



House of Commons
Trade and Industry Committee

**Royal Mail Group:
Government Response
to the Committee's
Ninth Report of
Session 2005–06**

**First Special Report of
Session 2006–07**

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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.

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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).

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First Special Report

The Committee published its Ninth Report of Session 2005–06¹ on 30 October 2006. The Government's response was received on 10 January 2007 and is published as an Appendix to this Report. We wish the response to be in the public domain before we take oral evidence from the Secretary of State for Trade and Industry about the Government's intentions concerning the Post Office network and the financial framework for the Royal Mail Group as a whole. We may return to the substance of the Government's response following that evidence session.

Government response

Introduction

The Government welcomes the Committee's report on Royal Mail Group. The report covers important issues relating to the future of the Royal Mail and it has been useful to have the Committee's views to help with the development of Government policy in these areas.

The Government's ambition is to see a publicly owned Royal Mail fully restored to good health, providing customers with an excellent service and its employees with rewarding employment.

Since the report was published the Government has made an important statement to the House of Commons on the future of the post office network and published a consultation document on the network. Copies of these are attached at Annex A and B.²

Responses to Conclusions and Recommendations

Below we have set out our responses to the conclusions and recommendations directed at Government and where we believe it is appropriate for Government to respond. We have numbered the conclusions and recommendations as they appear in the report. Our response is set out below on each of them.

Conclusions and recommendations

A new financial framework³

1. We are encouraged to see that the Government is prepared to support the Royal Mail Group financially, albeit on a commercial basis. We would expect this of any responsible shareholder in a company needing significant investment to enable its business to flourish. We are also encouraged to see that the Government, as

1 Ninth Report from the Trade and Industry Committee, Session 2005-06, Royal Mail Group, printed as HC 1556-I on 30 October 2006.

2 Not Printed

3 Paragraphs in bold are quotations from the Committee's Ninth Report.

shareholder, has agreed to assist Royal Mail Group's employees through helping Royal Mail Group plug its pension fund deficit. (Summary)

2. We were surprised to hear from Royal Mail Group that it had had the temerity to place conditions on agreeing to the Government's proposed financial package. We hope the Government does not accept these conditions. We understand that the management believes the revitalisation of Royal Mail is possible only if the workforce is given the incentives to deliver the desired growth in productivity. However, the Royal Mail Group managers' insistence that they would not accept the new financing framework unless their proposed share scheme was agreed by the Government is perverse given that the company is technically insolvent (because of its pension liabilities) and especially so since we have grave doubts whether the proposed share scheme would provide sufficient or appropriate incentives. (Summary)

The Government agrees with the Committee that it is the role of a responsible shareholder to invest in a company when there is a clear, commercial need to do so. This remains our position. The Committee commented that they are encouraged that 'Government,..., has agreed to assist Royal Mail Group's employees through helping Royal Mail Group plug its pension fund deficit'. We should make it clear Government has not provided any funds to go directly into the pension fund to address the deficit. We propose to allow the company to use its own resources to effectively manage the pension deficit—we have agreed that it can transfer reserves that are on its Balance Sheet into an Escrow account. This may be used to fund the pension schemes in the unlikely event that the company fails, otherwise it will be returned to Government when the deficit has been repaid through contributions by the company.

In respect of the Committee's view on the incentivisation conditions put on the financing framework by the company, we remain committed to ensuring that Royal Mail has an appropriate financing package as soon as possible. This is indeed important given the financial situation of the company and the need for it to implement its transformation plan as soon as possible. However, we recognise Royal Mail's desire to ensure that the plan that we are prepared to invest in is backed with suitable employee incentives and we are actively engaging them on this point.

Ownership of the Royal Mail Group

3. Neither the Royal Mail Group nor the CWU has provided sufficient evidence for us to determine if Royal Mail Group's employees are in favour of or against the proposed share scheme. Royal Mail's letter did not directly ask employees whether they supported the share scheme, only asking them to register an interest in order to "receive your free shares". The survey results do not therefore show that "all but a handful were in favour of an employee share scheme", as claimed by the Royal Mail Group; it is arguable rather that these employees were afraid that they would miss out on an amount of money if they did not return the form. Registering an interest in a putative share allocation scheme is not the same as thinking that such an allocation would be desirable. The evidence the CWU provided from their ballot asked their membership if they supported their union's views on "higher basic pay, job security, pensions and fairer workloads", not if they were for or against the proposed share

scheme. Again we feel that to rely on this ballot as proof of opposition to a share scheme is misleading. (Paragraph 37)

4. The Government told us that it would not agree to an employee share scheme, until it had taken “views from a number of stakeholders”. If the Government is seriously considering the part privatisation of Royal Mail Group—even if the ownership is only extended to employees—then the Government’s priorities should be to hold a public consultation and also to ascertain the views of Royal Mail Group’s employees. This is especially necessary given the fact that no one has provided supporting evidence that such a scheme in a publicly owned plc would produce the expected results. (Paragraph 38)

5. Whatever view we might take on the ownership of the Royal Mail at this time, we remain unconvinced that separating a part of Royal Mail’s equity from the current shareholder would act as a tool to motivate Royal Mail’s workforce. The explanations offered to us by Royal Mail’s current management are incomplete, lack robust evidence, and are little better than mere assertions. This may be because negotiations with the Shareholder are ongoing. However, we still believe that there are less controversial—and far more straightforward—ways for Royal Mail’s management to improve motivation, such as adapting the current profit sharing scheme. (Paragraph 39)

Government notes the view of the Committee in respect of an employee share scheme at Royal Mail. We are discussing the company’s proposals with them. Given the scale of the change that is needed at Royal Mail to transform the business so that it can be successful in a fully competitive market, we recognise that the workforce needs to be appropriately rewarded for their role in delivering that change. We have noted the Committee’s views about the merits of delivering incentives through an employee share scheme and will have regard to these in our discussions with the company. We expect to be able to announce a decision soon.

Post Office Card Account

6. We do not believe that the Government deliberately set out to mislead our predecessor Committee with regards to the longevity of the POCA. However, nor do we believe that the Government made clear the possibility that the contract would not be renewed. Most of the DWP’s partners in the POCA assumed that the contract would be renegotiated after 2010. This has, quite understandably, led to a lot of bad feelings amongst these partners and a sense of betrayal amongst sub-postmasters. Sub-postmasters will have made business decisions based on the understandable, but ultimately false, expectation that the contract would be renewed. We note that the Minister is now holding out the possibility of a substitute for the POCA. We would welcome any clarification of what this would be. (Paragraph 51)

The Government has now announced that after 2010 (when the current POCA contract ends) it will continue with a new account that will include similar features to the POCA. This will be available nationally and customers will be eligible for the account on the same basis as they are now. The detailed design for the product, including the precise functionality, will be decided as part of DWP’s tendering and contractual process.

7. The DWP suggested that the key findings of its pilots would enable Post Office Ltd to “help them identify customers’ needs”. We cannot see how this is so. The key findings give no indication of what customers want instead of their POCA as they were refused the choice of keeping the POCA, or an as yet undeveloped alternative. Customers may have feared that if they did not comply with the DWP’s requests they would have their benefits stopped. We are not convinced that these pilots were carried out in a methodologically sound way, and so we cannot comment on whether their conclusions were in fact valid. (Paragraph 83)

The pilots were intended as operational trials designed to test customer reaction, and identify customer needs, in the event that the POCA was no longer available. They were not designed to be part of any formal study of the POCA and its alternatives. DWP also wanted to test various approaches to moving people from having their benefit or pension paid into a POCA to payments into a bank account (both DWP and Post Office Ltd were obliged to do this under the terms of the POCA contract). The Committee has been critical of the pilots, but the DWP’s view is that it would also have been subject to criticism had it moved straight to migrating people from the POCA, or designing new products, without testing customer reaction and needs first. As mentioned above, the Government has since decided that after 2010 it will continue with a new account that will include similar features to the POCA.

Post Office Ltd recognised that the pilots have provided them with some useful information, particularly around the sort of account features customers like, e.g. receiving interest on their balances. Post Office Ltd has already introduced the Post Office Instant Saver which may be of benefit to customers who do not regularly withdraw money from their POCA. This allows six free withdrawals per year and pays 5.25% gross/AER on balances over £500. Customers who have large balances that have accumulated in their POCA may benefit from POL’s new Five Year saver which has a fixed term deposit that pays 6.25% gross/AER on half the balance with the other half linked to the FTSE-100 index. POL⁴ will continue to look at the scope for introducing other attractive financial products in the future.

8. We are concerned that the DWP’s pilot did not include an alternative to the POCA. We do not believe that it is beyond the Post Office and DWP to offer customers an alternative product to the POCA which, while retaining the advantages of the POCA, would also offer the greater functionality of a mainstream bank account. The DWP has so far released just the preliminary findings of its pilots and we will watch its full conclusions with great interest. (Paragraph 91)

The “alternatives” to the POCA currently include around 25 or so different bank accounts that can be accessed at Post Office branches. These all provide cash over the counter and offer additional functionality. Interestingly, the pilots highlighted that many customers were not aware they could use their bank account at the Post Office. This could be of interest not just for those receiving a benefit or pension but all those who have a relevant bank account accessible at a Post Office. DWP is therefore working with Post Office Ltd to support it in its efforts to increase awareness of this among the 16m benefit recipients.

All the key findings from the pilots have been made public through the Parliamentary-Under-Secretary of State's (Mr Plaskitt) written statement on 20 July 2006 (Cols 60 and 61WS).

9. Also, although it is accepted that an alternative is likely to be less profitable to Royal Mail Group than the POCA, we still do not know what impact it would have on the income of sub-postmasters. Indeed, an alternative offering with more functions, such as an ability to make deposits, might increase their income directly or indirectly, through greater footfall. (Paragraph 91)

10. The perceived financial benefit for the taxpayer from DWP's ending of the POCA is questionable if revenues for Post Office branches continue to be found from the public purse in the form of increased subsidy payments to keep the network afloat—always assuming that the size of the current network be maintained. (Paragraph 45)

The Government's recent proposals are intended to maintain a national network with national coverage which provides customers with a choice on how they access and pay for their services and also recognises the important social and economic role the network plays particularly in rural communities and deprived urban areas. The Government believes that the package of support announced for the network, together with the continuation of a new account with similar features to the POCA after 2010 will help deliver this.

DWP (and the other paying departments) will pay Post Office Ltd for the services they provide while the Government continues to pay a subsidy to ensure that there is a sustainable nationwide network of post office branches.

Post Office Network

11. The rapid pace of change throughout financial services presents unavoidable challenges for Post Office Ltd. It is almost inevitable that Post Office branch incomes will fall over the coming years as customers become more financially aware and naturally graduate to bank accounts (including internet banking), which can offer them greater functionality, such as bill payment. We regret that Government policy is accelerating this process. (Paragraph 68)

Customer trends have changed in recent years towards alternative and more convenient choices for accessing services. Increasingly people are choosing to send an e-mail or text message; they pay bills by direct debit, use the telephone and internet for banking or to access information on Government services. Many people now find it more convenient to pay car tax on-line or have benefit paid directly into a bank account. The Government is simply responding to popular preferences in offering the public more choice and flexibility in how they access Government services. But the Post Office remains an important way of accessing services and the proposals announced by Government will help place it on a stable long-term financial footing. This will put the network in a better position to compete for contracts, whether from Government Departments or other clients.

12. With the reduction in income for Post Office branches from the termination of the POCA, coupled with a fall in income from other sources, we are very worried about the future of the Post Office network as it stands today. We are especially concerned about

the impact on commercially unviable parts of the network and the implications Post Office branch closures would have on their wider communities. (Paragraph 69)

13. If the Post Office network were just a commercial entity, it would not deserve to be supported by Government. However, it fulfils a wider community need. In many places Post Office branches serve as the heart of the community. (Paragraph 73)

14. Some Post Office branches, especially those in rural areas, will always remain unviable. We believe that it is vital that across the whole of Government there is a clear recognition of the role that Post Offices play in delivering Government objectives in the community. Decisions are needed by the Government now to plan the Post Office network for the future, taking into account postal services and the wider social functions provided by Post Offices in local communities. If the Government fails to act, the network and all the benefits it provides for communities could be lost forever. (Paragraph 74)

Government acknowledges and accepts the Committee's concerns about parts of the network that are likely always to be unviable and fully agrees that the Post Office plays a vital social and economic role. The proposals outlined to Parliament on 14 December [2006] demonstrate the Government's commitment to a national network of post offices providing access throughout the UK despite the fact that many parts of the network will never be commercially viable for Post Office Ltd. The proposals, which are subject to national consultation until 8 March 2007, include safeguards for most vulnerable customers in remote rural and deprived urban areas and it is hoped that the Committee will recognize that the Government has sought to protect these parts of the network.

While recognising the wider community role played by post offices the Government must balance this with the need to spend taxpayers' money responsibly. The financial package proposed of up to £1.7bn seeks to do just that by investing in the long-term health of the network, tackling both over supply in densely populated parts of the network (we understand that there are over 1,000 urban sub-post offices that have 6 or more other branches within 1 mile) and under-use in other areas and putting the network on a more stable footing to the benefit of Post Office Ltd, sub-postmasters and customers.

15. The Government is rightly concerned about financial exclusion. This is not just a question of encouraging participation in banking services, it is about access in some areas to the most basic of banking services: access to cash. The Post Office is often the only outlet offering free access to cash for people in deprived areas, be they urban or rural. For many their Post Office branch provides access to vital services, such as bill payments. We welcome the Government's agreement to make social network payments for the next two years. However, we recommend that the Government should now commit itself in principle to making social network payments for the period post 2008. This would reduce the anxiety currently felt by many customers and sub-postmasters. (Paragraph 78)

The Government understands that there is a degree of anxiety felt within the network and accepts the Committee's recommendation to continue to fund the social network payment beyond March 2008. Government recognizes that Post Offices that can never be commercially viable, but that play an important social and economic role, will need

continued public funding. Consequently, the financial package proposed on 14 December includes the extension of the Social Network Payment at up to its current level until March 2011. In response to the role that post offices play in financial inclusion, the Committee will be pleased to note that Post Office is increasing the number of free ATM's deployed across the network to 4,000.

16. The Government has agreed to consult with regards to any decision it takes on the Social Network for the post 2008 period. We will watch with interest the form and outcome of such consultation, which must be conducted in the most open and thorough manner and with a reasonable period for interested parties to respond. (Paragraph 67)

The Government agrees with the Committee's views on consultation and is committed to open and transparent consultation on matters of public interest. Proposals announced on 14 December are set out in more detail in a national consultation document on the Post Office Network. This consultation will run for 12 weeks with a closing date of 8 March 2007.

Following the Government response to consultation, Post Office Ltd will develop area proposals for network change based around groupings of Parliamentary constituencies on which they will consult.

17. Historically the UK has enjoyed the benefits of a comprehensive network of sub-Post Offices, often in very remote, rural locations, because of the wide range of services the Government chose to deliver through those Post Offices. On top of unavoidable technological and social change, which have reduced client footfall, the Government is now withdrawing services from the Post Offices. If the country wants a comprehensive network of Post Offices to continue, a more explicit funding mechanism must be put in place, together with product diversification and a replacement for the Post Office Card Account. (Paragraph 97)

The Government agrees with the Committee on the need for a comprehensive national network. The proposed access criteria, the continuation of the Social Network Payment and the new Post Office Ltd business plan, will ensure that a national network remains sustainable. In addition, the Government has announced that after 2010, it will continue with a new account that will include similar features to the POCA. This will be available nationally and customers will be eligible for the account on the same basis as they are now. The detailed design of the new account, including the precise functionality, will be decided as part of DWP's tendering and contractual process.

18. There has been a lack of joined-up thinking between Government departments, perhaps to be addressed, at last, by the Cabinet sub-committee. The DWP is undermining the Post Office network by removing the Post Office Card Account, although the Government now appears to be considering the need for a substitute. The end of the Post Office Card Account has been the most serious but not the only cause of the present difficulties, as decisions by the BBC and the DVLA (with respect to licensing) have also removed income from Post Offices. Given that the DTI then have to put money in to keep the network going, taxpayers' money is going round in a circle,

while there is a climate of uncertainty for sub-postmasters. This makes no sense to us. (Paragraph 98)

The Committee will understand that Government Departments have a responsibility to ensure value for money for the taxpayer and choice and convenience for their customers. DVLA licences can still be obtained at the Post Office—the on-line service simply offers customers an alternative and, for some, a more convenient choice and makes it as easy as possible for drivers to tax and therefore insure vehicles. The BBC's decision to offer TV licences through a new supplier was taken solely by the Corporation and on the basis of a competitive tender. Government had no basis for interfering in that decision. The Government's proposals provide a transparent subsidy for the non-commercial part of the network that needs continued public support because of its vital social role whilst putting the overall network in a better position to compete for specific contracts, such as the replacement for POCA. These proposals have been put together following cross-Government discussion and agreement at MISC33.⁵

19. We are seriously concerned about the apparent lack of urgency in the remit given to the Cabinet sub-committee examining the future of the Post Office network. Sub-Post Offices have already lost sources of income, and postmasters will be making decisions now on whether they can sustain their business. There is a danger of seeing considerable closures before the Social Network Payment ends, unless postmasters are given a much better indication of future sources of income after 2008. (Paragraph 99)

The Government does not accept the Committee's concerns that the Cabinet sub-committee displayed a lack of urgency in addressing these issues. The Committee discussed and agreed the proposals set out in the consultation document published on 14 December.

20. There appears to be widespread, if reluctant, acceptance among our witnesses that a network of 14,500 branches is unsustainable. Postcomm has said that a network of 4,000 Post Offices could breach the universal service obligation. We expect the Government to work with Royal Mail Group and the regulator to determine the size and shape of a network that would meet the universal service obligation. Once this is done, if some individual Post Offices which are judged to provide a valuable social service are still incapable of making a profit, then the Government should be prepared to continue a subsidy to parts of the network post 2008. It should make this commitment as a matter of urgency. (Paragraph 100)

The Government recognises the Committee's views and has made the commitment they recommended. The proposals for the network are based on the need to maintain a national network that is reasonably accessible throughout the country. The Government's proposals include a maximum number of 2,500 compensated closures which will go some way to providing the certainty that sub-postmasters need. The access criteria proposed in the consultation document substantially strengthens the existing Universal Service Obligation and reflects the Government's belief that Post Offices play a valuable social role.

5 The relevant Cabinet sub-committee