay up to £750 million annually for 17 years into the 450,000 member scheme.[20] Our concern is how Royal Mail intend to meet this financial commitment and whether this is to be paid for by ending the final salary scheme for new entrants and/or forcing members to retire later, make greater contributions or suffer worsening benefits.

[16] "2006 Royal Mail Price Control and Service Quality Review: Initial Proposals", Postcomm, June 2005.

[17] "Postcomm's Initial Proposals for Royal Mail's Price Control and Service Quality Review", CWU Submission, August 2005.

[18] "Postcomm confirms price and service quality controls for Royal Mail", Postcomm press release, 14 March 2006.

[19] "New Royal Mail Financing Framework Announced" DTI Press Release, 18 May 2006.

[20] "Royal Mail acts to honour pensions", *Daily Telegraph,* 21 June 2006.

Shares

14. The CWU clearly favours a greater degree of employee involvement in the running of the business and a permanent share in the success of Royal Mail. But the degree and nature of employee involvement and the form and timing of any reward scheme must be a matter for negotiation and agreement with the employees' recognised trade union—not debated through the national media.

15. To date the CWU has seen no proposal from Royal Mail managers on the structure of any share scheme. All we have seen are a series of press reports which refer to Allan Leighton's proposal to release £1 billion of equity to private individuals which he describes as giving a 20% stake to the workforce.

16. The CWU have a number of serious concerns about the principle and practical application of Leighton's proposed share scheme. We believe the option of issuing private shares to individual staff is a particular form of privatisation. It changes Royal Mail's ownership structure and is a clear breach of Labour's election manifesto to keep Royal Mail 100% in public hands. Given Labour's explicit manifesto commitment we believe Leighton is abusing his position as chair of a public corporation to push for a change of ownership. This is for Government not Leighton to determine. Issuing shares represents a sugar-coated pill on the road to future privatisation of the industry. The experience from other privatisations of UK utilities is that the issuing of shares is an opening step which ultimately leads to further share issues and eventual privatisation.

17. Shares will be a costly distraction from the real challenges facing Royal Mail. Issuing shares will do nothing to raise revenues and help tackle the real problems of chronic underinvestment, a record pensions deficit and the threat from private competition.

18. The CWU want workers to have a stake in the company they work for but we don't believe this can only be done through issuing shares. We reject the suggestion that postal workers do not currently have an interest or "stake" in the business. Employment in the industry, wages and a guaranteed pension represent a massive investment for all employees.

19. There is little support for Leighton's share plan among Royal Mail's workforce. Despite offering "free shares" to staff, extending the balloting deadline and boosting the return by including Royal Mail managers and sub-postmasters, just one in three (37%) of the workforce have actually registered their interest in shares—hardly the ringing endorsement Leighton was seeking. Moreover, our own poll of members found 98.5% in support of the CWU's alternative agenda of higher basic pay, a better work-life balance and fairer workloads, maximising job security and safeguarding pensions.

20. In our submission to the Bain Review[21] the CWU signalled our willingness to enter into a serious debate about employee involvement aimed at improving efficiency and raising the status and financial rewards of postal workers. But there is no clear evidence that share schemes will actually improve productivity. Indeed, postal workers have already delivered record levels of service quality without a 20% stake in the business.

21. Leighton's proposals could actually prove divisive and demotivating as the lowest paid staff sell their shares for an instant financial return. This will create a situation of "haves" and "have nots"—those who sell their shares will have no stake in the business and no prospect of one in the future. There is also a risk that senior managers and executives on higher incomes will look to buy up large tranches of shares over time.

22. Leighton's share proposal would be an impractical and inappropriate model for Royal Mail. This view is also supported by the Job Ownership Ltd (JOL), the voice of employee owned business. In a recent report, the JOL argued that a collective profit share would be a far better model for Royal Mail than imposing an individual share plan which it said was "inappropriate" in the context of a publicly-owned Royal Mail and collective bargaining with a recognised trade union.[22]

23. The CWU believe that Royal Mail have failed to make the case to support Leighton's share plan. Instead of embarking on a costly, time consuming and potentially damaging debate about issuing shares, it may be better, as the *Financial Times* recently suggested, to adapt and agree the current *Share in Success* scheme—which is a straight profit sharing scheme—and perhaps look to add in quality of service measures and even some form of savings plan.

Post Office Card Account

24. The CWU is deeply concerned at the decision by the Department for Work and Pensions to withdraw the Post Office Card Account when the existing contract expires in 2010. This decision will have serious consequences for the finances of Post Office Ltd and our members' job security.

25. The Post Office Card Account represents an important element of any Post Office's customer traffic and income. The figures show that nearly five million people a week in the UK chose to use a PO Card Account as a convenient way to collect state benefits.

[21] Delivering Quality: CWU Submission to Sir George Bain, November 2005.

[22] "A Stake in the Post: Making employees stakeholders in Royal Mail", Maoiliosa O'Culachain and David Farfar, Job Ownership Ltd, September 2005.

26. Since the announcement, the CWU has been actively seeking meetings with the DWP over their decision to ensure the Government recognise the true value of Post Offices as a focal point for many communities and the damaging impact the loss of the Card Account and the estimated £1 billion of revenue will have on the long term viability of such a valuable public asset.

27. We are particularly concerned by the Department's attempts to kill off the Account in advance of 2010 through pilot schemes being introduced immediately and without consultation which will:

— deny to new benefit claimants the option of opening a PO Card Account;

— inform 35,000 existing customers that they will have to use a bank or building society instead of the PO Card Account and require them to provide their account details; and

— pay benefits of 2,500 existing customers into a bank account rather than the PO account, ignoring the preferences they made when their benefit books were stopped.

28. Post Office Ltd is facing its most difficult and challenging financial period in its history. At a time when the business is already struggling with the financial impact of the Government's decision to transfer the payment of state pensions and benefits to Direct payment into bank and building society accounts, the DWP's decision to withdraw the PO Card Account will have a further and immediate detrimental impact on revenue and raise serious questions about POL's long term commercial viability.

29. The CWU believe that the Government should halt the pilot schemes immediately and institute an immediate review of the DWP's proposal to abolish the PO Card Account by 2010. The CWU believe the Government should recognise the vital economic and social role the Post Office Network plays in local communities throughout the UK and makes a commitment to provide the long term investment needed to safeguard the existing network, develop its role as the "shop front" for Government services that offers a greater responsiveness to the demands of local communities.

10 July 2006

APPENDIX 4

Supplementary memorandum by the Communication Workers Union

Background

1. On Tuesday 18 July 2006 the Communication Workers Union gave oral evidence to the Trade and Industry Select Committee's inquiry into Royal Mail. In the course of our evidence the Committee asked the CWU to:

— provide additional information on the CWU's consultative ballot of members and the response to Royal Mail's letter to staff asking them to register an interest in share ownership; and

— respond to the research evidence provided by Royal Mail and the DTI purporting to show the benefits of employee ownership on company performance.

CWU Consultative Ballot

2. In May 2006 the CWU held a national consultative ballot of our members working in Royal Mail Letters. The ballot was an attempt to gauge members' support for the CWU's vision for the future of the industry for higher basic pay, job security, pensions and fairer workloads.

3. We sent our branches ballot papers to distribute to all members working in Royal Mail Letters—around 136,000 in total. The ballot commenced on Monday 8 May and closed on Friday 19 May. Out of the 91,478 ballot papers returned, a massive 98.5% (90,103 members) voted yes in support of the CWU's vision to raise the status and value of a postal worker's job. This high rate of return was in spite of management's attempts to undermine the consultative ballot.

4. To reinforce the consultative ballot, the CWU also engaged an independent company to carry out a professional telephone poll. Out of 1,000 members contacted, 949 supported the CWU's workplace agenda.

5. Royal Mail's decision to write to all employees on the question of shares was taken as a direct response to the CWU's own consultative ballot. At a press conference on 18 May 2006, Royal Mail chair Allan Leighton announced that 80,000 employees had registered an interest in share ownership.

6. A return of 80,000 out of a total Royal Mail workforce of 212,000 (based on 2005 staffing figures) represents a return rate of just 37%. (Using more recent 2006 staffing figures in RM's latest Annual Report produces a revised figure of 38%). Clearly this return rate was not the ringing endorsement the chairman was hoping for. It is also important to realise that:

— in an attempt to pressure staff and boost the return, Royal Mail's letter was misleading in that it asked employees to register an interest in order to "receive your free shares". This implied staff would miss out on a huge amount of money if they didn't return the form, when the reality is that only the Government can sanction a change of ownership;

— in order to boost the return, the shares letter was also sent to around 13,000 sub-postmasters (who are not even direct employees of Royal Mail) and to thousands of managers across the company;

— in an act of desperation, the original deadline imposed by Royal Mail was extended when only 30,000 responses were received. At this point the goalposts were shifted and managers were instructed that they could register employees themselves directly by email; and

— Royal Mail's letter presented shares as a free gift for all employees without telling our members that their privatisation plans are directly linked to up to 40,000 job losses.

7. As chair of a public corporation we simply don't feel it's right and proper for Allan Leighton to be pushing the case for a change of ownership. We are aware of no part of Royal Mail's Memorandum and Articles of Association that permit it to survey staff on changing the ownership structure of Royal Mail, and have seen no information on the costs Royal Mail have incurred developing their share plan, consulting with staff and seeking any expert independent financial advice.

Employee Ownership

8. The Committee asked the CWU to respond to any research evidence on the success of employee ownership and, in particular, its success relative to other profit share arrangements. Royal Mail's written evidence to the Committee offers no specific examples or information to support its claims for employee ownership. While we would be happy to comment on any such evidence as and when it's provided, we are unable at this stage to respond directly to any written evidence provided to us.

9. However, we do wish to respond to the general question about the success or otherwise of forms of employee ownership, and deal directly with the specific example referred to by Royal Mail in their oral evidence on 18 July, namely the experience at Eirecom the Irish Telecommuniations company (the actual transcripts of the hearing on 18 July refer to Viacom but we are assuming this was an error in the transcription).

10. In general terms, assessing the impact of any particular pay and reward strategy on business performance is notoriously difficult. There is very little evidence to show a direct causal relationship between any particular pay input on the one hand and improved productivity and performance on the other. The effectiveness or otherwise of any reward strategy is dependent on a whole range of factors beyond simply the pay element. Work environment and culture, the degree of employee involvement and participation, the approach an organisation takes to managing performance, communications and staff development all influence the effectiveness of any pay plan.

11. In determining the success or otherwise of employee ownership, one first needs to understand that the term can cover a wide variety of arrangements from full employee ownership (the John Lewis Partnership) to various part-ownership arrangements. But whatever the particular model all the evidence on the experience of employee ownership shows that real improvements to company performance are bound up not simply with financial incentives but with a whole raft of other measures designed to give employees greater involvement and participation in business decision-making. As the recent report by the Job Ownership Limited (the association of employee-owned and trust-owned businesses) noted: "International research consistently shows that a combination of extensive employee stakeholding with real workforce involvement produces superior productivity and profitability compared with other companies."[23]

12. All the evidence suggests that the success of employee ownership is contingent on the active engagement and support of employees. "Employee ownership can't be successfully imposed without the assent of key stakeholders". According to the JOL, the research evidence shows that "harmonious, productive industrial relations and employee engagement" can only be achieved "when a meaningful equity share is coupled with far-reaching employee involvement and participation." Moreover the JOL argue that successful partial or extensive employee ownership is "inconceivable without the active participation of unions and their members in the process."

13. Allan Leighton's share plan is not based on proper consultation or partnership with the recognised trade unions. To date, the CWU have seen no formal proposal on any share plan and are aware of no measures or proposals from Royal Mail designed to increase employee involvement or participation in the business. Without any discussion or agreement with the CWU, Leighton is hoping to get approval from Government for his share plan and then impose it on the workforce. The key point is that any new pay or productivity scheme should be a matter for full consultation and negotiation with the CWU. Our earlier oral and written evidence (paras 14 to 23) reaffirmed the basis of our opposition to Royal Mail's share plan.

[23] "A Stake in the Post: Making employees stakeholders in Royal Mail", Maoiliosa O'Culachain and David Farfar, Job Ownership Ltd, Sept 2005.

14. Royal Mail's approach represents the very antithesis to real employee ownership where the workforce are consulted properly on any plans from the outset, the union is closely involved in developing new forms of participation and involvement (that give employees a greater say in future business planning and decision making) and there is a meaningful process of negotiation and agreement with the recognised trade unions.

15. At the oral hearings on 18 July 2006, the DTI Minister, Jim Fitzpatrick, made reference to the experience of employee ownership at Irish telecom company Eircom. But in this case, the plans for employee ownership came from the trade unions themselves which proposed a whole package of other measures designed to increase employee involvement and participation. Any financial benefits of share ownership have been inextricably tied to a wider series of measures which give employees a real and meaningful say in the running of the business.

16. In terms of the success of employee ownership relative to other profit share schemes no specific research is available since it's very difficult to compare "like-with-like" and separate out and quantify the impact of any specific pay incentive relative to other key determinants of company performance (automation, skills and training, management communications and performance management, workplace environment and culture, etc).

22 August 2006

APPENDIX 5

Memorandum by the Department for Work and Pensions

1. Introduction

This memorandum is submitted by the Department for Work and Pensions (DWP).

Financial exclusion is one of the key factors in wider social exclusion. In 2002–03 1.9 million households (which equates to around 2.8 million adults) in the United Kingdom were without a bank account of any kind. Households that operate solely on a cash budget are unable to make savings via direct debits on utility bills; are more vulnerable to loss or theft; and they are far more likely to use the alternative credit market—and pay interest many times that of a standard personal loan—often contributing to spiralling debt.

The majority of households in the UK now have access to, and make use of, mainstream banking and consumer credit facilities such as high street bank accounts, credit and store cards, unsecured personal loans or hire purchase. However, there are still many people and households who have no access to banking services and this imposes costs on both individuals and society.

DWP has an important role to play in tackling financial exclusion but its main contribution to financial inclusion is focused on improved access to banking and affordable credit. In line with our wider policy on financial inclusion, the Department has always made it clear that payment into a bank or building society account is the best option for the overwhelming majority of customers. Encouraging benefit recipients and pensioners to make greater use of existing bank accounts or open new ones is a key element of the Department's strategy to improve financial inclusion. It provides people on low incomes with access to savings on their fuel bills through making payments by direct debits; the ability to cash cheques free of charge; access to cheaper credit; and it helps people of working age show employers that they are "job ready".

The move to Direct Payment and the introduction of universal banking services, which started in April 2003 and was completed in March 2005, has resulted in increased customer choice, is helping to improve financial inclusion and has brought banking services into many rural/urban deprived areas for the first time. It has significantly improved access to banking services to groups who have traditionally been financially excluded such as the long-term unemployed and Muslim women.

In April 2003, 15 million of the Department's customers were paid by order book or giro. Now around 16 million customers have payments made directly into an account and fewer than 400,000 are being paid only by cheque. Within the Department, the proportion of customer's benefits paid by Direct Payment has increased from 43% in April 2003 to around 98%. DWP provided help and support for those people who needed to open an account for the first time.

Millions more pensioners, mothers, disabled people, carers and jobseekers are enjoying the greater choice, safety and savings Direct Payment brings. The results of independent research show that there are very high levels of satisfaction amongst customers who have transferred to Direct Payment with 93 per cent stating they were happy to receive their benefits in this way.

2. Post Office Card Account

The Post Office card account is part of the wider universal banking services scheme, and was introduced in April 2003 to help support the conversion of some customers from having their benefit or pension paid by order book to having their money paid directly into an account (Direct Payment).

The Post Office card account is a simple account with limited functions. It can only receive payments of benefits, pensions and tax credits. The Post Office card account does not, for example, allow customers to make savings on fuel bills by paying by direct debit; it cannot receive payments of wages; cheques cannot be paid in; and the account does not pay interest on balances.

For the purposes of defining financial inclusion, Post Office card account holders do not have access to the same benefits and savings to those who hold mainstream banking products, and so are not considered to be financially included ie banked. Around 3.7 million DWP customers are paid into a Post Office card account.

Although the Post Office card account was designed for those who did not already have a bank or building society account, 70% of people who have opened one already have such an account. The remaining 30% have shown that by managing to open and operate a Post Office card account, they should be able to use other easy-to-operate banking products, including basic bank accounts, which are widely available and accessible at post office branches. We also plan to put in place arrangements to provide help and support for customers to open new bank accounts when appropriate.

The Post Office card account has allowed some customers to move from receiving their benefit or pension through cashing an order book at the post office counter, to getting used to the basics of banking. In practice, there is no real difference in accessing money at the post office via a bank account compared to a Post Office card account. Customers can collect the same money, on the same day as they do now at the post office, by using a plastic card and a personal identification number.

Government funding for the Post Office card account will end in March 2010 as was always planned. We want people to continue to access their cash at the post office and are working with Post Office Ltd and other stakeholders on what options will be available to customers after the card account ends, including the form of any alternative products to the Post Office card account. All existing Post Office card account customers will still be able to use the post office to collect their benefit or pension if they wish by using a bank account there and Post Office Ltd will still receive a payment for providing this service. Around 25 or so different bank accounts can be accessed at post office branches now, and we hope there could be more in the future.

There is no reason why the end of Post Office card account funding in March 2010, as always planned, should automatically lead to post office closures. There is also no reason why Post Office Ltd should not be able to retain the business of existing Post Office card account customers if it offers them the services they want, or, indeed, if it improves on what is currently available via a Post Office card account through its own new products.

The rapid pace of change throughout financial services presents unavoidable challenges for Post Office Ltd, but also brings opportunities for new business. That is why it is important that the Government, Post Office Ltd and sub-postmasters should work closely together to ensure customers are fully aware of developments, and continue to have a range of choices in how they access their money. The Post Office is a strong brand, with a high level of customer loyalty. However, the business still needs to modernise its services and to be sure it is offering the best available products to its customers. There have been claims that there will be significant post office closures or that customers will no longer be able to collect their benefit or pension at the post office. Such claims are misleading, are worrying customers unnecessarily and are not in Post Office Ltd's own interests.

The contract for the Post Office card account was signed by DWP and Post Office Ltd in March 2002. It was clear in the contract that Government funding for the Post Office card account would only continue until 31 March 2010. The Government will pay around £1 billion for the Post Office card account over the lifetime of the contract. The contract also obliges both Post Office Ltd and DWP to help migrate customers to alternative accounts during the seven-year period of the Post Office card account. It costs DWP 1p to make a payment into a bank account compared to around £1 into a Post Office card account. And 80% of our payment costs go on the 23% of customers who are paid by Post Office card account.

With four years of the Post Office card account contract remaining, both Post Office Ltd and DWP now feel it is the right time to begin widening the choice of alternatives and helping people to make the straightforward move to new accounts, both those already available at post offices and those which Post Office Ltd itself is planning to introduce.

Post Office Ltd itself accepts the limited functionality of the Post Office card account and that an alternative product could and should do more to improve financial inclusion, as well as providing the Post Office with new income. At the Treasury Select Committee Inquiry into financial inclusion on 9 May 2006, Alan Cook, the Managing Director of Post Office Ltd said:

> "You cannot do much with it at all, you go to a post office, you take the cash out. If you take too much out by mistake you cannot put any back in. It literally is an encashment vehicle. I think we can produce a card account that has more capability, which would enable you to access cash in

> different ways and pay bills. I believe that would be a big step forward for current customers that we regard as socially excluded who do not wish to make, for whatever reason, the bigger step towards taking out a current account. We could produce a successor vehicle."

We are working with Post Office Ltd to move people from the Post Office card account into the financial mainstream. Post Office Ltd has introduced one new savings account, and is developing other savings and banking products which are likely to be more attractive to many of its customers than the current Post Office card account. More can be done for financial inclusion if these new products are better targeted on the customers without bank accounts, and perhaps offer some services the Post Office card account does not, for example, the ability to pay in cash and cheques.

3. Looking Ahead

Recent discussion has very much focussed on the end of Post Office card account funding in March 2010. But this does not mean that customers will no longer be able to access their cash at the post office or that post office branches will automatically close. Rather than focus on one particular product which has served its purpose, we believe we now need to move the debate forward to look at what arrangements need to be put in place in the future.

We aim to ensure that every DWP customer who currently collects their benefits from the post office will still be able to do so free of charge if they wish—around 25 different bank accounts can be accessed at post office branches now, and we hope there could be more in the future.

Customers will be best served if DWP and Post Office Ltd work together with the best interests of our joint customers in mind as we develop our plan to move people from the Post Office card account. Our priorities will be to ensure that this is a straightforward process for the customers themselves and to help Post Office Ltd manage the transition from Post Office card accounts to other products. Post Office Ltd has already introduced one new savings account, and is developing other savings and banking products which are likely to be more attractive to many of its customers than the current Post Office card account.

We accept that there must be appropriate products in place for vulnerable customers when the Post Office card account ends in 2010. We are working with Post Office Limited and others to make sure there are. But Post Office Ltd's own research shows that Post Office card account customers have differing needs and circumstances. They range from some vulnerable groups, to those who do not depend on their pension or Child Benefit but let large balances build up.

It is very likely, therefore, that we will be looking at a range of alternative accounts. For some people, using an existing bank account may well be the right answer. Many of these can be used at the post office, still generating income and other business for the sub-postmaster. Most of the big banks also offer basic bank accounts, which are very similar in day to day operation to a Post Office card account, and all with post office accessibility.

Those who allow large balances to build up in their Post Office card account would be better served by a savings account, such as the Instant Saver Account which Post Office Ltd introduced on 3 April 2006. Post Office Ltd will be starting a three month trial in early July when it will be writing to 10,000 existing Post Office card account customers (with £500+ balance and who do not make frequent withdrawals) to encourage them to open one of its new Instant Saver accounts.

Clearly some will still need a product more like a Post Office card account, because they cannot manage or do not wish to have a bank account. Even there, we could do more for financial inclusion if the alternative products were better targeted on the customers without bank accounts, but perhaps offered some services the Post Office card account does not, for example, the ability to pay in cash and cheques.

None of this is going to happen overnight. The Post Office card account still has several years to run. But the responsible thing to do now is to start planning for the world of 2010 and beyond, and this is exactly what we and Post Office Ltd should be doing, and are doing, as we are contracted to do.

4. Pilot Exercises

The Department for Work and Pensions ran a number of small-scale Post Office card account pilots between 13 February and 10 March 2006 to test various approaches to moving people from having their benefit or pension paid into a Post Office card account to payments into a bank account. Our emphasis was on those bank accounts which can be used at Post Office branches, to help Post Office Ltd manage the transition from Post Office card accounts to other products.

The pilots were designed to gather information about customer needs to help plan a smooth transition between now and 2010 when the Post Office card account contract ends. Our aim was to see how customers would react, including how many people would continue to use the Post Office, and how much we can contribute to the wider financial inclusion agenda by encouraging some people to open a bank account for the first time.

Nationally, the pilots affected less than 1% of Post Office card account customers. The pilots involved:

- we did not promote the option to open a new Post Office card account for a small number of customers making a new claim for Jobseeker's Allowance, State Pension or Pension Credit;
- we wrote to a small number of customers paid by Post Office card account asking them to supply account details; and
- we wrote to a small number of customers who have one benefit paid into a Post Office card account and another into a bank account saying that we intend to pay both their benefits into their bank account.

We have already shared the key findings with Post Office Ltd to help them identify customer needs as they develop new savings and banking products which are likely to be more attractive to many of their customers than the current Post Office card account.

A summary report of the findings will be placed in the House of Commons Library before the summer recess.

July 2006

APPENDIX 6

Memorandum by the Department of Trade and Industry

INTRODUCTION

1. The Department welcomes this inquiry which looks at significant issues that are potentially key to the development and future of the Royal Mail and the Post Office network.

2. This Memorandum is intended to provide the Committee with some helpful background and factual information on the proposed financial framework together with the latest position on that and employee incentivisation. We believe that it would also be helpful to reiterate our role as shareholder in the Royal Mail as this sets the backdrop for our approach to these issues.

3. We understand that the Department for Work and Pensions has provided the Committee with a Memorandum about the future of the Post Office Card Account.

GOVERNMENT'S ROLE AS SHAREHOLDER

4. The Shareholder Executive, located in the Department of Trade and Industry, has responsibility for the Government's shareholding in Royal Mail. The Executive was created in September 2003 with the overarching objective of making Government an effective and well-informed shareholder. Its remit extends to around 25 Government owned businesses with a combined turnover of around £20 billion. Its role is to advise Ministers and officials on a wide range of shareholder issues including objectives, governance, strategy, performance monitoring, Board appointments and remuneration. The Executive draws on the skills of both the private and public sectors to meet its objective.

5. The Shareholder Executive directly manages the Government's financial interests in Royal Mail. It takes full account of Government policy (which, of course, includes non-commercial objectives), but within this context, it seeks to use its discretion to act as a commercial shareholder. As set out in the 1999 Post Office Reform White Paper, this is an arm's length relationship to ensure that the management has the commercial freedom to run the business and the Executive does not seek to micro-manage it. The Executive has sought to increase Royal Mail's accountability to its owner and to ensure that the company delivers the shareholder's objectives. These objectives are:

- Royal Mail to be a best-in-class, publicly-owned postal service provider with robust, long-term, sustainable business health; and
- the delivery of government and other services effectively through an efficient and fit for purpose Post Office branch network which offers maximum access to those who need it.

PROPOSED FINANCE FRAMEWORK

6. This is a pivotal moment in the history of the Royal Mail. From 1 January 2006, the postal services market was fully liberalised by the independent regulator, Postcomm. Royal Mail now has to respond to the challenges that a fully open market represents. It has to be efficient and provide the quality of service that customers require so that it can maintain volumes and build on the turnaround that has taken place over the last four years.

7. Added to this the company also faces the challenge, as do many private sector companies following adverse stock market and bond conditions, changing actuarial assumptions and new accounting standards, of a very large pension deficit that stands at £5.6 billion. This pension deficit is the largest of any UK corporate.

8. In order to succeed under these conditions, the Royal Mail Board decided that it required access to finance to enable it to modernise the business while at the same time seeking to address the pension fund deficit. Royal Mail was asked to submit a business case to justify an investment by the shareholder in the company.

9. Following discussions between the shareholder and the company, an agreement in principle was reached on a new finance framework for Royal Mail that gives the company wider freedoms to use its resources and borrowing facilities to modernise and secure its future in the competitive market. It also provides stability for the pension fund and reassurance to those in the Royal Mail pension schemes.

10. As the Secretary of State announced in a Parliamentary statement on 18 May, the proposed financial structure includes:

— the release of £850 million of the Royal Mail Reserve for the company to transfer into a pension escrow account that may be drawn on by the pension trustees in the unlikely event that the company should fail;

— in principle agreement by Government to extend the existing debt facilities such that £900 million is available for use by Royal Mail on commercial terms.

11. The detail of the finance framework is still being discussed with Royal Mail and formal documentation has not been put in place. The shareholder's overriding objective in these discussions has been to ensure that the arrangements put in place are commercially based. During the period while the company is being transformed, the Government does not expect to receive a dividend but it does expect to receive a return on its investment through an increase in the value of the company. It is not the Government's intention to provide access to finance on un-commercial terms that could be construed to be illegal state aid and distort the newly liberalised market, and have received professional advice to that effect.

12. Once the loan facilities are in place, the management of Royal Mail will be able to access them as they see fit to carry out its transformation of the business through the investment in new machinery and to meet other restructuring costs. Royal Mail will also have access to funds generated through its business activities to invest in the company. The price control agreed with Postcomm allows for £1.2 billion to be invested by company in modernisation over the next four years.

13. In his statement, the Secretary of State also said that level of support for the post office network, beyond the Social Network payments of £150 million per annum until 2008, depended on decisions taken on the future of the network which the Government will consult on. This remains the position.

14. A copy of the Secretary of State's statement is attached at Annex 1 for ease of reference.*

Employee Share Scheme

15. As set out in its manifesto, the Government have no plans to privatise the Royal Mail.

16. The shareholder's position on an Employee Share Scheme remains unchanged since Barry Gardiner, then DTI Minister for Competitiveness, appeared before the Committee last November. He said then that "Royal Mail is not for sale" and that the Government would only consider an employee share scheme where the shares were held in trust and could not be traded on the open market. Within this context, the shareholder was prepared to listen to the company's ideas for such a scheme. The shareholder continues to believe that it is important for the workforce to be appropriately incentivised during this period of change in the company.

17. Since Barry Gardiner gave evidence to the Committee, the shareholder has received a proposal from the Royal Mail Board for an employee share scheme. We are carefully considering this proposal that involves the establishment of a trust and would not permit shares to be sold on the open market. No decision has, however, been taken to proceed with such a scheme. The Government has not set a timetable for its deliberations as we wish to carefully weigh up the pros and cons of such a scheme, taking views from a number of stakeholders, and to reach a decision that would be in the best interests of the shareholder, the tax payer, the company and its employees.

Post Office Card Account

18. Decisions on the future of the Post Office Card Account are matters for the Department of Work and Pension and we understand that the DWP is submitting a separate Memorandum on this to the Committee. We are currently considering with Post Office Limited the impact of the ending of the POCA in 2010 and this will be a factor in any decisions taken on the future of the post office network.

3 July 2006

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* Not printed, *see* HC Deb Col 65WS (18 May 2006).

APPENDIX 7

Supplementary memorandum by the Department of Trade and Industry

At my oral evidence session on 18 July, I promised to provide you with additional information on some of the points that were raised.

Post Office "Dividends"

You asked for a note on whether the Government took money out of the Post Office during the period of the pension holiday. As Barry Gardiner explained in his letter to you last December (published in Volume II of the TIC Second Report of Session 2005–06), the External Finance Limit (EFL) set for the Post Office did not constitute money received by the Treasury. The money generated under the EFL was retained in a reserve on the business' balance sheet and none was taken out of the company. Under the Government's Post Office reforms, the corporation was transformed into a public limited company in 2001 and was able to pay dividends to its shareholder. However, the shareholder decided to forego dividends in view of the company's poor financial performance around that time. I enclose for ease of reference the list of the EFL and dividends received since 1981–82 (ie from the BT/Post Office split) that was attached to Barry's letter (Annex A). The pension holiday ran from 1990–2001 to 2002–03.

The Government has allowed the reserve to be used mainly to support the post office network, for example to fund the Horizon project and to support the rural network through the Social Network. The intention is that the remaining funds in the reserve (£850 million) will be placed in an escrow account to help stabilise the pension fund. Any surplus cash could be paid over to Government in the future once the pension fund deficit has been recovered and the Royal Mail balance sheet is strengthened by successful operation.

Public Sector Classification

The Committee asked whether 95% of the shares in a company needed to be owned by Government for that company to be classified as public sector. The Office of National Statistics (ONS) has responsibility for classifying bodies in the public or private sector. The criteria that the ONS use to judge whether a body is public or private sector is control of general corporate policy. Most usually this is evidenced through the appointment process for the board, but can come through other means, such as contractual relationships or rights over key business decisions.

Transferring 20% of the economic interest in Royal Mail into a trust for the benefit of employees would not, on its own, lead to ONS reclassifying Royal Mail. Even if those 20% shares came with 20% voting rights, the majority voting rights would be held by the public sector, and so the public sector would still be able to exert dominant influence over the body and the classification would be unaffected.

POCA

You asked whether POL and the banks knew that POCA would not be renewed after 2010 at the time the contracts were signed.

An agreement was made with the banks to provide a contribution towards the costs of the Post Office Card Account for five years of the seven year contract. The banks, therefore, are committed to pay £182,250,000–£36,450,000 each year between them. DWP also has a contractual commitment to fund the POCA over the seven years of the contract. Government therefore funds the POCA until March 2010 and the banks provide a contribution to the costs until March 2008. That is what all the parties signed up to in March 2002.

While it was made clear to all parties that the contract would run for seven years to 2010, DWP could not have known in 2003 what new banking and savings products might be available in the future which would be suitable for POCA customers. The Government response to the 2002–03 TISC Inquiry 11th Report made this clear stating that it was the first year of a seven year contract and it was too early to speculate about what might happen in the future. At no time has DWP committed itself to an extension and none should have been assumed.

25 July 2006

Annex A

External Finance Limited/Dividends

(£m)

Year	*Post-Tax profit*	*EFL (paid into reserve on balance sheet)*	*%*
1981–82	96.2	12	13%
1982–83	138.5	60	43%
1983–84	118.9	62	52%
1984–85	112.2	100	89%
1985–86	99.5	75	75%
1986–87	132.9	93	70%
1987–88	121.4	80	66%
1988–89	102.5	102	100%
1989–90	3.0	102	–
1990–91	31.0	–	0%
1991–92	152.0	74	49%
1992–93	187.0	80	43%
1993–94	195.0	182	93%
1994–95	314.0	235	75%
1995–96	270.0	245	91%
1996–97	361.0	268	74%
1997–98	447	313	70%
1998–99	496	310	63%
1999–2000	(415)	151	50%
		Dividends	
2000–01	(44)^	0*	–
2001–02	(940)^	0	–
2002–03	(559)^	0	–
2003–04	7^	0	
2004–05	235̂	0	–

* A dividend of £93 million was declared but was not paid to HMG. It was placed in a reserve on the Royal Mail balance sheet alongside the accumulated EFL.

^ These figures represent (loss)/profit after tax and exceptional items.

APPENDIX 8

Memorandum by Help the Aged

We understand that your Committee is undertaking a brief follow-up inquiry into Royal Mail Group. Help the Aged would like to take this opportunity to make a number of comments in relation to your inquiry.

1. The Post Office Card Account (POCA) was launched in April 2003 as an alternative for those who could not or did not want to open a basic bank account when direct payments of benefits were introduced. In some ways, the POCA has been a major success and there are now around 4.3 million people receiving their benefits via a Post Office Card Account, of which approximately 40% are pensioners.

2. Help the Aged are very concerned about the impact the closure of the POCA will have on the post office network. The move towards direct payments of benefits removed more than £400 million of annual revenue from the post office network. This has played a part in the resulting closure of 2,500 post offices.

3. The POCA contract is worth around £1 billion to post offices between 2003 and 2010. The decision to end POCA will have a real detrimental impact on the long term planning for post offices across the country. Further Post Office closures will mean that vulnerable older people will have to increasingly rely on ATMs, some of which charge for access to cash.

4. The Post Office faces a number of other significant challenges, of which the end of POCA may be one of the most significant. The other threats include:

— The doubt over the future of the rural subsidy for the post office.

— Adam Crozier, Chief Executive of Royal Mail arguing that that he could meet the criteria set down for a full distribution of post offices with roughly 4,000 sub-post offices (there are presently in excess of 14,000).

— The proposal to set up 70 high street offices to vet and interview applicants for passports.

— The Post Office potentially losing its right to issue TV licenses.

— The Home Office decision not to allow post offices to be involved in delivering passport services.

— The Department for Transport not allowing some post offices to issue driving licences.

— Driver and Vehicle Licensing Agency advertising to purchase of car registration online, with no mention that it can still be bought at post offices.

We hope that you will consider these issues during your evidence sessions. We would welcome the opportunity to give oral evidence.

20 June 2006

APPENDIX 9

Memorandum by the Highland Council

I refer to the Trade and Industry Select Committee's follow-up enquiry into the Royal Mail Group and would like to take this opportunity to submit some comments for the perspective of the Highlands of Scotland.

The Highland Council recognises the inevitability of a rural post office reduction programme, however it is important that the government, with Post Office Ltd, seeks to sustain a yet to be defined accessible and basic universal service as the Government still has an obligation to secure a national network of post office services which remains reasonably accessible to all households. The definition of "reasonable access" still has to be agreed. The Highland Council would be willing to be involved in discussions about what this should include, recognising that the variety of road networks and public transport provision might suggest different solutions for local communities.

With many of the services provided at post offices still remaining unprofitable it will be important that some public service subsidy is retained. This will be particularly important to remote peripheral and rural communities, where access to an adjacent post office could mean a round trip of over 30 miles. The Highland Council has seen the experimentation of a range of new Rural Post Office Services only some of which have been successful. In the Mid Ross area the Post master at Muir of Ord has sustained part time rural services to several outlying communities. However the new mobile service in communities around Wick has not been successful. It is accepted that this latter service whilst sound in theory, proved to be difficult to implement in practice. It is important that with the introduction of any changes in service provision, that Post Office Ltd have back up plans when new pilot projects fail as many individuals faced real difficulties with the failure of the mobile services north and south of Wick.

It must be recognised that Rural Post Office Services are not simply a public service in their own right. Many rural post offices exist as part of another private enterprise such as the running of a rural shop. The partnership approach is an essential feature of most rural post offices where the demise of one part of the partnership can undermine the profitability of the whole business enterprise. The subsidy to Post Office Ltd to continue the support of rural, and most likely unprofitable, post office services allowed many wider community services to be retained.

The Scottish Executive is currently consulting on the development of a strategy for an ageing population. The increases in the older population in the Highlands are substantial with the population 65+ projected to grow by 5,690 people to 2010 and by 24,030 people by 2024. The population 75+ is projected to grow by 2,768 people to 2010 and 13,721 to 2024 (almost double its present level). The older people representatives that the Council consulted with as part of our consultation response indicated how important rural post offices are as they are often linked to shops and often form a focus for older people in the community.

It is important that in any rural post office service reduction programme that communities, households and individuals are not left with replacement services which have an additional cost for their usage for example: a cash machine with a usage charge is not a suitable alternative to a basic post office service.

The Highland Council recognises that there are many individuals, households and small businesses, who remain heavily reliant on access to basic postal services and believes that it is imperative that local authorities are involved in any service reduction programme that affects rural communities.

4 July 2006

APPENDIX 10

Memorandum by the National Federation of SubPostmasters

1. The National Federation of SubPostmasters

1.1 The National Federation of SubPostmasters (NFSP) is the only body representing the interests of 14,500 subpostmasters throughout the United Kingdom. Sub post offices make up 97% of the national network of post offices and are run by private business people, subpostmasters.

1.2 Of the three areas outlined as the focus of the Committee's Inquiry, the NFSP's written submission will largely look at "the future of the Post Office Card Account and the effects on the Post Office network", as this is the area of most direct relevance and concern to subpostmasters.

2. Post Office Network

2.1 With 14,500 branches, the Post Office is the largest retail and financial services chain in the UK. This means it is larger than all of UK's banks and building societies combined, with branches in locations where banks and building society branches long since ceased to exist. 94% of population lives within a mile of a Post Office branch and 28 million customers visit every week.

2.2 As well as its unparalleled infrastructure, the Post Office is a trusted brand. This is particularly the case among marginalised or vulnerable members of society, which form a disproportionately high percentage of the customer base.[1] According to research among financially excluded consumers by the National Consumer Council, "the Post Office is well regarded as offering a good, accessible service", and is viewed as both better trusted and more accessible than banks.[2]

3. Post Office Card Account

3.1 The Post Office Card Account (POCA) is a simple account which allows the receipt only of benefit, state pension and tax credit payments. Account holders can access their cash and make balance enquiries at any post office. The card account is the only option for benefit receipt through which claimants cannot get into debt. It is also the only option with no restrictions on who may be able to open an account as long as they are in receipt of a state pension or benefit.

3.2 It was introduced in April 2003 as the sole Post Office based option for the receipt of pensions and benefits within the Government's Direct Payment programme, wherein traditional order books cashed at the Post Office were replaced with payment of pensions and benefits directly into bank accounts.

3.3 Despite strong concern from our members about the impact on their livelihoods, NFSP fully co-operated with the Direct Payment programme, with subpostmasters across the country at the forefront of enabling customers to make the transition from order books to Direct Payment.

3.4 Post Office Ltd estimates that a £400 million a year loss was incurred by the network through the introduction of Direct Payment of pensions and benefits, or around 40% of traditional income.

3.5 Around 4.3 million benefit and pensions customers regularly use their card accounts to access their benefit payments. NFSP has regarded the POCA as a key product for sustaining the post office network.

3.6 A further 750,000 customers use the cheque-based exemptions service, for pensioners and benefit claimants who cannot manage to use electronic payment. Cheques can be cashed at any post office or paid into bank accounts.

3.7 That the Government has discouraged Post Office Card Account use and encouraged bank account use has been well-documented. Throughout the programme of Direct Payment, the Government consistently presented the POCA as the third option, after bank accounts and basic bank accounts, and the process for opening a POCA was made extremely and unnecessarily complex.

3.8 *Withdrawal of POCA.* It emerged in January 2006 that the Department for Work and Pensions (DWP) does not intend to extend the Post Office Card Account contract beyond 2010. The DWP now claims that it was always clear that POCA would only run until 2010, as a transitional device following the introduction of Direct Payment.

3.9 In reality, while the current contract does indeed come up for renewal in 2010, NFSP had always understood that the contract would be renegotiated during its lifetime, and it was our intention to work with Post Office Ltd (POL) and with the DWP to develop any future Post Office based product. It has always been the understanding of NFSP that POCA or an equivalent Post Office based scheme would be continued beyond 2010.

The Government stated at the time of the introduction of POCA that the card account or an equivalent scheme allowing customers to access their pensions and benefits through the post office network would be guaranteed. A 2003 joint DWP/DTI statement described the POCA as “the cornerstone” of new banking products at the Post Office. POCA customers, the NFSP and Members of Parliament were never at any stage informed that the POCA was a short-term or temporary scheme.

3.10 Subpostmasters have invested around £2 billion of their own money into their businesses and therefore into the network on the understanding that the network would continue to have a role in, and thereby receive income from, the provision of Government pensions and benefits.

The NFSP is deeply concerned that there is currently no clear proposal for any Post Office based successor product(s) to POCA. We would ask for assurance from the Government that it is working closely as a matter of priority with POL to develop POCA successor product(s) to meet customer needs.

3.11 *DWP Pilots.* The DWP ran a series of pilot schemes—scheduled to operate between 13 February to 10 March 2006—with over 40,000 current or potential POCA users refused access to the facility without their consent.

3,000 new benefit claimants were not given the option to open a POCA; 35,000 existing customers received a letter from the DWP telling them to use a bank or building society account and demanding their account details; while 2,500 existing customers, without choice or consultation, found their benefits are no longer paid into their card accounts, but paid instead into a bank account, totally ignoring the preferences made when their benefit books were stopped.

3.12 The pilot schemes were introduced with no consultation with account holders, Parliament or with other stakeholders; the NFSP learned of the DWP’s intentions less than three weeks prior to the start date of the pilots. The nature of the pilots suggest that by the time of the 2010 POCA contract expiry, sufficient account holders will have been driven out of POCA that the Government will be able to terminate the contract without public resistance, while Post Office Ltd will not have had time to develop an alternative Post Office-based product.

3.13 The DWP states that one of the objectives for the pilots is to help them see how customers behave, including how many people continue to use the Post Office, and to inform future DWP policy on the payment of pensions and benefits. NFSP believes that it is not possible to assess this when no Post Office based product has been offered to customers within the pilots, and therefore to a significant extent any findings are rendered meaningless.

3.14 Furthermore, the DWP has yet to report on the outcome of the pilots. The NFSP would ask when the findings are to be made publicly available.

3.15 The NFSP has been concerned that the DWP has been acting in isolation from other Government Departments on the issue of the POCA and is failing to recognise the much wider social and economic implications of withdrawing the POCA without a Post Office based alternative in place. This lack of coherent thinking within Government could prove fatal for many post offices.

The ending of POCA—through the expiry of the contract in 2010 or by its destruction through pilot schemes such as those already run by the DWP—without an alternative Post Office based scheme in place will inevitably lead to a massive reduction in the network of several thousand offices. While this may represent a short-term saving to the DWP, we have urged the Government to instead take a more long-term and joined-up view and consider the wider social and economic costs that such a move would trigger.

The NFSP therefore welcomes the creation of the new Cabinet Committee MISC 33, to be chaired by the Deputy Prime Minister and to “consider issues relating to the future of the Post Office network.” The NFSP looks forward to working with the Committee and trusts that its creation will lead to the Government taking a longer-term and more holistic view of the network and its purpose than has recently been demonstrated.

4. Impact on Subpostmasters and on Post Office Network

4.1 NFSP believes that the Government’s decision to withdraw the card account from 2010, and to have already begun migrating current and potential future POCA customers into bank accounts, will inevitably lead to the closure of thousands of post offices across the country.

4.2 Subpostmasters are paid transaction payments which relate to the amount of money withdrawn from the Post Office card accounts by account holders. Subpostmasters are also paid a one-off payment for each card account opened.

Although the NFSP has always argued that POCA should offer a more flexible, fully functional service, including the ability for customers to make deposits as well as withdrawals, we nonetheless believe that the card account has provided an opportunity for the network to offset some of the losses incurred by Direct Payment. In addition, the card account brings people into the Post Office that may otherwise not have made that visit and thereby provides additional custom.

4.3 Post Office Ltd recorded an operating loss of £111 million for the year 2005–06. POL estimates that the loss of the card account will cost the network £200 million a year up to 2010.[3] NFSP believes that the network can ill afford a further loss of this nature and that for many subpostmasters, already living on low incomes, the loss of the card account will directly lead to the loss of their businesses.

4.4 *Ipsos MORI 2006 Survey on Subpostmaster Pay.* NFSP recently commissioned Ipsos MORI to carry out a survey[4] looking at the major sources of sales-related income following the introduction of a range of new Post Office products and services by Post Office Ltd and the full implementation of Direct Payment. The survey also looked at the profitability of post offices and their attached businesses. This is the third phase of an NFSP-MORI research project looking at subpostmaster income.

The survey looked at subpostmaster's income in January 2006; payments from Post Office Ltd came from the January 2006 payslip which covers sales and transactions carried out between 27 October and 23 November 2005.

4.5 Ipsos-MORI found that Post Office card account transaction were responsible for a higher proportion of subpostmaster pay than any of the other products surveyed, at 10% of net pay (£249). Subpostmasters in urban deprived areas are most dependent on card accounts as a source of income, as card account transactions bring in £403 on average, or 12% of net pay. Subpostmasters with non-deprived urban post offices receive an average of £310 (9% of net pay) for card account transactions. Rural subpostmasters receive an average of £158 (8% of net pay) for card account transactions.

4.6 After POCA transactions, the next highest income source for subpostmasters was from bill payments. This covers dealing with post office customers' payments for bills ranging from electricity and gas bills to cable television, telecommunications services and council tax, as well as savings stamps and the charging of pre-payment cards for utility companies, local authorities and a range of bill issuers.

However, this income source is also under threat. Recently, alternative suppliers have developed bill payment services, which are available in local shops, eg PayPoint. These alternative suppliers have been awarded some of the contracts previously held by Post Office Ltd. Most recently, in April 2006 the TV Licensing contract was awarded to PayPoint.

On average, bill payments brought in £132 (5% of net pay). As with POCA, subpostmasters in deprived urban areas are more reliant on bill payments for their income at £309 (9% of net pay).

4.7 In contrast, income from banking transactions earned an average of £46 equivalent to 1% of net pay. Banking transactions include current account banking transactions made over the post office counter and payments for cash withdrawals and balance enquiry transactions for basic bank account customers using the post office. Subpostmasters are paid at fixed rates per transaction.

Scottish post offices brought in particularly low levels of income from banking transactions (£18 on average)—this reflects the fact that the major Scottish banks have not signed up to offer their services through the post office network.

4.8 Post Office financial services have been available since March 2004 when, following encouragement from the Government, Post Office Ltd introduced a range of financial products designed to bring considerable new business into the post office network, in part to offset some of the losses incurred by the network following the introduction of Direct Payment. Post Office financial services include personal loans, credit card, instant saver account, guaranteed equity bonds, growth bonds, child trust fund, car insurance and home insurance.

Ipsos MORI's survey found that income brought in by sales of Post Office financial services was very low, with subpostmasters earning an average of £5 for counter sales of financial services. 58% of subpostmasters received no income at all from financial services counter sales. In rural areas, this figure was higher: 65% of subpostmasters received no income from Post Office financial services.

Post Office Ltd's Home Phone service, launched in January 2005, earned subpostmasters an average of £5. A total of 83% of subpostmasters received no income at all from Home Phone.

4.9 Ipsos MORI concludes: "This report paints a bleak picture of subpostmasters operating on tight margins, with decreasing personal drawings and increasing overheads. Subpostmasters are heavily reliant on income from the Post Office card account and bill payments, both of which are under threat; and the new flagship products, intended to offset loss in pay from traditional products, are bringing in low levels of income and in many cases nothing at all."

4.10 In view of this, it is not surprising that when asked about their single biggest fear for their post office over the next six months, the most common concern, mentioned spontaneously by over one third of subpostmasters (35%), relates to the withdrawal of the Post Office card account. After this, the highest figure was that of 23% of subpostmasters citing their biggest fear as losing custom due to changes in the benefits payment system. Other major concerns mentioned were loss or withdrawal of Government work and a general decline in income.

4.11 Average personal drawings for subpostmasters (that is, money taken as a salary) were £941 from the post office part of their business. This is a 6% real terms decrease since February 2004.

4.12 NFSP believes that these results demonstrate the urgent need for the Government to work with Post Office Ltd to develop products—and foremost among these a successor or successors to POCA—to ensure any opportunity of securing a viable post office network.

5. Impact on Customers

5.1 NFSP believes that the Government's withdrawal of the POCA will have grave consequences for the many vulnerable groups who are dependent upon their post office as the only place where they can gain free and local access to cash.

5.2 *Basic Bank Accounts*. The Government cites basic bank accounts as an alternative means for POCA users of receiving state pensions and benefits and managing their money. However recent research by Citizens Advice (CAB)[5] demonstrates the unsuitability of these accounts for many financially excluded citizens. The CAB research finds that banks are able to take money out of basic and current accounts to pay other debts to the bank without checking the customer's circumstances, and that charges levied by banks (for example, for failed direct debts) can cause considerable hardship to financially excluded groups. In addition, CAB found that few banks promote their basic account, while only a few will allow people in debt to open accounts. CAB also found that banks sometimes upgrade basic accounts to full current accounts where this is not in the individual's best interests.

5.3 *Access to Banking Services.* The Post Office is better trusted and viewed as more accessible than banks by financially excluded groups.[6] NFSP believes that post offices are ideally placed to provide the public with convenient free local access to cash and banking services.

5.4 This is particularly true in rural and in deprived urban communities; recent research from the University of Nottingham[7] found that it is poorest areas which suffer disproportionately high rates of bank and building society branch closures.

5.5 Nearly 6,000 bank branches have closed since 1990, leaving 1,000 mainly rural communities bankless. Only 4% of villages have a bank branch, while 60% have a post office.[8]

5.6 Meanwhile, most banks continue to deny their current and basic bank account holders the opportunity to access their accounts at post offices. POL estimate that only 40% of current accounts are accessible at the Post Office, with Royal Bank of Scotland Group, HSBC and Halifax-Bank of Scotland among those whose customers are unable to access their accounts at post offices; while around seven in ten basic bank accounts are not accessible at the Post Office.

5.7 NFSP believes that the Government must take the lead in ensuring that all the major high street banks offer free access to their bank accounts at the Post Office. We also believe that POL should be permitted to gain membership of the LINK network.

5.8 *DWP Migration of POCA Customers.* The NFSP has been given several examples of POCA customers being given as little as three working days notice in writing or less than 24 hours notice by telephone that their benefit payments were to be switched from their POCA to a bank account during the DWP's pilot schemes; while another POCA customer received a letter inferring that she has increased chance of being mugged as a POCA user than if she had her pension paid into a bank account.[9] We believe that such communications are wholly unacceptable, particularly to often elderly and vulnerable individuals.

5.9 POCA customers have fought to exercise their choice in obtaining their POCA. NFSP believes that rather than force customers into banking scenarios which may cause them hardship or inconvenience, Government should respect the customers' choice and allow them to continue to use the POCA, at least until a Post Office-based solution can be developed; and that if the POCA is not to be extended beyond 2010, then ultimately the Government should migrate POCA customers directly into Post Office based successor products.

6. Impact on Communities

6.1 NFSP believes that the withdrawal of the Post Office card account and the consequent impact on the viability of post offices across the country will have further significant knock-on effects on the economic and social wellbeing of communities across the country, the full cost of which the Government must fully consider in its decision on the future of the card account.

6.2 Post offices act as major sources of cash within the UK's communities. Research strongly demonstrates that people frequently spend cash locally to the place they access it. In this regard post offices often act as the glue which binds local economies together, providing access to cash to safeguard or boost other local business, while the existence of other local businesses is threatened when a post office closes. Countryside Agency research found that in local shops and businesses with a nearby post office, 15% of customers' expenditure is directly due to the presence of the post office, amounting to £194,000 on average per year.[10] The postal services regulator, Postcomm, estimates that in settlements with a population of 1,000–3,000 people, £417,000 per year could be lost by nearby shops following the closure of a post office.[11]

6.3 As well as boosting local economies, post offices provide a well-documented and critical social role in communities across the country, providing direct support and advice for vulnerable local residents, including elderly and disabled people, and acting as a focal point for communities.

6.4 NFSP believes that the post office closures which will result from the withdrawal of the POCA will further impoverish choice and access to goods and services in many communities in the UK through the knock-on closure of other local business, with socially and financially excluded groups the hardest hit.

7. Royal Mail Refinancing Package

On 18 May 2006 the new Secretary of State for Trade and Industry, Rt Hon Alistair Darling MP, announced a new financing framework for Royal Mail Group. The two main aspects of the new framework were the release of £850 million from Royal Mail Reserve to help offset the company's estimated £4 billion pension deficit; and the provision of £900 million for use by Royal Mail on commercial loan terms in order to help modernise the company's infrastructure.

7.1 NFSP is interested in the impact which the new funding arrangements will have on the financial wellbeing of Royal Mail Group. With Royal Mail products and services a major source of income for Post Office Limited, Royal Mail's profitability in turn significantly impacts on the future of the national post office network and of subpostmasters. NFSP therefore welcomes any arrangements which better enable Royal Mail to achieve its financial and other targets.

7.2 However, the only information within the Government's announcement specific to the post office network was that remaining Social Network Payments up to 2008 and any future Government funding after 2008 will be met by the Government rather than by Royal Mail reserves.

While this clarification is useful, it does not begin to address future funding arrangements for the network, a decision which we believe the Government must now prioritise as a matter of urgency.

8. Proposed "Shares" Scheme

Royal Mail Group's management proposes that up to 20% of the company should be offered to employees as shares.

For NFSP, ownership of Royal Mail Group is of secondary concern to ensuring a profitable post office network within Royal Mail Group.

We do however acknowledge that it is motivational for employees to have stake in their business. Therefore, NFSP supports the proposed scheme in principle, and we have advised our members to accept the option to take up any future share offer, as subpostmasters are key investors in the business both in terms of their time and their money.

9. Conclusions

9.1 Subpostmasters, particularly those in deprived urban areas, are heavily dependent upon income from the Post Office card account.

9.2 Without a full migration of POCA customers to a Post Office based successor product or products, the NFSP believes that the loss of the Post Office card account will result in the closure of thousands of post offices through loss of income to subpostmasters.

9.3 This post office closure programme will in turn have a severely detrimental impact on the wellbeing of individuals, communities and local economies.

9.4 The Government must therefore work with Post Office Ltd as a matter of urgency to develop a Post Office based successor product(s) to POCA and ensure that POCA customers are migrated onto Post Office based alternatives, rather than being forced to receive payments into bank accounts which may not be accessible at the post office.

9.5 The Government must start to look at the future of the post office network, including those products and services available through the network, in a long-term and joined up way, rather than permit individual Government Departments and Agencies to make narrow self-interested short term decisions which have a profound effect on the network's viability.

References

[1] Performance and Innovation Unit, June 2000, "Counter Revolution"; and Post Office Limited estimates.

[2] National Consumer Council, March 2003, "Everyday Essentials: Meeting Basic Financial Needs".

[3] Letter from Alan Cook, Managing Director, Post Office Ltd, to MPs, 13 March 2006.

[4] Ipsos MORI-NFSP, July 2006, "Subpostmaster income Wave 3".

[5] Citizens Advice, January 2006, "Banking Benefits—CAB Evidence on Payment of Benefits into Bank Accounts (Evidence Report)".

[6] See 2.

[7] University of Nottingham, February 2006, "The Changing Geography of British Bank and Building Society Branch networks, 1995–2003".

[8] See 5.

[9] Hansard, 23 March 2006, Column 405.

[10] Countryside Agency, July 2000, "The Economic Significance of Rural Post Offices".

[11] Postcomm, December 2001, "Serving the Community I—evidence of the community value of post offices in rural areas".

July 2006

APPENDIX 11

Memorandum by the National Federation of Women's Institutes

The National Federation of Women's Institutes (NFWI) is the UKs largest national voluntary organisation for women. It has some 215,000 members, in 7,000 Women's Institutes across England, Wales and the Islands. It is an educational, social and non-party political and non-sectarian organisation that particularly represents the views of women in rural communities.

The NFWI fought hard on behalf of its members to keep the benefit and pensions books but when these were withdrawn and the POCA was introduced many of our members chose to use the card, despite many hurdles put in their way. They are now used to using the cards and have expressed their considerable concerns to NFWI at the thought that these cards are going to be withdrawn in 2010 when they will have to cope with a whole new system of banking. Many of our members are pensioners and their only access to their pensions is through their Post Offices. They have already had to suffer one change of system and to make them start again seems very unfair to an elderly and vulnerable section of the community.

The fact that 4.7 million users took the POCA confirms that there is a need for this form of banking. The reason is that it is simple to use and it is impossible for users to go into overdraft. We believe that the card account also proved popular because our members trust the Post Office network as well as, for many members in rural areas, it is much closer than banks. The fact that POCA was so successful should mean that the Government should encourage its development by adding simple features with smooth transitions, not cancel it and make customers start all over again. The NFWI believes that the POCA can be developed, possibly allowing Direct Debits for bill payments leading to savings for the customer as well as more income to sub-postmasters.

Cancelling the POCA would affect customers in Post Offices and in turn the income to sub-postmasters which may threaten the future of many Post Offices. The NFWI campaigns hard for the retention of Post Offices as they are a vital village resource and a huge social benefit. If POCA and the Social Network payment are both withdrawn it is expected that many Post Offices will be forced to close.

If the Government proceeds with cancelling the POCA then the NFWI believes that pensions and benefits must still be able to be collected from Post Offices which are closer to many peoples homes and, in some areas are the only access point when transport is not available. In order to do this the Government should ensure that basic bank accounts, suitable for people on low incomes, can be opened easily with simple identity restrictions; all bank accounts should be available free of charge at post office counters.

In Summary the NFWI would ask the Trade and Industry Committee to recommend continued support for the POCA which should be continued and extra features added to make it even more attractive. This would bring more customers to the Post Offices encouraging an essential social network system to be maintained. Withdrawal of the POCA will affect many elderly and weak people who are not able to travel to local towns for banking facilities even if they were able to open accounts with High Street banks.

APPENDIX 12

Memorandum by Postcomm

Background

1. Postal services are just one of a range of services offered by Post Offices on behalf of Government and others. The Postal Services Act gave Postcomm a limited role in relation to Post Offices which is to conduct research on developments and give advice to the Secretary of State in an annual report on the network. We have submitted five annual reports and two *ad hoc* reports on the rural network to the Secretary of State since 2001. The next annual report will be published in October 2006.

2. Postcomm's role as the national regulatory authority for the postal sector is to ensure the continued provision of the universal postal service. Through Royal Mail's licence we require it to provide "reasonable" access to the universal postal service. We cannot require it to provide access to the full range of Post Office services that are important to local communities. This is a matter for the Department of Trade and Industry.

Network Must be Planned to Survive

3. Our research and discussions with stakeholders show that there is no single model and no magic number of Post Offices to meet the needs of different communities all over the UK. Simply specifying a minimum number of Post Offices is meaningless because it would not ensure that they are in the right locations with the right services for communities.

4. There have been rumours from Royal Mail Group about reducing the Post Office network to 4,000 offices. These rumours, together with announcements on the Post Office Card Account (POCA) and the loss of government business, are damaging to customer confidence and create uncertainty for the thousands of subpostmasters currently keeping the network going. Postcomm does not believe that there is any value in trying to place a numerical figure on the size of the network. We have not seen any evidence to support the assertion that this is all that would be needed to meet the Universal Service Obligation. Our view is that such a reduction would break the terms of Royal Mail's licence, as it would not be serving the reasonable needs of customers in terms of access to postal services.

5. Decisions are needed to plan the network, taking into account postal services and the wider social functions provided by Post Offices in local communities. It is vital that across government there is a clear recognition of the role that Post Offices play to deliver government objectives (such as access to cash in the community) and that this is not lost sight of in the desire to establish a commercial network.

Access to Postal Services

6. Ensuring the continued provision of the universal postal service across the UK is Postcomm's overriding statutory duty. This means ensuring that Royal Mail is able to provide delivery and collection every working day to all parts of the country at an affordable and uniform price. In January 2006, Postcomm fully opened the UK postal market to competition as the best way of securing the universal service and encouraging Royal Mail to deliver an improved service for customers.

7. Through Royal Mail's licence we are able to require it to provide reasonable access for users to postal services. The minimum access requirement in Royal Mail's licence only relates to postal services and cannot be used to dictate the size of the Post Office network.

8. The Post Office network also fulfils other important services to the community on behalf of Government in relation to access to cash, bill payment, licences etc. Royal Mail's licence does not require it to provide a network of Post Offices with their full range of other services.

A Flexible Approach to Providing Services

9. Postcomm supports Post Office Ltd's use of more innovative methods of service provision such as mobile post offices and Post Offices in partnership with local communities (police stations, libraries, pubs etc) where it is difficult to keep the local Post Office going. With the report from Post Office Ltd on the rural pilots the Government now has the information that it needs to consult more widely and take decisions on the future of the Post Office network—its size and range of services.

The Rural Network

10. Postcomm has consistently recommended that there should be a flexible approach to providing Post Offices that meet the needs of the communities they serve and takes into account the needs of vulnerable members of society (those on lower incomes, the disabled and chronically ill, and the aged). We want to see the rural network planned in relation to population and small business distribution to ensure access to services that enable communities to survive.

11. In relation to the extension of the "no avoidable closures" policy in the rural network, Postcomm understands that the government does not want to cause concerns about the rural network in advance of taking decisions about the future of the network.

Post Office Card Account

12. Postcomm is concerned that the demise of the POCA will lead to a lot of confusion for many people, especially vulnerable groups, who found the move to direct payment difficult. However, we hope that the Department of Work and Pensions and others will work with Post Office Ltd to ensure there is an appropriate account available at the Post Office that will be easy to transfer to, and that will allow real financial inclusion (allowing direct debits etc). The reality is that the Post Office is often the only outlet offering access to cash for people in many rural and urban deprived areas.

June 2006

APPENDIX 13

Memorandum by Postwatch

— the extent to which the refinancing package announced by the Government will help Royal Mail to pay for modernisation and deal with its pension fund deficit;

— the structure of the "shares" scheme proposed by Royal Mail managers, and its implications for the future of Royal Mail Group; and

— the future of the Post Office Card Account and the effects on the Post Office network.

1. Postwatch welcomes the opportunity to contribute to the Trade and Industry Committee's timely review of the Royal Mail Group with an informed customer view of developments in the postal services market.

2. The review comes at a period of considerable change in the UK postal market:

(i) Full liberalisation of the postal market was introduced in January, and, whilst full competition will not happen rapidly, the competitive market continues to develop.

(ii) Royal Mail has chosen to introduce "Pricing in Proportion"; and will do so on 21 August, representing a major change to the way the company charges for postage, and a significant challenge to increase customer understanding and awareness of the change and its implications.

(iii) Royal Mail continues to improve both its financial and quality of service performance. However, important customer concerns remain, including the company bringing forward many post box final collection times, inconsistent delivery times, and mail security issues.

(iv) There is continuing uncertainty over the long-term future of rural and urban deprived post offices, with a government consultation on the "social" network's future originally expected in late 2005, but yet to be published.

3. We would also like to take this particular opportunity to point out to the Committee that, if the DTI's current proposals on the restructuring of consumer representation, including Postwatch, were implemented unchanged, it seems unlikely that the Committee—and other interested parties such as Postcomm—would in future be able to access such knowledgeable sector-specific advice from the perspective of the consumer. Postwatch invites the Committee to consider this matter and make its views known to the DTI. We would be pleased to provide further information on how Postwatch could be maintained but restructured and made more cost-effective.

The extent to which the refinancing package announced by the Government will help Royal Mail to pay for modernisation and deal with its pension fund deficit

4. It is understood that Royal Mail is facing a pension fund deficit in the region of £5.6 billion, and it has warned that without some form of assistance from the government the company will be unable to compete in a fully liberalised postal market. Raising prices was, on its own, regarded as insufficient to fund the £2 billion investment programme needed to compete with other postal operators, as well as making inroads into the pension fund deficit.

5. We welcome the financial package as set out by the government. Postwatch is pleased that Royal Mail has approached the shareholder for the investment funding the company needs. This is preferable to Royal Mail asking customers again to pay more. Stamp prices are already set to increase above the rate of inflation for each of the next three years. Customers are doing their bit so it is therefore encouraging that the shareholder should also contribute.

6. We recognise that Royal Mail needs to invest in automation to be a world-class postal service provider and this £1.75 billion package will provide the necessary funds for Royal Mail to catch up with the likes of Deutsche Post and the Dutch based TPG who have both invested substantially in machinery.

The structure of the "shares" scheme proposed by Royal Mail managers, and its implications for the future of Royal Mail Group

7. Royal Mail management introduced "Share in Success", a profit-sharing scheme. The company recently announced that 2005–06 was the second successive year in which employees would benefit from this scheme (including, for the first time, subpostmasters).

8. Postwatch wants to see an effective Royal Mail underpinned by a stable, workforce, and we therefore welcome efforts to motivate and retain staff, including subpostmasters. Similarly we are pleased to see a reduction in industrial action among Royal Mail staff.

9. Postwatch understands that Royal Mail management wants to give the workforce a stake in the business through the distribution of shares. We understand the desire to gain employee buy-in when going through a period of change.

10. The structure of the "shares" scheme is not a matter for Postwatch. However, we are aware that this is a controversial issue for the Communication Workers Union, and that there is currently no negotiated agreement between the union and Royal Mail on any such share scheme. We would urge that every effort be made by the partners to work together on this matter to avoid disruption of service to customers.

The future of the Post Office Card Account and its impact on the post office network

11. The Department for Work and Pensions (DWP) has announced that it will not renew its contract to fund the Post Office Card Account (POCA) in 2010. The introduction of this card and its use by 3.4 million people has helped Post Office Ltd retain some of the £400 million worth of transactions that could otherwise have been lost through the government's change to the direct payment of pensions and benefits.

12. Post Office Ltd has said that Post Office Card account business is falling away already, less than six months since the DWP's announcement.

13. Postwatch has a responsibility for monitoring the number and location of post offices. We are therefore concerned about the impact of the DWP's decision on the future viability of individual branches and the network as a whole. A further reduction in footfall may jeopardise the viability of post offices, and therefore the accessibility of postal services.

14. Postwatch wants customers to have a choice in the ways they are able to receive their pensions and benefits. We recognise that payment into bank accounts is the most suitable option for the majority of people. However, the fact that there are more than three million POCA holders underlines both the importance of the product, and also the popularity of collecting benefits at post offices.

15. From 2002, Postwatch, in conjunction with other organisations, campaigned nationally and through its regions to influence the DWP and Post Office Ltd to take proper account of customer interests when migrating some 14 million pension and benefit recipients from payment by order book and giro cheque to payment electronically directly into a suitable bank account, including the POCA.

16. One of the tasks undertaken by Postwatch was monitoring and advising the DWP on the material provided to customers. This material did not advise that the card account was only going to be in place until 2010.

17. Additionally, as a result of information received from the DWP in the past, Postwatch, in its education and informing role, has never described the POCA as an interim, time limited, solution when speaking to customer groups about their options for receiving benefits.

18. Postwatch is also concerned about the timing of the government's decision to discontinue funding the POCA. In a letter dated 23 December 2005 to the Postwatch Wales Chairman, the Parliamentary Under-Secretary of State wrote that

> "it is too early to decide what our customers' needs will be in 2010".

Yet less than two months later, the government had announced the end to POCA funding—in effect, the government had decided that its customers did not need it to fund the POCA post-2010. Postwatch is unaware of any research or consultation undertaken in this interim period that informed this decision.

Announcement without Consultation

19. Postwatch and its Counters Advisory Group[24] was not consulted on the decision to discontinue government funding of the POCA, or the likely impact on customers of this decision.

20. Postwatch raised the Group's concerns about the future of the POCA and the proposed pilots in a letter to the Secretary of State for Work and Pensions (see annex).

21. The Parliamentary Under-Secretary of State, James Plaskitt MP, responded by saying that all existing POCA customers will still be able to use the post office to collect their benefit or pension if they wish by using a bank account there.

22. For many DWP customers, this means that they need to change their bank account to one that can be accessed at post offices. Postwatch considers many customers may be resistant to such change; having already applied for and opened a POCA, they are likely to feel changing to a bank account to be unfairly burdensome.

23. For vulnerable customers, the Secretary of State said that his department would work with Post Office Ltd to make sure that there is an appropriate alternative product. Postwatch believes such a product should have been developed prior to any announcement. This would have prevented the current levels of uncertainty and concern among stakeholders. This may also have helped Post Office Ltd retain customers.

24. Postwatch agrees with the DWP that a range of products could meet customers' needs but is concerned that there is an assumption that the costs of migrating customers can be externalised on to them.

25. We consider that the DWP should not invite any other customers to migrate from POCAs until alternative products have been developed or identified.

26. Postwatch understands that three types of products or services are required to meet the needs of three types of customers:

(a) Those who cannot open a bank account: These individuals will need a basic account that can be accessed in every High Street. A continuing partnership between the DWP and Post Office Ltd appears the most suitable and sustainable answer to these customer needs—preferably with a product that offers greater functionality than the Post Office card account.

(b) Those who have a bank account but have chosen to have their benefits paid into the Post Office card account: The motivation of these customers is not fully understood. Their needs could be met through the development of the basic account suggested in (a) and if all bank accounts were made accessible at post office counters (at present 60% accounts cannot be accessed there).

(c) Those who use the Post Office card account as an easily accessible savings account, ring-fenced from their current account: These customers would benefit from a post office savings account that offers them interest.

27. Products should be developed in consultation with relevant stakeholders and Post Office Ltd, and should be actively promoted to POCA holders and new benefit and pension recipients.

28. Alternative products should be available for all customers who do not wish to, or cannot, use a bank account to receive their benefit or pension. For example, customers who have a bank account, but for budgeting reasons wish to have an additional account into which they can receive benefits, should be able to do so. The POCA currently allows them this option; any future replacement should do likewise.

Pilot Schemes

29. Postwatch was informed in January that pilots would be run during February to test approaches for moving customers from the Post Office card account. The short period between the DWP announcing the trials and their commencement did not give stakeholders sufficient time to inform the development or methodology of the pilots.

30. There were three pilots running during February 2006, affecting up to 40,000 people across the UK. They involved:

(a) removing the option for some customers to open a POCA when they make a new claim to benefit;

(b) writing to some existing POCA customers asking for bank account details; and

(c) converting some customers who have one benefit paid by POCA and another already paid into a bank account.

[24] A stakeholder forum that informs Postwatch policy and processes, with members including Age Concern, Commission for Rural Communities, Federation of Small Businesses, Help the Aged, Local Government Association (LGA), MENCAP (non-attending), Citizens Advice, National Association of Local Councils (NALC), National Federation of Sub-postmasters (NFSP), National Federation of Women's Institutes (NFWI), Postal Services Commission (Postcomm), Public Utilities Access Forum (PUAF), Royal National Institute for the Blind (RNIB), Townswomen's Guild, Village Retail Services Association (ViRSA).

31. Postwatch found the language planned for the pilot's communication materials to be misleading. The letters to be sent to customers imply that it is mandatory that POCA users migrate to a bank account. For example:

> "Those people who can use a bank (or building society) account should have their [x benefit] paid into it, rather than into a Post Office card account."

32. We requested DWP to clarify whether it is obligatory for customers who receive such a letter to stop receiving state pensions or benefits into their POCA. We also sought confirmation that customers involved in the pilots would be given comprehensive and accurate information about their options, including retaining a POCA account if they wish to do so. Without this information it would be impossible for the customer to make an informed decision and take appropriate action to meet their needs.

33. The DWP did not state in either its promotional literature for the Payment Modernisation Programme, or in scripts for use by the Customer Conversion Centre, that the POCA is an interim measure for customers. However, Postwatch is concerned that this was suggested in the letters being used in the pilots, for example:

> "As you have been using your Post Office card account for some time, now is the time to make arrangements to pay your benefit/pension into a bank (or building society) account."

34. We consider that letters to customers should have stated explicitly that customers are free to use the POCA for as long as it is eligible for them to do so, regardless of whether they hold an alternative bank or building society account.

35. The DWP has not been able to answer our question of why different types of customer prefer to use their POCAs rather than their bank accounts. We feel this question is key to understanding customer needs, and to the development of new products, and to the development of a customer migration process.

36. Postwatch accepts Mr Plaskitt's assertion that trials are more informative than surveys when trying to understand what customers would do "if the POCA' weren't available". However, these trials were undertaken before the alternative that DWP announced would be developed was in place and therefore the pilots did not present customers with a full range of options, nor give the DWP with a comprehensive insight into customer behaviour.

37. The DWP has agreed to share the findings of its research with Postwatch and our Counters Advisory Group.[25] The Group looks forward to informing future processes and communications to ensure they meet the needs of all DWP customers.

Existing Alternatives to POCAs

38. The POCA is not a perfect product. Postwatch would like any alternative account that replaces the POCA to have, among other improvements, a simpler application process, and an improved system for allowing temporary third party collection of account funds.

39. We also consider it is vital that the government undertakes every effort to encourage banks to make available more current accounts at post office counters. Only 40% of UK current accounts are accessible at post offices. As long as Abbey, HSBC, Royal Bank of Scotland, HBOS and Natwest reject proposals to make their accounts accessible at post offices the majority of citizens cannot access cash at their post office.

40. According to the British Bankers Association (BBA), of the 5.93 million basic bank accounts in operation, 2.37 million are accessible at post offices. The BBA claims that "the growth in the number of basic accounts which can be operated in bank branches and post offices remains healthy and banks are fully engaged with the government's Financial Inclusion Taskforce to monitor progress toward the shared financial inclusion goal agreed with the Treasury." It also notes the role played by the POCA in financial inclusion.

41. Postwatch welcomed the government's decision to introduce a Cheque Payment service for those customers who do not want or who are unable to move to Direct Payment. This service is used by approximately 400,000 people, despite no publicity. The main features of the service are:

- Cheques are issued to the customer's home address on a regular basis to match the frequency of their benefit or pension payments.
- The cheque provides the facility for a third party to cash the cheque on the customer's behalf. The customer is required to sign the back of the cheque to indicate consent, and the third party also signs the cheque and is required to produce identification.

[25] The Postwatch Counters Advisory Group consists of a range of organisations that act on customer concerns about issues affecting the post office network. Members are Age Concern; Commission for Rural Communities; Federation of Small Businesses; Help the Aged; Local Government Association; Citizens Advice; National Association of Local Councils; National Consumer Council; National Federation of Subpostmasters; National Federation of Women's Institutes; Postcomm; Public Utilities Access Forum; Royal National Institute for the Blind; Townswomen's Guild; Village Retail Services Association.

— Contingency arrangements will vary according to individual circumstances, but may be: another cheque being sent, a payment at a Benefit Office, a home visit by a DWP officer.

42. Postwatch welcomes the DWP's decision that the cheque payment service will remain in place.

Effect on the Post Office Network

43. Post Office Ltd made an operating loss last year of £111 million. Government business transacted through post office counters is down £168 million year-on-year, and this trend is expected to accelerate following the DWP's decision to end funding for the Post Office Card Account from 2010.

44. The rural network is currently supported by the "Social Network Payment", a payment of £150 million a year that helps Post Office Ltd meet the cost of maintaining the non-commercial part of the rural post office network and to test new ways of delivering services into rural areas. This payment is only in place until March 2008.

45. In addition to the challenges facing Post Office Ltd management, the reach of the network is reliant on nearly 14,000 private businessmen and women. These subpostmasters are concerned about their future; they cannot be expected to continue to run a business that cannot cover its costs.

46. Further change to the network is inevitable due to the decline in government use of the network and changing customer usage. However, without clear government policy, and notice of future funding (or otherwise), Post Office Ltd cannot fully develop its strategy for curbing losses. The resultant uncertainty and loss of income will result in further closures of individual branches, whatever the efforts of Post Office Ltd and individual subpostmasters to keep services open. No-one wants post offices to close, but Postwatch wants to see any changes managed, in order to avoid *ad hoc* closures and the creation of gaps in the network.

47. The DWP's decision to discontinue funding the POCA is likely to have a significant impact on the viability of individual branches and the wider network, with 1 in 6 post office customers using POCAs. The great unknown is whether people will choose to undertake bank account transactions at post office counters or whether the business will be lost to the network altogether.

48. Use of the accounts not only results in a transaction fee for subpostmasters; it also brings in the opportunity for sales of other products, either at the post office counter or in the attached retail unit. Such sales help support the financial viability of the retail unit as a whole.

49. The government's decision to discontinue the POCA and continuing uncertainty about long-term future funding for rural post offices inevitably affects customers. They are uncertain about future methods of payment for their benefits, and are concerned about the continuity of a valued local service and the need to participate once again in a government-sponsored migration campaign, which many may have found onerous during the original Payment Modernisation Programme.

50. Postwatch believes the government needs to recognise the impact of its decisions on the viability of the post office network, and produce a coherent, cross-government strategy for the network's future.

Annex

EXCHANGE OF LETTERS BETWEEN POSTWATCH AND DEPARTMENT FOR WORK AND PENSIONS IN CONNECTION WITH THE Post Office CARD ACCOUNT

Letter from Postwatch to the Rt Hon John Hutton MP, Department for Work and Pensions

13 February 2006

Dear Secretary of State

The Future for The Post Office Card Account

Postwatch and its Counters Advisory Group (CAG) is concerned about the approach being taken towards the Post Office card account (POCA) by your department. As you know the Postwatch CAG was extremely concerned about the lack of clear information and choice given to customers during the migration to Direct Payment. We have now been briefed about the pilots for migration from POCAs to bank or building society accounts and are concerned about the purpose and method of the pilots.

The Postwatch CAG is concerned about the future of the POCA and its customers because:

— its demise could have a direct effect on the number of post offices throughout the UK;

— the Group represents post office customers, with a particular focus on those on low incomes, the elderly, those with a disability, and people who live in rural areas—the groups to whom the POCA most appeals;

— the Group also represents small businesses' interests. Small firms depend on their local post offices for many services. A threat to the survival of local post offices is also a threat to SMEs and the local community as a whole. The proposed change is of concern to business as well as social customers, particularly because many local bank branches have closed, leaving the Post Office as the only banking option in some areas.

— As a consequence of information we received from your department in the past, members of the Postwatch Council and CAG members have never described the POCA as an interim, time limited, solution when speaking to customer groups about their options for receiving benefits;

— the communication around the proposed pilots are not focused around customer needs, and do not provide sufficient information about all of the options open to the POCA account holder;

— The DWP has not provided details about the help that it will provide to customers who are to be migrated from POCAs, but do not have an alternative account.

— Alternatives to the POCA, including basic bank accounts, are not designed and delivered around the particular needs of disadvantaged consumers, resulting in problems with access, appropriateness, affordability and availability of these services for vulnerable customers.

Postwatch recently met your officials to discuss this issue following the press interest surrounding the announcement in the House of Lords. You will appreciate that it would have been better if the department had made an official announcement on this important public policy issue and had actively sought the views of the CAG, as a well established interested party.

Following the meeting we now have a better understanding of why the DWP wants to contact POCA users who also have a bank account. However, we remain concerned about the forthcoming pilots for the following reasons:

1. There seems to have been a lack of sensitive research into customer needs to support the path being pursued. Your department knows why customers like POCAs, but has it undertaken qualitative research to understand why different types of customer prefer to use their, POCAs rather than their bank accounts? If the research has been undertaken, then we along with other stakeholders need to see the outputs to inform our views. If this research has not been undertaken, then the pilots should be suspended until this work has been carried out. The appropriateness of migration to bank and building society accounts can only be established with this information. It would be irresponsible to migrate POCA customers to other accounts which fail to meet their particular needs.

2. We believe the language planned for the pilot's communication materials is misleading. The letters to be sent to customers imply that it is mandatory that POCA users migrate to a bank account. For example:

> "Those people who can use a bank (or building society) account should have their [x benefit] paid into it, rather than into a Post Office card account."

We request clarification from DWP about whether it is obligatory for customers who receive such a letter to stop receiving state pensions or benefits into their POCA. We also seek confirmation that customers involved in the pilots will be given comprehensive and accurate information about their options, including retaining a POCA account if they wish to do so. Without this information it would be impossible for the consumer to make an informed decision and take appropriate action to meet their needs.

3. The DWP did not state in either its promotional literature for the Payment Modernisation Programme, or in scripts for use by the Customer Conversion Centre, that the POCA is an interim measure for customers. However, Postwatch is concerned that this is suggested in the letters being used in the proposed pilots, for example:

> "As you have been using your Post Office card account for some time, now is the time to make arrangements to pay your benefit/pension into a bank (or building society) account."

Letters to customers need to be clear and consistent with DWP policy, stating explicitly that the POCA is not an interim account, and that customers are free to use it for as long as it is eligible for them to do so, regardless of whether they hold an alternative bank or building society account.

4. Despite the proposed removal of the funding for POCAs, we welcome the government's assurance that anyone who wants to draw their benefit or their pension from post offices can continue to do so, but it must be noted that only 2.3 million of 5.7 million basic bank accounts are accessible at POs and that majority of current accounts are not accessible at POs. Additionally, we understand from the DWP that Post Office Ltd is looking at developing new accounts that will help people move from POCAs. We look forward to these services being developed and introduced. However, they can only be a real alternative to the POCA if they are designed and delivered appropriately for the needs of disadvantaged consumers and are introduced on a timescale that meets with the planned migration from POCAs.

5. All customers should be free to choose any of the range of account options that meets their particular needs. For 4.5 million people the Post Office card account is their preferred option. It is likely that this will continue to appeal to disadvantaged customers. We seek your assurance that individuals becoming eligible for state benefits or pensions will be allowed to opt for a POCA and that it will remain one of the options they choose from.

For these reasons it is inappropriate to start the pilots now. It would be better to conduct pilots after adequate customer research has been completed and suitable alternative products have been made available. Conducting pilots at a later time would be more instructive for government and stakeholders on the needs and concerns of benefit and pension claimants.

The Postwatch CAG does not view the POCA as a perfect product. Indeed, we have argued for improvements to be made both to the product and its application process. However, there is a clear demand for a simple product that allows customers to access their pension and benefits payment free of charge at post offices. We want all customers who need to access cash at post offices to be able to do so, and we look forward to working with you and other stakeholders in achieving this aim.

I understand that a DWP official has agreed to attend the next Postwatch CAG meeting in March to explain the decision and the DWP's short-term plans. As this is some time away, and your department has given stakeholders so little notice of the plans, I and other CAG members listed below would like to discuss this concern with you at the earliest opportunity. I understand that Citizens Advice, another member of the Group, has also written with their concerns and is supportive of the issues raised above.

I have copied this letter to Barry Gardiner MP.

Yours sincerely,

Millie Banerjee CBE
Chair

On behalf of:

Age Concern.

Commission for Rural Communities.

Federation of Small Businesses.

Local Government Association.

National Consumer Council.

National Federation of Subpostmasters.

National Federation of Women's Institutes.

Postcomm.

The Royal National Institute of the Blind.

Letter from DWP, Department for Work and Pensions to Postwatch

7 March 2006

THE FUTURE OF THE POST OFFICE CARD ACCOUNT

John Hutton has asked me to thank you for your letter of 13 February about the future of the Post Office card account (POca).

May I begin by congratulating you on your recent appointment—you have joined Postwatch at a time when the Post Office network faces a number of challenges, but also has great opportunities. The ending of Government funding for the POca provides just such challenges and opportunities.

There has been a great deal of misleading coverage and comment about this issue over the last few weeks. People have suggested that the ending of funding for the POca will close thousands of Post Office branches; that customers will no longer be able to get their benefit or pension at the Post Office; and that we have, in some way, gone back on commitments around the POca. None of this is true and I am pleased to be able to put the record straight:

— Government funding for the POca will continue until March 2010 as always planned.

— All existing POca customers will still be able to use the Post Office to collect their benefit or pension if they wish by using a bank account there—25 or so different bank accounts can be accessed at Post Office branches now, and we hope there could be more in the future.

— There is no reason why the viability of Post Offices should be threatened if customers continue to draw cash at the Post Office after moving on from the POca.

I understand the Post Office is developing new banking and savings products which may be suitable for some existing POca customers. We would like every DWP customer who currently has a POca to do their banking at the Post Office if that is what they want. Of course there must be appropriate products in place for vulnerable customers when the POca ends in 2010. We will work with Post Office Limited to make sure there are. But Post Office's own research shows that POca customers are far from a homogenous group. They range from some vulnerable groups, to those who do not depend on their pension or Child Benefit and let large balances build up. It is very likely, therefore, that we will be looking at a range of accounts. For some people, using an existing bank account may well be the right answer. I agree with you that it was unfortunate that a Royal Mail Non-Executive Director drew attention to the end of the POca before Post Office Limited themselves were ready to say more about replacement products.

We must agree to disagree on the approach to research. As you recognise, we have accumulated a great deal of research evidence. But it is generally accepted that research is not always a good way to answer hypothetical questions—eg what would you do if the POca weren't available? For this, it is widely accepted that trials are far more informative. We, are therefore, undertaking some small-scale pilots to test real customer behaviour. When we have the results, we will be happy to share them with you. We, and Post Office Limited, will use the information to plan the approach to 2010, and to inform the design of new products.

There have been suggestions that our planned changes are about shutting down Post Offices. In fact, we want to work with the Post Office to plan how we can best manage the change and ensure they are delivering services fit for the 21st century. The Government has invested over £2 billion in total since 1999 to help them to do so. The Government wants to see a Post Office network that can prosper on the basis of today's and future needs and not on those of 20 or 30 years ago. It is important for the Government and Post Office to work closely together to ensure customers are fully aware of developments and continue to have a range of choices in how they access their money.

I know that Postwatch and the Counters Advisory Group have a number of detailed questions about our pilots and overall strategy. I think these are best dealt with by officials at the meeting on 15 March as already planned.

I am copying this letter to Barry Gardiner MP.

Yours sincerely,

James Plaskitt MP
Parliamentary Under Secretary of State

APPENDIX 14

Memorandum by Royal Mail Group plc

1. EXECUTIVE SUMMARY

1. Royal Mail Group welcomes the Trade and Industry Select Committee's continuing attention to developments in the fully liberalised UK postal services sector and important issues relating to our business in particular.

2. Fundamentally, our business needs to be strong so that we can take on the competition and win. Success in the future will be based on our transformation from a monopoly operator to a modern, ambitious business that can thrive in a competitive market.

3. During 2005–06, Royal Mail Group delivered a year of record high quality of service to its customers. Financial performance was outstanding, especially in the face of competition, with an operating profit of £355 million—an increase of 17.5% compared with the previous year—on record revenues of more than £9 billion.

4. We have come a long way since 2002 when the Group was losing well over £1 million a day and we were struggling to hit many of our customer service targets.

5. It's encouraging that the building blocks we need are beginning to slot into place. A vital part of our plans was securing, after lengthy negotiations with Postcomm, a tough but fair price control that allows significant investment in the Royal Mail letters business and gives us the ability to increase the cash payments into our pension fund.

6. Good financial results and record quality of service have resulted in the Government—our shareholder—agreeing in principle to our case for commercial investment in Royal Mail Group.

7. The task now is to transform the company into a modern, world-class postal operation able to compete in an increasingly tough market. A key part of this change will be to make sure we give our people the necessary incentive and the right reward for their part in future success. We believe giving everyone a real stake in the business will be critical to implementing our investment plans. It is our postmen and women who have helped put in place a strong platform on which to build and we know this is something they want and would respond to. This wouldn't be privatisation under another name but a real chance for our people to own a part of the business and help drive our success.

8. The investment package now being discussed in detail with the Government will enable Royal Mail Group to embark on its major modernisation programme. It will also help to secure the company's pension fund, giving the business more time to plug the funding gap of £5.6 billion which will require a cash payment of £735 million this year, growing with inflation.

9. With such a large branch network and customer base, the Post Office® is well aware of the responsibility that comes from our unique role at the heart of communities across the United Kingdom. Post Office Ltd however is losing £2 million every week. This year the loss is expected to rise to £4 million a week which is clearly unsustainable long-term.

10. Government business undertaken through the Post Office® branch network has declined and the contract for the Post Office® card account will not be renewed when it expires in 2010. We continue to discuss with the Government the best ways of creating a stable, sustainable Post Office® network.

11. Our vision remains—to be demonstrably the best and most trusted mail company in the world. The key to achieving our goals is to ensure that our investment plan is successfully implemented.

2. Inquiry on Royal Mail Group

12. In the Committee's Press Notice issued on 5 June 2006 the following three areas were outlined for consideration during its follow-up inquiry on Royal Mail Group:

— the extent to which the refinancing package announced by the Government will help Royal Mail to pay for modernisation and deal with its pension fund deficit;

— the structure of the "shares" scheme proposed by Royal Mail managers, and its implications for the future of Royal Mail Group; and

— the future of the Post Office® card account and the effects on the Post Office® network.

13. The Committee has correctly identified these three important areas each of which is currently the subject of ongoing discussions between Royal Mail Group and the Government both as our shareholder and as a major client. By their nature these are private discussions involving commercially sensitive issues which require confidential treatment.

14. We are proud of Royal Mail Group's unique role in reaching everyone in the UK through its mails, Post Office® and parcels businesses—which directly employ almost 193,000 people in the UK.

15. Every working day Royal Mail collects, processes and delivers around 84 million items to 27 million addresses for prices that are amongst the lowest in Europe; each week we serve nearly 28 million customers through our network of 14,376 Post Office® branches and each year our domestic and European parcels businesses—General Logistics Systems and Parcelforce Worldwide—deliver some 337 million parcels.

New Financing Framework for Royal Mail Group

16. It is our understanding that the Committee's inquiry was prompted by the Government announcement made on 18 May 2006 of a new financing framework for Royal Mail Group. In a news release issued by the Department for Trade and Industry (DTI) it was stated:

17. "The proposed financial structure includes:

— the release of £850 million of the Royal Mail Reserve for the company to transfer into a pension escrow account that may be drawn on by the pension trustees in the unlikely event that the company should fail;

— in principle agreement by Government to extend the existing debt facilities so that £900 million is available for use by Royal Mail on commercial terms; and,

— expenditure for Post Office Limited, including Social Network Payments for the next two years and any funding after 2008, will be met by the Government rather than from Royal Mail Reserves. The level of any support after 2008 will depend on decisions on the future of the Post Office network."

18. In the "Notes to Editors" section the same DTI news release explained:

> "1. The Government intends to exercise its powers under section 72 of the Postal Services Act 2000 to release the £850 million of reserves that Royal Mail has built up through past profitable performance so that the company can transfer those funds to a special account, the pension escrow account, which the pension fund trustees could draw on in the unlikely event that Royal Mail should fail as a business.
>
> 2. When the pension fund deficit has been recovered and Royal Mail's balance sheet strengthened by successful operation, it is expected that the escrow fund will be released and surplus cash returned to the Government as shareholder.
>
> 3. Royal Mail already has undrawn borrowing facilities of £844 million and these will be rolled forward, amended and increased to £900 million whilst remaining on commercial terms. This will allow the company to embark on an investment programme so that it can transform its effectiveness, secure the efficiency improvements required under the regulatory settlement and successfully compete in a newly liberalised market. Borrowing facilities will be provided by Government."

19. The biggest hurdles by far for Royal Mail Group are tackling the £5.6 billion pension deficit in our accounts whilst ensuring that the Group has an appropriate financing package to permit Royal Mail to invest in its network and provide a long-term sustainable solution to Post Office Ltd's loss-making branches.

20. We have made good progress in our discussions with the Government—our shareholder—on our investment case for the future. We put a commercial plan to the Government which we are confident will enhance the value of the organisation for the shareholder. It is not a Government subsidy but a clear investable case for our shareholder and we have reached agreement in principle with Government on this investment case as a whole.

21. Since the Government's 18 May announcement we have been discussing the huge amount of detail to be worked through, including ensuring we get the right incentive scheme in place for our people. We await the outcome of these discussions with the Government.

22. We have also made significant progress on putting in place another important building block for the future. A vital part of our plans was securing, after lengthy negotiations with Postcomm, a price control for 2006–10 that allows significant investment in the business and gives us the ability to increase the cash payments into our pension fund.

Tackling the Pension Fund Deficit

23. Royal Mail Group plc is the sponsoring employer for the Royal Mail Pension Plan (RMPP), the Royal Mail Senior Executive Pension Plan and the Royal Mail Retirement Savings Plan.

24. The RMPP is the sixth largest pension scheme in the UK in asset terms. As at 31 March 2006:

- The plan had 170,000 people paying into the scheme and 174,000 retired members receiving a pension and 105,000 deferred members who have left Royal Mail Group plc but not yet started to draw their pensions.
- During the year 2005–06 the scheme assets have grown by £4.5 billion to £21.8 billion. Our assets are made up of shares, bonds, properties and other investments: equities £17.4 billion, bonds £2.8 billion, property £1.6 billion.
- Scheme liabilities (the expected amount we will pay to our pensioners in today's money) have also grown to £27.4 billion, generating our deficit of £5.6 billion, as recorded in our accounts.

25. Our RMPP trustees comprise an independent body of 10 people including employees, union representatives, pensioners and independent members. In addition, there is an independent chairman. They take external professional advice and are responsible for full and interim valuations and agreeing with Royal Mail appropriate funding for the pension schemes. The pension trustees now face increasing regulation from the pensions regulator, which was created in the Pensions Act 2004.

26. Looking back at the past performance of the company's main pension fund, for just under 13 years until 2003 the main pension scheme "The Post Office Staff Superannuation Scheme" (POSSS) had a surplus funding level. It made little economic sense however to continue contributions during this period, bearing in mind there was reasonable conservatism built into assumptions used by the plan actuary.

27. Employers have to take action to utilise any surplus assets above the 105% funding level either to improve benefits or take a "contributions holiday" (under the "Prescribed Basis" set out in Schedule 22 to the Income and Corporations Taxes Act 1988).

28. In essence, companies cannot simply pump money into fully funded schemes without allocating the funds to a benefit/liability which will in due course need to be paid out. Surplus assets cannot be returned to the employer.

29. During 2002–03 the position of the main Royal Mail scheme RMPP (created by the merger of the POSSS and the Post Office Pension Scheme (POPS) in 2000) moved from actuarial surplus to deficit, principally because of changes in asset valuations, changes in the independently appointed actuary's assumptions, a fall in the expected long-term investment returns and increased life expectancy of employees and pensioners.

30. As for the current situation, the pension fund deficit recorded in our accounts has increased this year from a liability of £3,958 million in 2005 to £5,588 million. The increase in the deficit is principally due to the lower discount rate assumption driven by market movement in "AA" Bond rates and revised mortality assumptions.

31. To put this deficit into stark perspective, it outstrips the Group's pre-deficit net asset value of £2.3 billion by £3.3 billion.

32. The current Group management has reached an agreement in principle with the pension scheme trustees on how we fund the pension scheme going forward and any related deficit. During 2005–06 the regular employer contribution rate amounted to some £340 million and we paid some £140 million to clear the pension deficit—in 2006–07 the total contributions are expected to be £735 million.

Need for Investment in Modernisation

33. Crucially, we need to embark swiftly on the modernisation of Royal Mail. This is the key challenge the whole organisation is facing. It's an even more daunting task than the three-year Renewal Plan we accomplished from 2002–05.

34. We need to be more efficient. In the Royal Mail letters business, we need a £2 billion investment programme with financing both from the Government and internal cash we generate from turnover. We have to replace ageing and obsolete equipment and put in place new technology giving us the efficiencies, capabilities and a more flexible cost base in order to compete successfully and provide the service our customers need.

35. With competition intensifying and clear signs that the letters market may well decline further, the need for Royal Mail to drive efficiency changes is unmistakable. Improving efficiency in a declining market is much tougher than making productivity gains in a growing one. A key challenge we face is to make rapid progress by investing in new technology and modernising the way we work.

36. Putting in new technology and replacing obsolete equipment, in time and to budget; further streamlining our operations and bringing our people with us at all times; increasing the focus on customers so that we deliver even better service in a market where rivals are after our business—all this will be incredibly stretching. It will mean a great deal of hard work.

Importance of the Proposed Employee Shares Scheme

37. In a company made up of 193,000 employees we know taking our people with us is critical to our plans. We believe giving them a stake in the company is a necessary incentive to achieve the efficiency gains essential if we are to compete successfully to retain and win customers in the face of tough competition and importantly we know this is something they want and would respond to.

38. We believe that a stake in Royal Mail Group—an equal stake for everyone—will motivate our people and help deliver the transformation we need. Our people are fundamental to our modernisation plans and we have stressed their role in the commercial investment plan we have submitted to the shareholder.

39. Under the proposals Royal Mail Group people working in the UK would own a significant share of the company, with the rest held by the Government. The proposals have nothing to do with privatisation.

40. An invitation to our people to express their interest in a company share scheme sparked one of the biggest responses in Royal Mail's history. Within two weeks more than 85,000 people had signed and returned their forms.

41. We are determined that we make further improvements to benefit our people. We want everyone to enjoy working for the company and that means ensuring they are motivated, they have the right working environment, the tools to do the job and they are treated properly at all times. The commitment of all our stakeholders to reform and revitalise the company, long term rewards and a real stake in our future success are crucial.

Post Office® network and the Post Office® Card Account

42. The Department for Work and Pensions (DWP) has decided not to renew the contract with Post Office Ltd for the Post Office® card account (POCA) after March 2010 when the contract expires. The Post Office® network's income from Government—in the past one of its main sources of revenue—fell by £168 million in 2005–06 as more benefits were paid directly into bank accounts. In five years' time less than 10% of Post Office Ltd's income will come from the Government.

43. Post Office Ltd made an operating loss of £111 million for 2005–06 but this was a £12 million improvement on the previous year and represented a real achievement as it showed solid progress in the business's drive to replace lost revenue from pension and benefit book payments.

44. The loss of the traditional benefits income of £168 million during the year 2005–06 was partly offset by attracting new revenue streams, primarily from Telephony, Banking and Financial Services activity, together with continued improvements in overall cost efficiency.

45. The most pressing issue for the Post Office® network involves creating a sustainable future for the rural service, where the majority of the 7,854 branches are fundamentally loss-making and have depended on the £150 million of funding made available by the Government to stay open. The rural branches make up more than half the total number of branches in the network, but they account for less than 10% of total business. Some 1,000 branches serve fewer than 50 customers each week.

46. We await a decision on future funding for the rural branch network from the Government. It is down to us however to give the 500 directly managed branches in high streets and shopping malls—currently losing £50 million a year—a much stronger financial base, as well as making the busiest urban branches—directly managed or privately owned—much more attractive to visit by our customers.

47. Post Office Ltd is currently in discussions with the DWP as to how we can continue to serve as many as possible of the current 4.3 million POCA customers in the future. We are also discussing with the DWP their evaluation of the results of the Department's pilot schemes to test ways of moving existing customers away from the POCA to other payment channels for receipt of their pensions and benefits, as well as not making the POCA available as a payment option to some new customers.

48. Post Office Ltd is determined to retain and continue serving as many of the current POCA customers as possible. We are considering how we can utilise and develop our current range of banking and financial products, although these will not be suitable for all customers.

49. We do believe however, there is a need for a product that would enable individuals who, even after some further encouragement to open a bank account, choose for whatever reason not to do so. It is likely that there will be a cost to the Government to make benefit payments to this group of individuals and we understand they will be required to put that work out to competitive tender. In that situation Post Office Ltd will make every effort to tender for and win that business although of course we accept there are no guarantees.

50. Whilst we are keen to retain as many customers as is possible, clearly some will inevitably stop using the Post Office® and we are working with DWP to try to keep this to as small a number as possible.

July 2006

APPENDIX 15

Supplementary memorandum by Royal Mail Group

Thank you for your letter of 1 August asking Royal Mail Group to provide some further information and points of clarification relating to our appearance before the Trade and Industry Committee on 18 July. We are happy to submit the following supplementary evidence.

1. In Q18 and Q19 of the uncorrected evidence, Mr Crozier offers to provide the Committee with a breakdown of how funding for investment for modernisation and the pension fund deficit will be split between the increased price of postage stamps, income generated by the pension fund, from the shareholder and from efficiency savings at Royal Mail Group. We would be grateful if you could provide us with this evidence?

A total investment of £2 billlion will be required to complete Royal Mail's modernisation programme. This will be funded by:

(a) the Group's own cashflows. These will depend, in part, on the agreement reached with Postcomm for the current price control. This gave us scope to increase stamp prices although the benefit of this is offset by constraints on our ability to fully rebalance our prices in line with real costs. At 32p, the first class stamp price is approximately 6p below fully allocated costs. (This is particularly relevant given that, after the initial increase of 4% in 2006–07, prices will fall in real terms as they will increase, on average, below inflation.)

In business mail, where increases could have a more significant impact, it is not possible to put up prices without loss of market share because of competitive forces. The price control is predicated on Royal Mail achieving efficiency savings of 3% per annum (a challenging aim when considered with the need to absorb inflationary costs, including pay rises).

(b) a £900 million loan facility from Government. The Government loan will be provided on commercial terms and be equivalent to what would be available in the open market.

In respect of the pension fund deficit, Royal Mail has reached agreement in principle with the Trustee to pay down the deficit over the next 17 years, with an initial payment this year of £735 million (covering the 2006–07 ongoing contribution and deficit correction payments). The pension deficit will be funded in part from the price control agreed with Postcomm (for the period 2006–10) in so far as payments relate to the regulated business. The balance will be funded from Company resources.

This contribution profile should allow the deficit to be paid down over 17 years and has been agreed, in principle, with the Trustee on the basis of its assessment of future returns from pension fund assets and the likely cost of meeting future liabilities. For the avoidance of doubt, any returns generated on pension fund assets are for the benefit of the pension fund beneficiaries (ie current and future pensioners). Moreover, the pension is managed by the Pension Fund Trustee who is independent of the Company. It is the case that any fluctuations in the returns that accrue in the fund are not available to finance the Royal Mail going forward (although returns from the assets in the pension fund will be taken into account in determining the Company's future contribution levels—up or down).

In addition, we will, as part of the financial framework agreed in principle with Government, be transferring £1 billion into an escrow account for the benefit of the Pension Fund, which may be drawn by the Trustee in the unlikely event the company should fail; this should give the Trustee the necessary comfort to accept the 17-year payment profile. Any income generated on the funds while in this escrow will also be for the benefit of the Trustee, on the same basis.

We should stress that the £900 million loan facility, the 17-year deficit correction payment schedule agreed with the Trustee and the £1 billion payment into the escrow account are all dependent on final agreement of the funding deal with Government. In turn, the funding deal is dependent on Government agreement to an employee share scheme, which will provide the right incentives to implement a challenging strategic plan.

2. We would also request that the Royal Mail Group provides the Committee with an updated version of the table you provided us with, during our previous inquiry into the Royal Mail Group, on the pension plans funding position. The original table can be found in the printed evidence to the inquiry: TISC, Royal Mail after Liberalisation, Second Report 2005–06, HC 570 II, Appendix 20, Section 3, Ev 116.

We have added an additional line to the table to update it:

Date of Actuarial Valuation		*Funding level (%)*	*Surplus (£m)*	*Recommended period for suspension of Company contributions*
31 March 2004	RMPP (Royal Mail Pension Plan—POSSS and POPS)	85.1%	(2,670) Deficit	Nil
31 March 2005	RMPP	88.7%	(2,200) Deficit	Nil

3. The Committee would also like to know if there were any legal impediments to the Royal Mail Group creating a pension escrow account into which monies could have been placed when the pension fund was in surplus and was 105% funded?

It would have been legally possible to create a pension escrow account at a time when the pension fund was in surplus, providing the sums put in it were solely for the benefit of the pension scheme. However, putting funds into a pension escrow account would have inevitably meant that such funds were not available elsewhere in the company to invest, as we did, in improving customer service, keeping prices down or building up reserves.

It is worth noting that the escrow account now being established is largely composed of funds from the mails reserves—ie, funds which were paid into the reserve from past profits.

4. In Q27 of the uncorrected evidence, Mr Crozier offers to advise us of the date the Royal Mail Group put the proposed finance package formally to the Government. We would be grateful if you could provide us with this evidence?

The proposed finance package was formally put to Government on 14 February 2006.

5. In Q39, Mr Leighton offered to provide the Committee with any relevant part of a Memorandum or Article of Association relating to the spending of Post Office resources on surveying your employees opinions: "If there is one, we will send it to you with pleasure; if there is not one, there is not one". And later in Q42, that he would send the Committee a copy of the letter, which was sent to employees with regards to the proposed share scheme. We would be grateful if you could provide us with these two pieces of evidence? The Committee would also be interested in being provided with the results of this survey in as much detail as is possible.

You will see that Clause (T) of the Memorandum of Association of Royal Mail Holdings—which I have enclosed as Annex 1—allows the Company: "To do any other thing which in the opinion of the board of directors of the Company is or may be incidental or conducive to the attainment of the above objects or any of them".

In addition to this general power a couple of other areas are relevant to this particular activity. Firstly, the Company has a policy to encourage effective communication and consultation between our people, particularly on matters relating to strategy, financial and economic factors that may influence the Company's performance; and secondly, statutory provisions such as the Information and Consultation of Employees Regulations 2004 (SI 2004/3246) require a company to inform and consult with employees about a wide range of business decisions.

A copy of the letter dated 2 May 2006 concerning the proposed employee shares scheme sent by Royal Mail Group Chairman Allan Leighton to employees and subpostmasters is also submitted to the Committee and attached at Annex 2. The letter was sent to 208,000 people and 91,703 returns were received; all but a handful were in favour of an employee share scheme.

While the company's Articles of Association do not bear directly on the point you raised, please let me know if you would like me to send you a copy, by email or hard copy.

6. In Q46, Mr Leighton offered to provide the Committee with "empirical evidence that shares for employees works". We would be grateful if you could provide us with the empirical evidence that the particular model of share scheme Royal Mail Group proposes would "work"?

The support comes from all sides: as well as academics, it comes from the private sector, from institutional investors and from governments of different persuasions all of whom put their money where their mouth is when it comes to employee share ownership:

1. The overwhelming majority of the FTSE 100 runs employee share ownership plans and have done so for many years. The Boards of nearly every major company in the UK strongly believe that letting their employees have shares makes sound business sense. Their annual reports describe the benefits they get from these plans.
2. The major institutional shareholders know the advantages of aligning the interests of employees to their own: they have long allowed UK companies to print new shares to the value of one percent of the issued share capital each year for employee share plans. This is a real cost to investors which proves their belief in the motivational value of employee share plans. Investors just would not do this if it didn't get them better results.
3. Successive governments wanting to strengthen the economy have long invested in employee share ownership. Governments have backed their belief in the effectiveness of these plans through tax advantages. There has been ShareSave, Profit Sharing Shares and the current government's Share Incentive Plan—which is really four different types of employee share plan covered in one piece of legislation. The appendix to this letter quotes a number of government ministers strongly supporting employee share plans—including Gordon Brown citing academic research with approval. The European Union also officially encourages Members States to provide incentives through share ownership schemes.

We firmly believe that when Boards, investors and governments are all in agreement and back their judgements financially that there really is an advantage in employee share ownership.

Comprehensive evidence to back our belief is included in Annex 3 to this letter, while Annex 4 shows support for the principle of employee share schemes from Government Ministers. Study after study shows that there is real economic sense in employee share ownership. It is not an untried idea. It is recognised by everyone as beneficial to all parties. If there are fewer academic studies in the UK that's because UK companies haven't needed to reflect on the matter—they've just got on with it and put the plans in—and our leading companies have almost all got employee share ownership plans.

It has always proved very hard to produce radical reform in the public sector—there is a strong mindset that makes it difficult. But we have to make changes, for the sake or our employees, our customers and our shareholder. Employee share ownership is essential to changing the psychology—people behave differently if it is their business and they have something to gain if all goes well and something to lose if it doesn't.

The academic studies show companies with shares doing better financially than those without them. For Royal Mail it is more fundamental than that. We are convinced that we need shares if we are to stand a chance of building and maintaining a worthwhile business.

I hope this letter has clarified the points you had raised but please do not hesitate to get in touch if the committee requires further information.

11 August 2006

Annex 1

Company No. 4074919

THE COMPANIES ACT 1985

A PUBLIC COMPANY LIMITED BY SHARES

MEMORANDUM OF ASSOCIATION OF

Royal Mail Holdings plc

(Previously Consignia Holdings plc)

1. NAME
The Company's name is "Royal Mail Holdings plc".[26]

2. TYPE OF COMPANY
The Company is to be a public company.

3. REGISTERED OFFICE
The Company's registered office is to be situated in England and Wales.

4. OBJECTS
The objects for which the Company is established are:
   (A) To provide:
      (i) postal services and services for or connected with the distribution or communication of all descriptions of goods, information and other things;
      (ii) banking, money transmission and other financial services;
      (iii) all kinds of services to businesses and other service providers in connection with the management of customers and clients;
      (iv) all services for or connected with the communication of information, messages and data, and the carrying out of transactions, over all kinds of physical, electronic and other media; and
      (v) services to or for Her Majesty's Government, the government of any other territory, and any national, supranational or local authority or other governmental, state or public sector body and services to or for citizens in connection with their relationships with any of the aforesaid bodies.
   (B) To carry on business as a general commercial company and to carry on any trade or business whatsoever.
   (C) To acquire any estate or interest in and to take options over, construct, develop or exploit any property, real or personal, and rights of any kind and the whole or any part of the undertaking, assets and liabilities of any person and to act as a holding company.
   (D) To provide services of all descriptions.
   (E) To lend money and grant or provide credit and financial accommodation to any person and to deposit money with any person.
   (F) To invest money of the Company in any investments and to hold, sell or otherwise deal with investments or currencies or other financial assets.
   (G) To enter into any arrangements with any government or authority or person and to obtain from any government or authority or person any legislation, orders, rights, privileges, franchises and concessions.

[26] Incorporated on 20 September 2000 as Expandreserve Public Limited Company. Name changed by special resolution to The Post Office Group plc on 12 December 2000 and by further special resolution to Consignia plc on 4 January 2001 and by further special resolution to Consignia Holdings plc on 25 January 2001. The name was changed to Royal Mail Holdings plc by special resolution on 4 November 2002.

(H) To borrow and raise money and accept money on deposit and to secure or discharge any debt or obligation in any manner and in particular (without prejudice to the generality) by mortgages of or charges upon all or any part of the undertaking, property and assets (present and future) and uncalled capital of the Company or by the creation and issue of securities.

(I) To enter into any guarantee, contract of indemnity or suretyship and in particular (without prejudice to the generality) to guarantee, support or secure, with or without consideration, whether by personal obligation or by mortgaging or charging all or any part of the undertaking, property and assets (present and future) and uncalled capital of the Company or by both such methods or in any other manner, the performance of any obligations or commitments of, and the repayment or payment of the principal amounts of and any premiums interest dividends and other moneys payable on or in respect of any securities or liabilities of, any person, including (without prejudice to the generality) any company which is for the time being a subsidiary or a holding company of the Company or another subsidiary of a holding company of the Company or otherwise associated with the Company.

(J) To amalgamate or enter into partnership or any profit-sharing arrangement with, or to co-operate or participate in any way with, or to take over or assume any obligation of, or to assist or subsidise any person.

(K) To sell, exchange, mortgage, charge, let, grant licences, easements, options and other rights over, and in any other manner deal with, or dispose of, all or any part of the undertaking, property and assets (present and future) of the Company for any or for no consideration and in particular (without prejudice to the generality) for any securities or for a share of profit or a royalty or other periodical or deferred payment.

(L) To issue and allot securities of the Company for cash or in payment or part payment for any real or personal property purchased or otherwise acquired by the Company or any services rendered to the Company or as security for any obligation or amount (even if less than the nominal amount of such securities) or for any other purpose, and to give any remuneration or other compensation or reward for services rendered or to be rendered in placing or procuring subscriptions of, or otherwise assisting in the issue of, any securities of the Company or in or about the formation of the Company or the conduct or course of its business.

(M) To establish or promote, or concur or participate in establishing or promoting, any company, fund or trust and to subscribe for, underwrite, purchase or otherwise acquire securities of any company, fund or trust and to act as director of and as secretary, manager, registrar or transfer agent for any other company and to act as trustee of any kind.

(N) To pay all the costs, charges and expenses preliminary or incidental to the promotion, formation, establishment and incorporation of the Company.

(O) To grant or procure the grant of donations, gratuities, pensions, annuities, allowances or other benefits, including benefits on death, to, or purchase and maintain any type of insurance for or for the benefit of, any directors, officers or employees or former directors, officers or employees of the Company or any company which at any time is or was a subsidiary or a holding company of the Company or another subsidiary of a holding company of the Company or otherwise associated with the Company or of any predecessor in business of any of them, and to the relations, connections or dependants of any such persons, and to other persons whose service or services have directly or indirectly been of benefit to the Company or whom the board of directors of the Company considers have any moral claim on the Company or to their relations, connections or dependants, and to establish or support any funds, trusts, insurances or schemes or any associations, institutions, clubs or schools, or to do any other thing likely to benefit any such persons or otherwise to advance the interests of such persons or the Company or its members, and to subscribe, guarantee or pay money for any purpose likely, directly or indirectly, to further the interests of such persons or the Company or its members or for any national, charitable, benevolent, educational, social, public, general or useful object.

(P) To cease carrying on or to wind up any business or activity of the Company, and to cancel any registration of and to wind up or procure the dissolution of the Company in any state or territory.

(Q) To distribute any of the property of the Company among its creditors and members or any class of either in cash, specie or kind.

(R) To do all or any of the above things or matters in any part of the world and either as principals, agents, contractors, trustees or otherwise and by or through trustees, agents or otherwise and either alone or in conjunction with others.

(S) To carry on any other activity and do anything of any nature which in the opinion of the board of directors of the Company is or may be capable of being conveniently carried on or done in connection with the above, or likely directly or indirectly to enhance the value of or render more profitable all or any part of the Company's undertaking property or assets or otherwise to advance the interests of the Company or of its members.

(T) To do any other thing which in the opinion of the board of directors of the Company is or may be incidental or conducive to the attainment of the above objects or any of them.

(U) In this clause "company", except where used to denote this Company, shall include any partnership or other body of persons, whether incorporated or not incorporated, and whether formed, incorporated, domiciled or resident in the United Kingdom or elsewhere, "person" shall include any company as well as any other legal or natural person, "securities" shall include any fully, partly or nil paid or no par value share, stock, unit, debenture, debenture or loan stock, deposit receipt, bill, note, warrant, coupon, right to subscribe or convert, or similar right or obligation, "and" and "or" shall mean "and/or" where the context so permits, "other" and "otherwise" shall not be construed ejusdem generis where a wider construction is possible, and the objects specified in the different paragraphs of this clause shall not, except where the context expressly requires, be in any way limited or restricted by reference to or inference from the terms of any other paragraph or the name of the Company or the nature of any trade or business carried on by the Company, or by the fact that at any time the Company is not carrying on any trade or business but may be carried out in as full and ample a manner and shall be construed in as wide a sense as if each of those paragraphs defined the objects of a separate distinct and independent company.

5. LIABILITY OF MEMBERS

The liability of the members is limited.

6. SHARE CAPITAL

The Company's share capital is £100,001 divided into 100,000 shares of £1 each and one special rights redeemable preference share of £1.[27]

We, the subscribers of this Memorandum of Association, wish to be formed into a company pursuant to this memorandum; and we agree to take the number of shares shown opposite our respective names.

Names and addresses of Subscribers		Number of shares taken by each Subscriber
1. For and on behalf ofInstant Companies Limited, 1 Mitchell Lane, Bristol BS1 6BU.	—	One
2. For and on behalf of Swift Incorporations Limited, 1 Mitchell Lane, Bristol BS1 6BU.	—	One
Total shares taken	—	Two

Dated 8 September 2000

Witness to the above Signatures: Glenys Copeland,
1 Mitchell Lane,
Bristol BS1 6BU.

Annex 2

Royal Mail Group plc

The books are now closed on the last financial year and the finance people are busy totting up the numbers. The books need to be audited and signed off by the accountants, but all the signs are looking good. I'm optimistic that we'll hit the profit target and that we'll be paying out £400 Share in Success to everyone who's eligible. Don't spend it yet . . . and remember you'll have to pay tax on it . . . but it's worth giving some thought to what you might do with this year's payment. If we do hit the numbers it'll be down to your hard work. . . so thanks for that.

With all the talk of possible share schemes in the press, I thought it would be helpful to give you our perspective on the issue.

— *Is it a done deal?* No, it's not. And the final decision rests with Government, our shareholder, but I'm confident we'll get you shares.

[27] The Company was incorporated with a share capital of £100,000 divided into 100,000 shares of £1 each.
On 4 January 2001 the share capital of the Company was increased from £100,000 to £100,001 by the creation of one special rights redeemable preference share of £1.

- *Do I think it's a good idea?* Yes, absolutely. I'm passionate about giving some of the business to the people who actually deliver for our customers, ie you.
- *Is this privatisation?* No! Let me be clear. There are no plans to privatise this business. Under the scheme I'm proposing, up to 20% of the business would be shared with people working for Royal Mail in the UK, with the rest staying in the hands of the Government.
- *Will the shares grow in value?* I don't have a crystal ball . . . but if the business grows so will the value of your shares. All we have to do is to continue to hit our targets and deliver for our customers . . . as we have over the past few years. We know we can deliver. We've a track record of success. So there's no reason why we shouldn't plan to carry on making money and increasing the value of the business.
- *Are there any strings?* Not if Government accepts our proposals. You'll have to work for the business . . . and have been employed for at least one year . . . but that's hardly a string! We would start by sharing out a chunk of the business—equally to everyone—just because they work for Royal Mail Group. And, as well as the value of the shares, you'll also get a cash bonus—like a dividend—each year, as long as we hit our targets.
- *Will this cost you anything?* Not a penny. You won't have to buy your shares so you can't possibly lose any money. They will be available to everybody who has been with us for a year or more.
- *Will this mean less in pay?* No way. Pay is what you get for doing your job. Shares would give you real ownership of the business and are extra to basic pay. We will continue to give you the best pay rise we can afford under the current market conditions, but with so much uncertainty around the impact of competition and the loss of volumes it's impossible to predict the future . . . and I never make promises that I can't keep.
- *Will you be able to cash in your shares?* Yes, that's the plan, although not immediately. You'll be able to sell your shares after three or five years—but only within the company—or buy more shares if that's what you want. Between the share value and the dividend we hope you will be sitting on a nice nest egg.
- *What happens to Share in Success?* It's going to take us a while to get the share scheme agreed and sorted—and we'll have to get the law changed before you can own shares. So . . . until then . . . we plan to keep paying you your share of the profits . . . like an annual dividend.
- *Will this affect my pension?* No, but we do need to keep improving our efficiency, to free up cash to fund the scheme—which is likely to be an extra £250 million a year.
- *Isn't this about board members getting rich?* No—everybody in the company will have the same allocation of shares with the same value, regardless of position.

So, that's shares!

We hope to complete a funding package shortly—to protect pensions and provide money to invest in the business. And we're focusing our efforts on balancing the many calls on our cash—so people can get a bit more in pay, can enjoy some job security—because the business is strong and has a bright future—and continue to look forward to a good retirement. It's a difficult balancing act . . . but that's what I believe is in the best interests of you and the company as a whole.

More to come on all these topics . . . but here's what I need from you . . .

If you would like to receive your free shares please register your interest by completing the enclosed slip and sending it back to me, in the pre-paid envelope, within the next seven days.

Thank you . . . I look forward to hearing from you . . .

My best regards to you and your family,

Allan Leighton
Chairman

2 May 2006

Proposed employee share scheme—expression of interest

I would like to register my interest in receiving employee shares. Please put my name on the list to make sure I get more information, when it's available.

Name:

....

Business unit:

....

Work location:

....

Pay number:

....

Home email address (if you are happy for us to contact you in this way):

....

Annex 3

Academic studies on employee share ownership

The following academic studies all provide evidence of the benefit of employee share schemes:

— **The Rutgers Study**. In 2000 Douglas Kruse and Joseph Blasi of Rutgers University found that companies with employee share ownership plans increased sales by 2.3% to 2.4% a year above those of other organisations. This study was based on information from Dun and Bradstreet relating to companies that had adopted employee share plans between 1988 and 1994. They examined sales and employment data three years before the introduction of the plan and three years afterwards. It covered 343 companies with employee share plans and matched them on the basis of size and other characteristics with 343 other companies. The results showed that companies with plans performed better after their adoption than their previous results would have indicated. The improvements were in sales growth, employment growth and in sales per employee. The authors point out that over a 10 year period this gives a 25% advantage to companies with employee share plans.

— **The US National Centre for Employee Ownership (NCEO) Study** of 1986 was perhaps the first to demonstrate the causal link between corporate performance and employee share ownership. This study looked at the performance of companies five years before and five years after establishing a plan. General market effects were indexed out. This study found that sales growth was 3.4% higher each year and employment growth 3.8% higher. Over a 10 year period this equates to 40% higher sales and 45% higher employment growth. The study also found that when share ownership was coupled with an open and participative style of management the additional growth was between 8% and 11% each year.

— **The New York and Washington Studies**. The NCEO study was repeated using a different set of companies. It was found that companies which combined employee share ownership with participative management grew by between 6% and 10.9% extra each year.

— **The General Accounting Office (GAO) Study**. In 1987 the US General Accounting Office surveyed 110 companies and found that share ownership combined with open and participative management increased a company's growth rate by more than 50%—ie if it would have been growing at 10% this would be boosted to 15%.

— **Northwestern University.** A 1999 study by Hamid Mehran of 382 companies looked at performance in the two years before implementing an employee share plan and the four years after. This found that those companies with employee share plans increased their Return on Assets by 2.7% over what would otherwise have been expected. The study also noted that over 60% of companies experience an increase in their share price in the two days after announcing the introduction of employee share ownership plans—again showing that investors recognise the value of such plans.

— **Kruse and Blasi of Rutgers University and Conte of the University of Baltimore** created an "Employee Ownership Index" in 1992 which tracked the share prices of companies where 10% or more of the shares were owned by employees and which had a market value of at least $50 million. Between 1992 and 1997 the Employee Ownership Index grew 193%, compared with a grow in the DOW of 145% and in the S&P 500 of 140% during the same period.

— **Collat** in a 1995 study found that companies with employee share plans saw their operating margins improve 2.1% per year more than would otherwise be expected. The study looked at performance three years before and three years after the introduction of employee share ownership, and indexed for market movements.

— **Watson Wyatt** in a 2003 study looked at 800 companies and concluded that "companies with higher levels of participation in stock option plans create greater shareholder value than companies with low participation."

— **A Wharton Study** in 2001 by Larcker, Ittner and Lambert looked at 159 new economy companies and found that giving higher grants to more junior people resulted in significantly greater than expected share price growth—indicating that broad based share plans are better for investors.

— **Hewitt Associates** has found that Employee Share Ownership Plans in 382 publicly quoted companies increased the return on assets by 2.7% above what would otherwise have been expected.The Hewitt study looked at the companies' financial returns for two years prior to the plan's implementation and for the next four years with an Employee Share Ownership Plan. These companies had a 14% greater return on assets compared to their peer group over the four year period.

Annex 4

Government Ministers' comments on employee share schemes

1. Gordon Brown, Chancellor of the Exchequer, speaking to the Labour Party Conference of 2000:

"In the United States, share incentive plans have proved a winner for many companies. An analysis by William M Mercer concluded from a wide-ranging study of US companies that broad-based option grants had improved sales growth per employee. For the period 1993 to 1997, a comparison of 49 companies employing broad-based share option plans against 301 firms which did not do so, revealed that the former earned anything between $9,000 and $28,000 more in sales per employee than the latter.

These findings are confirmed by a study undertaken by Washington University. In an analysis of the performance of 205 major companies, those firms which offered a popular employees share option plan outperformed those with less attractive employee share schemes by 22% per annum.

Other academic research also suggests that share-based remuneration is likely to work best when it is linked directly to other best-practice human resource programmes such as decision making at the shop floor level.

In the United Kingdom, a study by Bradford University found that profit-sharing arrangements put in place by companies across a broad spectrum of manufacturing helped, in conjunction with other factors, to improve productivity by 23%."

2. Speech By Stephen Timms MP, Financial Secretary To The Treasury, At The Proshare Conference, 25 November 1999:

"This is why employee share ownership is so important to this Government. And this is why we want to encourage more companies to offer all their employees a stake in their business.

Employee shareholders have a direct interest in the performance of their company and a real stake in its success. Research in both the US and the UK shows there is a clear link between employee share ownership and improvements in productivity. Over time, employees have an incentive to contribute more actively to the development of the business. And if the majority of employees have an ownership stake, then individual efforts become mutually reinforcing.

Employee shareholders also feel a greater commitment to their company which helps the company recruit and retain employees and improves its return from investment in employee skills and training. Employee shareholders better understand the risks faced by the business, which in turn can lead to greater pay responsibility."

Refering to the new Share Incentive Plan, SIP, he said:

"From what we have heard already, we think the new plan will be very successful. These developments herald a dramatic change in the way many businesses operate, and point towards a new era of partnership between employees, shareholders and managers. They are a key building block for Britain's future prosperity, for the modern and decent Britain we are working for. Join with us in promoting employee share ownership, so that we can make the most of the benefits which are on offer."

3. Speech by Patricia Hewitt to Proshare Conference 2000:

"None of us should underestimate the role of employee share ownership in driving up productivity.

I'm a believer that if people know why they are doing things, they will do things better, if they are told the result of their actions that is better still, but ideally, the optimal results are realized when people have a stake in the outcome as well—and that's employee ownership in a nutshell.

Share ownership helps people who work in a company feel as if they own part of that business. They have a stake in it, they have a voice, and they are more likely to be happier, more productive individuals as a result."

. . .

"My mission back then was to try and maximise the number of companies that offered Employee Share Schemes. It is now estimated that around 5,000 companies in the UK operate Employee Share Schemes with around 3.5 million employees participating.

Although this is a significant number, we must not be complacent. We all have a duty to make sure that the work goes on to increase the number of participants further still."

. . .

"Schemes which involve the widest range of workers possible are the ones that realise the largest benefits. It is the optimal way to promote fairness, and to enable the whole of the workforce to benefit in the success of the company.

In short, it is clear to me that there can be no better incentive and motivation for employees than for their work to be recognised and for them to share in the firm's success."

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