

Report of the Post Office Working Group

**Report Dated
23 July 2001**

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A - Terms of Reference

Terms of reference

- This report sets out the findings and recommendations of the inter-Departmental Working Group (“IDG”), established by the Minister for Public Enterprise to determine a basis for the sustainable operation of the Post Office network.
- This followed a submission by An Post to the Minister for Public Enterprise in late 2000 that it expected its Post Offices division to incur losses of £27.7m per annum by 2004 on a do-nothing basis.
- More recently Mr Phil Flynn, acting as arbitrator between An Post and the Irish Postmasters’ Union (“IPU”), recommended increases in the rates paid to postmasters. Due to the levels of losses being projected by An Post, the Flynn report recommended that these increases be funded by the Exchequer. An Post has cited inability to pay these increases and the Flynn report as a basis for not paying any increase in rates to the IPU. due to the levels of losses being projected by An Post, he recommended that these increases be funded by the Exchequer.
- This has led to the establishment of the IDG.
- The operating framework of the IDG included the following:
 - An assessment of the current financial and trading position of the network;
 - A review of the services it currently provides;
 - A discussion of the positives and negatives of the alternative organisational models (including Government and private services, which are or could be provided by the network);
 - A comparison of the Irish situation with other countries;
 - An assessment of the costs (if any) which could be taken out of the current system;
 - The legality of a subvention from An Post (cross-subsidisation) or the State (subvention); and
 - Consideration of the restructuring options available to the network.

Terms of reference

- The IDG comprised the following members:
 - Mr E Molloy Dept of Public Enterprise - Chairman
 - Mr J O'Brien Dept of Finance
 - Mr D Ó'Briain Dept of An Taoiseach
 - Mr A Hall Dept of An Taoiseach
 - Mr G Daly Dept of Social, Community and Family Affairs
 - Mr P Curley Dept of Social, Community and Family Affairs
 - Ms S Reeves Dept of the Environment/Local Government
 - Ms M Mahoney Dept of Agriculture, Food and Rural Development
 - Mr D McGeady Dept of Public Enterprise (secretary)
 - PricewaterhouseCoopers (external consultants)

B - Summary Conclusions/Options

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

The following section sets out in summary format the views of the IDG. More detailed analysis and background material is set out later in the detailed report which has been prepared by our advisors PricewaterhouseCoopers on our behalf .

Financial and Corporate Background

- The An Post Group as a whole has been profitable in the recent past. Operating profits for the Group have averaged £10m over the past five years. An Post has net assets of over £200m including a substantial property portfolio. The Group currently has a large cash balance at hand and in bank as a result of successful acquisition and disposals in the telecommunications sector. The Group (including subsidiaries) employed 1,346 (or 16%) more staff in 2000 than it did in 1996. Mail volumes increased by over a third in the same period.
- The Post Office counters service lost just under £3m in 2000 – the first recent year in which the Division lost money. Forecast losses for the service in 2001 are £12.0m. Losses in 2001 and 2002 are forecast at £29.6m in aggregate (£12.0m and £17.6m respectively). Total losses for the post office service over the four-year period 2001 to 2004 are forecast at £79.2m with losses in 2004 forecast to total £27.7m.

- The IDG has been advised that these projections are robust. Notwithstanding this, the IDG feels there is an element of self-fulfilling prophecy about these projections. An Post has, in the context of the recent Flynn Report, indicated its preference for the retention of a network of no more than 400 outlets. The business strategy of An Post Group underlines the Company's lack of long-term commercial commitment to the full network as it currently exists. The development by the Group of some 2,000 post point terminals in retail networks nationwide, the Group's decision not to computerise all sub post offices and the Group's willingness to oversee a widening gap in the range of services offered in the larger, computerised offices compared to the small, non-computerised offices all suggest that the An Post Group is building its retail presence in future around retail outlets rather than dedicated sub post offices.

General Background Issues

- It is considered that, regardless of the options chosen to offset losses in the post office service, the arrangements proposed may involve the need for **State Aid clearance from the European Commission**. This will take a matter of months to finalise.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

- It should be noted that the bulk of the losses forecast to be incurred by the post office service will occur in the larger sub post offices and company owned offices. Small rural offices transact less business and therefore incur lower levels of losses. It follows that **the major issues surrounding the transformation of operating performance will be in headquarters operations and the larger post offices.**
- The post office service continues to play an important **social role** in providing a Government service presence to the broader community particularly in rural Ireland. This was acknowledged by all Departments represented in the IDG and is set out in more detail in the report.
- Discussions between An Post and the commercial banks in relation to the development of universal banking services are currently ongoing. This issue is dealt with in more detail in the body of the report. In the context of the funding issues being addressed in this Report, whatever proposal emerges, **the IDG, while recognising that it could make a helpful contribution, does not see the universal banking operation as having the potential to radically transform the financial outlook** for the post office service nationwide.

Options for Viability

- The seven principal means of funding or otherwise addressing the losses in the post office service within the confines of the current business structure are set out below. A proposal which seeks to protect the position of those rural communities whose post office would not otherwise continue in operation under the new arrangements is then presented.
- The options are:-
 - Option 1. Cost reduction through agency structures**
 - Option 2. Funding from An Post Reserves**
 - Option 3. Additional funding from new post office counters services**
 - Option 4. Funding from Existing An Post Businesses**
 - Option 5. Sale and Leaseback of properties**
 - Option 6. Contribution from the Banking sector**
 - Option 7. Subvention by the Exchequer**

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

IDG Findings and Recommendations

- The IDG believes that the ultimate solution to the viability issue will require An Post to move completely away from the current fixed cost “retainer” model to an agency or variable cost model, together with implementation of a number of options taken together.
- Implementation of a package of reforms by An Post to definitively solve the problem will take time and the transition period will need to be actively managed to protect the interests of the stakeholders in the interim.
- The primary responsibility for the long term commercial viability of the entire business must remain the management of An Post - this must include a willingness on the part of the Company to use some of its reserves, at least in the short term, to address the problem.
- Inter-Departmental agreement exists on the use of all options except option 7. It was not possible for Departments to come to a consensus view on either the principle or terms of an Exchequer subvention of the post office service.
- Long-term commitment by the State to some 1,900 post offices will result in substantial and growing long-term losses in the service. If the Government wishes to avoid the likelihood of Exchequer subvention in the long term, it must consider mandating a move by An Post Group away from a postal service based on almost 1,900 offices to a postal service based in other retail premises – a move from a fixed cost to a variable cost model for delivery of services. It must also, in this context, consider how information and other social services currently provided by post offices would continue to be available, especially in smaller rural communities.
- A Government commitment to a ‘safety net’ of a guaranteed continued Government Services presence in communities in that minority of cases where a post office service would not continue to be provided under the proposed new arrangements is an important part of the overall proposed solution.
- An Post to fund ongoing losses over a transitional period and for severance payments in respect of those sub postmasters who surrender their agencies.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

Next Steps

- The IDG recommends that:
 - The Government publish the Report of the Group with a view to considering the views of third parties on the issue.
 - After receipt of third party observations that the Government mandate An Post to implement the relevant options to improve the overall situation of the post office service in the short term.
 - Short-term actions by An Post need to focus on expedited nationwide introduction of postal agency arrangements in addition to other cost reduction programmes in the postal service.
 - Departments and Agencies should develop the Government Services Outlet model in conjunction with local authorities for implementation on a phased basis nationwide over a two-year period. The Government Services Outlet model should only be implemented in conjunction with the introduction of postal agencies and cost reduction programmes managed by An Post Group
- Certain measures implemented by An Post to address the deficit in the postal service may require clearance for State Aid purposes by the Company with the European Commission in advance of implementation by the Company.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

Option 1. Cost reduction through agency structures

- This would be an alternative method of providing post office services on a fee per transaction basis instead of the current structure of a minimum payment (£4,500) with a regressive scale where the rates per transaction reduce as activity levels increase. Post Office operators would be offered a ‘once off ‘ severance payment to become, in effect, free agents empowered to adapt the business to meet consumer demand. Although there could be significant up front costs to An Post, if applied universally the agency system would in time free An Post of the burden of supporting the uneconomic network. The Company, with the agreement of the Unions, already plans to introduce a pilot scheme with 26 agencies.
- An Post should move completely away from the existing model of funding post offices on a retainer basis (i.e. only indirectly related to volume of business or profit generated) to an agency or franchise model, with a contract being available to any approved retailer. In this latter model the agent’s profit would depend on the volume of business he or she could generate. Modern information technology opens up the possibility of any and every retail outlet in rural Ireland becoming a Post Office agent.
- *Allowing any acceptable retailer, in future, to be a virtual post office could do more to provide good quality and accessible services in rural Ireland than maintaining the existing network of under-utilised offices.*
- Individual businesspeople taking on the An Post agency would, in effect, have an additional retail product to enhance the viability of their overall enterprise. This could be significant in keeping shops and other rural outlets viable, maintaining a local postal service, and consequently in maintaining the fabric of services in small rural communities.
- The agency concept is a potentially attractive means of reducing costs in the post office service and should, in addition to a wide range of cost savings, be implemented as broadly as practicable regardless of any other measures taken to eliminate losses in the service.
- Application of this model could lead to improvement in accessibility of service offered to local communities, with the potential for a significant increase in the **number** of post office service points available nationwide.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

Option 2. Funding from An Post Reserves

- An Post currently has cash and bank balances of £167m. This cash, which comes mainly from profits on its disposals of non-core businesses, is earmarked by An Post for investment in the core business over the next four years. These funds could be used by An Post to fund losses in the post office service in the short term. The Board of the Company has indicated that it is not prepared to countenance use of Company funds to support the counters business in the future.

Option 3. Additional funding from new post office counters services

- An Post are currently pursuing a number of business initiatives to increase business at post office counters in the following areas, the provision of a Universal Banking Service, Reach/e-Government, Internet access, Electronic Commerce, Licensing and new Billpay facilities. These initiatives will form an important element of the business mix of the post office service in future. It is critical therefore that these initiatives are progressed by the Company. Notwithstanding this, their expected impact on the outlook for the Company, in purely financial terms, will be relatively small.

Option 4. Funding from Existing An Post Businesses

- Funding of the network from the monopoly letter post services of the An Post Group (by increasing the charge rates for letter post and other services to take account of increasing costs of operating the post offices division) is considered a legal possibility although, as a potential State Aid, it would have to be cleared by the EU Commission. It would also require domestic regulatory clearance.
- The Post Office Division also provides a range of services to the other business divisions of An Post on a cost recovery basis only. Given that these services are contributing to the overall profitability of the Group, it is reasonable to expect that a proportion of these profits should be attributable to the Post Office Division to ensure a more accurate reflection of its contribution to the Group's performance.
- Given the scale of the losses projected, this option taken alone, while capable of making a contribution, may not represent a long-term option for the resolution of the problems facing the post office service.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

Option 5. Sale and Leaseback of properties

- The book value of fixed assets according to the 2000 accounts of An Post was £163m. This does not allow for the uplift that would arise from current market revaluation of the property. The sale and lease back of suitable properties would release capital which could be used to help fund network losses.
- The use of released capital for this purpose would represent a substantial disposal of assets by An Post as well as having to meet lease back terms. Sale and lease back would require the approval of the Board of An Post.

Option 6. Contribution from the banking sector

- The UK banking sector has agreed to make a contribution of Stg£180m to the UK post office network in the context of the establishment of a universal banking service. Given the parallel closure of banking outlets in Ireland, the Government may consider that there is a case on social grounds for requiring a contribution from the banks to sustain the post office service on a nationwide basis. However, the scale of losses projected for the service mean that any contribution, if used to fund all losses, would initially start at almost 4 times the rate of the UK annual contribution (on a per capita basis) and move upwards from there.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

Option 7. Subvention by the Exchequer

- Under this option the Exchequer would provide a direct subsidy to An Post to cover losses incurred by the Company in the provision of the post office service. The Company has stated that retention of the network requires the State to subvent these losses. *Any commitment to a conditional short term capped subvention, were that acceptable to the Government, could create a short term breathing space for the post office service and could allow time to implement more far reaching proposals to solve the problem in the long term. Some of the conditionality attached to subvention would have to relate to independent external assessment and measurement of costs and revenues for the Post Office Division with specific reference to cost allocation and charges levied for counter services within the An Post Group.*
- The IDG believe that Exchequer subvention is not a long-term solution and may reduce the incentive for the Company to take ownership of the challenge presented by the post office network and manage its business more cost effectively.
- The IDG note that the use of a direct subsidy is not normal practice among other EU countries. The Attorney General has confirmed that use of subvention arrangements by the State would require prior clearance by the EU Commission as a State Aid.
- The Department of Finance has asked that the Group note its position that Exchequer subvention is not an appropriate option in the circumstances.

Reforming the Post Office Service by Redefining the Role of Post Offices

- Even if the most optimistic projections in regard to new business are realised, the post office service is forecast to face a substantial deficit – in excess of £27m by 2004. Given that the payment delivery services, provided by An Post under contract to the DSCFA, is estimated to carry a substantially higher transaction cost than that which is available using alternative, more cost-effective, delivery systems, it is arguable that the State, in effect, already makes a substantial indirect contribution, via that contract, to the operation of the service.

Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

- The provision of substantial State subventions arguably provides little incentive to An Post to address underlying cost and organisational issues or to apply best commercial practice to its business generally. Unfortunately for Government, it also gives no guarantee that the post office network will actually be preserved in the longer term. It is clear that the Company overall is moving into a very difficult commercial environment – with pressures on revenues and costs across all sections of the business – and that it does not see a long-term commercial future for the post office service as it currently stands.
- Furthermore, short to medium term developments in the market-place and at EU regulatory level may limit the ability of Government to directly influence future events.

The social and community role of post offices

- Having a post office in a small rural community is seen as vital in terms of maintaining the identity of the community and the fabric of other services. The fear is that removal of a local post office leads to decline in other services and is seen as an abandonment of the community by Government. Much of the concern about post office closures is about the need for a formal Government presence per se in the community, rather than purely about provision of a specific retail service that few people actually use. This concern could be laid at rest if Government were to give a guarantee that, in situations where it is impossible to continue a post office service on an agency basis, a Government Services Outlet network would be developed, having regard to the availability of already-existing equivalent community-based or statutory services, so as to meet the needs of the community within each County.
- Implicit in this approach is the view that any direct or indirect Government investment in the network in future could be used more effectively to achieve the same underlying objectives by separating out the question of providing a Government presence in rural and other areas from the financing of the commercial postal and payment services provided by An Post.

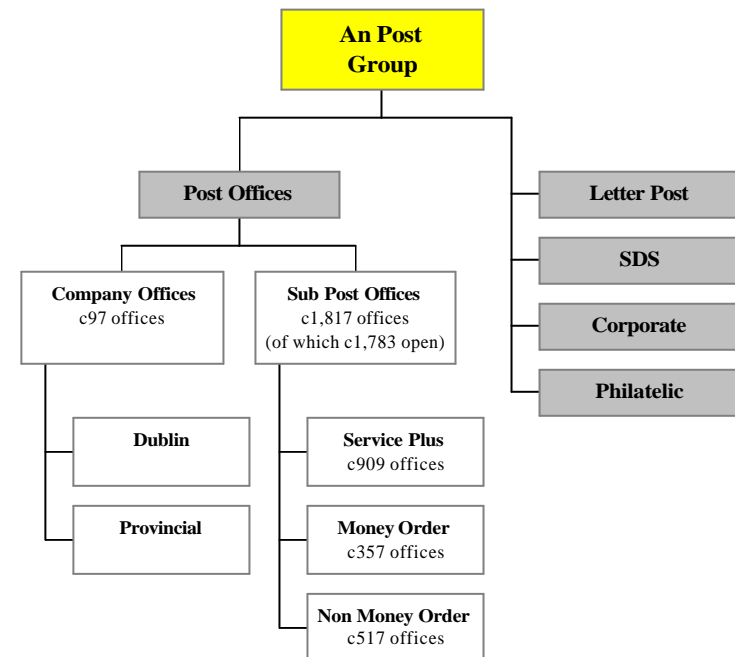
Summary Views of the Inter-Departmental Group established by Government to assess options for the long term viability of the Post Office Service

- Such a Government Services Outlet could provide a range of services to local people, including:-
 - Information and advice about all Government services, including application forms
 - Reception point for applications and assisted access to internet application mechanisms via the Public Services Broker
 - Access to the internet
 - Links to community development activities, family support services, Health board services, FÁS training and job referral services, etc.
- Government Services Outlets could be operated by a commercial agent or by a suitable Community Group, depending on local circumstances.
- Existing post offices would have the option of migrating to an agency model, or a severance deal. In the latter case, it would initially be An Post's responsibility to arrange a replacement post office service on an agency basis. However, there may be situations – more especially in smaller and more remote rural communities – where the agency option is not available or viable.
- In such cases, the guarantee of a Government Services Outlet would come into play and a network of GSOs would be developed, having regard to the availability of already-existing equivalent community-based or statutory services, so as to meet the needs of the community within each County.
- A lead Department or agency would be required to manage such a programme. Individual contracts would be between the programme management agent and the commercial agent or community group as may be the case, rather than An Post. This would ensure transparency in An Post's accounts and avoid any possible confusion between Government's funding of local access to Government services, with subvention of An Post's commercial business.
- If the Government considers this approach as being part of an overall solution, then the way forward might be to charge an appropriate Group/Agency with responsibility, after consultation, for drawing up a detailed implementation plan and guidelines for Government Departments, local authorities and public bodies. The approach might be piloted initially in four representative rural counties and subject to evaluation after 24 months.

C - Current Situation

The Post Offices division is projecting increasing trading difficulties

- An Post is a limited liability company, incorporated under the Companies Acts, 1963 to 1999. It consists of three main operating divisions: Letter Post (mail collection and delivery), Post Office (branch network and related services) and SDS (courier business).
- The Post Offices division operates the retail and financial services business of An Post. Its core business markets are mails, financial and government services. The Division's key role is to act as a vital link between corporate clients and their customers in these markets.
- The range of services offered in post offices continues to expand and now encompasses Saving and Investment products, Letter Post services, SDS services, welfare payments, bill payments, license services, National Lottery sales, post shop stationery, money transfer, and phone cards. In addition, Post Offices manages an independent retail chain of stamp agents on behalf of Letter Post and 900 nationwide electronic terminals.
- The Division has been making small profits over the past number of years. However due to increasing costs and falling margins, significant losses are forecast in the next five years. Management are projecting losses of almost £27.7m by 2004 for the Post Offices division on a "do nothing" basis. This would represent a serious risk to the viability of the An Post Group should these losses actually materialise.
- The Post Offices division provides ("mail") services to the Letter Post and SDS divisions, which are recharged on a cost-recovery basis. These include postage stamp sales, acceptance of postal packets, provision of high value mail services (registered mail, SwiftPost etc) and delivery co-ordination at 500 rural post offices.
- This recharging only takes place on a cost-recovery basis (Post Offices do not charge a margin).
- As An Post calculates its costs on an absorption costing basis, the cost recharged for services provided by the Post Offices division will therefore include an element of any spare capacity. These recharges (for services provided to other parts of the An Post Group) amounted to approximately £22m in 2000 and are in addition to the sales to third parties of £85m for that year. However in view of the significant amounts involved, the inter-departmental Working Group consider it important that An Post expand on the exact nature of these inter-Divisional relationships.

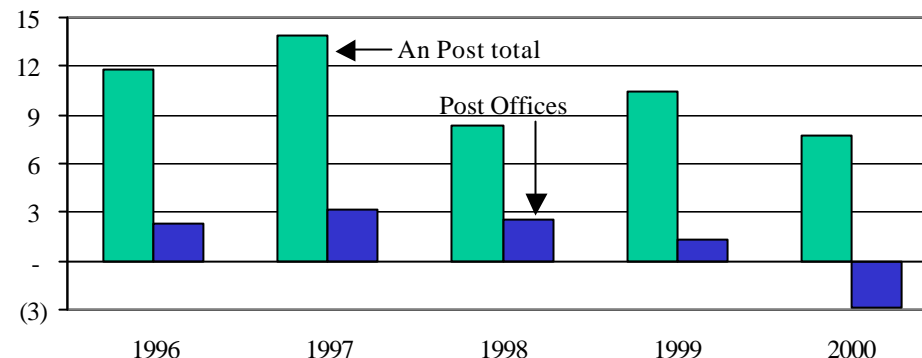


Source: An Post management

An Post has significant cash and property resources at present

- In recent years An Post as a whole has been profitable, although operating margins have tended to slip. This has been masked by cyclical events (such as periodic local and EU elections and the eircom floatation in 1999), which have a significant positive impact on the bottom line, due to the relatively fixed nature of An Post's cost base (especially labour).
- The Post Offices division contributes a decreasing proportion of An Post revenue and An Post profit (it actually recorded a loss of £2.9m in 2000).
- The Division is critically dependent on three major Government related contracts, which may not all be retained in the longer term. In addition, it maintains a network of 1,907 offices, a significant proportion of whom have a very small volume of transactions and are loss-making.
- The financial position of An Post is extremely strong at present, mainly due to:
 - Substantial bank balances still on hand following the sale of PostGem for over £100m in September 1999.
 - The last actuarial valuation of the An Post Superannuation Scheme (to 1 January 1999) showed the scheme to be in surplus (its assets represented 114% of the accrued liabilities at that date).
 - In addition An Post has a significant property portfolio. The last independent review was performed by Hamilton Osbourne King in 1996. KPMG carried out a valuation of An Post for management as at 30 June 1999, which estimated (based on the HOK valuation and application of a retail capital index to reflect market increases over the period 1996 to 1999) an uplift on the book value of the fixed asset portfolio of £43m to £206m (this ignores movements in property prices since 1999).

An Post Operating Profit (IR£m)



Source: Management accounts

An Post Financial Position

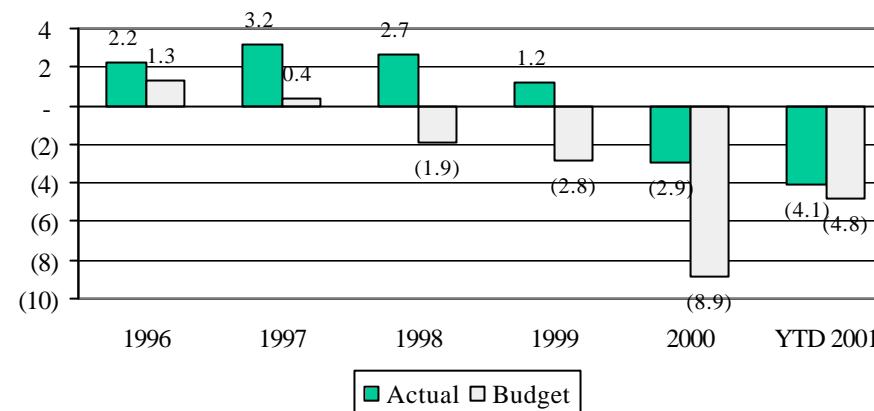
Figures in IR£m	31 December 2000
Fixed assets (excluding 1996 property valuation)	163.2
Debtors	22.9
Bank	167.3
Creditors and deferred income	(136.2)
Pension obligations	(9.6)
Net assets	207.6

Source: 2000 financial statements

The Division is projected to lose £27.7m in 2004; it has lost approximately £1m per month in 2001 to date

- The Post Offices division has been marginally profitable in recent years. It has a history of performing ahead of budget, although in many years this has been in large part due to non-recurring factors (such as lower than expected euro changeover costs in 2000).
- However losses of £4.1m have been recorded for the 4 months to 30 April 2001 (averaging £1m per month). While this is slightly ahead of the budgeted position of £4.8m, it compares very unfavourably with the same period in 2000, when the Division effectively broke-even. Revenues have remained relatively unchanged on 2000 levels, with much of the worsening in performance due to the impact of wage increases awarded under PPF (payroll related costs have increased by £2m, or 11%, for the first 4 months of 2001).
- Management are projecting annual losses of up to £27.7m by 2004 on a do-nothing basis.** While this reflects savings of approximately £3m expected under the transformation program agreed by An Post and the unions on implementation of the ESOP in 2000, it does not include any costs which might arise on the implementation of recommendations of the Review of the Sub-Post Office Network, prepared by Phil Flynn in April 2001. Management estimate the annual costs of these recommendations to be in the region of £3m to £5m.
- As noted previously, the top 1,000 offices account for 96% of revenues generated by the Division, with the top 400 offices generating 78% of the network's transactions. On that basis there would appear to be little financial justification in the 900 or so under-performing offices (many of which are not automated). However closure of this part of the (mainly rural) network could have severe social and cultural implications on the communities involved, given the focal point that the post office provides in small rural villages.
- In addition **closing these 900 offices (or even limiting the network to the top performing 400 offices) would still result in significant losses by 2004.**

Operating Profit (£m) - Actual vs Budget



Source: Management accounts

Status Quo Projections 2000 - 2004

Figures in IR£m	2001	2002	2003	2004
Top 1-400 offices	(2.2)	(6.3)	(10.0)	(13.4)
Next 401-600	(0.5)	(1.1)	(1.6)	(2.0)
Next 601-1,000	(3.8)	(4.4)	(5.0)	(5.6)
Next 1,001-1,907	(5.2)	(5.8)	(6.4)	(6.8)
General	2.0	1.6	1.1	0.1
Euro	(2.3)	(1.6)	-	-
Operating loss	(12.0)	(17.6)	(21.9)	(27.7)

Source: Management projections (late 2000)

Three Government related contracts generate 78% of revenues

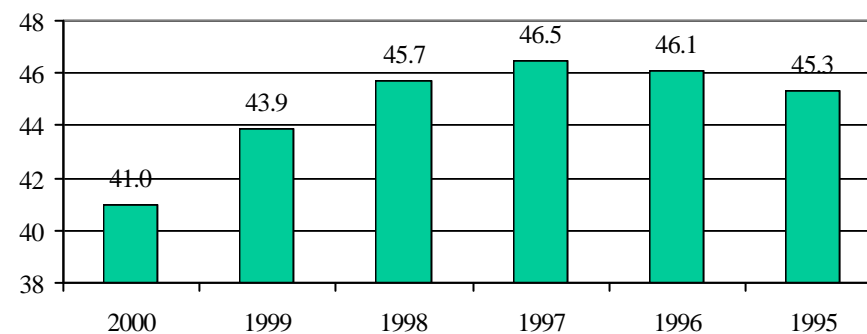
- A split of key contract revenues between network and non-network is presented opposite (the figures are taken from the 2000 budget, as the 2000 actual position has not yet been calculated by An Post). This demonstrates the critical importance of three Government related contracts to the Post Offices division (DSCFA, NTMA/Savings Bank and RTE licence collection), which accounted for 78% of actual third party sales in 2000.
- Revenues from each of these contracts are expected to remain static at best in the short term:
 - The Post Office Savings Bank is uncompetitive in the current low interest rate environment. Approximately 2.4m accounts are handled by An Post, of which only 0.6m are considered active. Individual balances are quite small, averaging at £172, with 90% of balances under £300;
 - The DSCFA contract expired in 1999. The Government had previously decided to extend the term of that contract for a further three years (2000 to 2002). However this decision was challenged by a third party and is being reviewed by the EC on procurement and competition grounds. The outcome of this could threaten the retention of this contract by An Post;
 - Only one licence fee increase has been granted in the last 10 years (although an increase is pending). The erosion of the relative value of this income to RTE has increased cost-consciousness, translating into pressures on the fees paid to An Post.
- As the analysis opposite demonstrates, the DSCFA contract is by far the most network dependent. If this contract were to be fully lost, management have estimated that losses could rise to as much as £45m by 2004 (compared to the £28m loss currently projected on a “do-nothing” basis).
- Notably the level of unemployment benefit has declined as a proportion of total benefits paid in line with the growing national economy. An Post management cites this as a significant cause of the decline in DSCFA revenue.

Revenue Split (by Key Contract)

Figures in IR£m	2000 Budget		
	Non-network	Network	Total
DSCFA outpayments	1.1	34.0	35.1
RTE licence	4.8	3.2	8.0
NTMA			
Savings Bank	1.9	11.4	13.3
Other savings	4.8	3.2	8.0
Total	12.6	51.8	64.4

Source: 2000 Budget

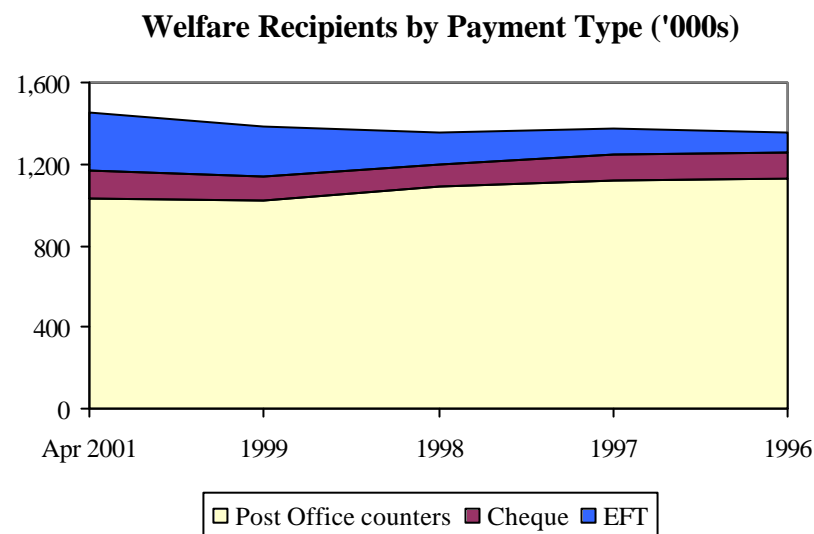
Welfare Transactions (millions)



Source: An Post

Annual losses could rise to £45m by 2004 if the DSCFA related revenues were lost

- The proportion of recipients choosing to use electronic funds transfer (EFT) as a means of welfare payment has grown from only 7% of all recipients in 1996 to 19% in 2000. This has resulted in a steady decline in the number of recipients dealt with through the Post Office network, falling from 84% in 1996 to 71% in 2000. In addition the overall number of welfare transactions is decreasing due to the strength of the economy, from 46.5m transactions in 1997 to 42.0m in 2000.
- The rates charged by An Post have not changed since 1999. The An Post projections assume price increases of 3% in both 2001 and 2004, although nothing has been agreed to date (a 3% increase in rates equates to an increase in revenues by approximately £1m per annum).
- In 1999 the Government decided to extend the contract with An Post up to the end of 2002. This decision is the subject of two complaints to the EU Commission. **If as a consequence of these complaints being upheld, An Post ultimately fail to secure the renewal of the DSCFA contract, it would be difficult to fully eliminate the related costs in the short to medium term.** Some savings would be made in the next triennial negotiation of the scale payment fees to Postmasters, although this would require acceptance by the Irish Postmasters' Union ("IPU") - the same would apply should either of the contracts with RTE or the NTMA be lost.
- The TV Licence Collection function employs approximately 84 staff. An Post management would hope to re-deploy these staff in the short term (through natural wastage) if the contract were lost. In addition savings would be made in certain direct costs (stationery/postage for reminders etc).
- NTMA services are supported by approximately 200 Headquarters (operational) staff. Management do not feel it would be as easy to re-deploy these staff in the event of the NTMA contract expiring, given the grades involved and the overall numbers, relative to the total Headquarters staff.



Source: DSCFA

- **However it is important to recognise that the loss of any of these key contracts, particularly the DSCFA contract, would be likely to have significant implications on other income streams.** For example, customers in receipt of social welfare payments (such as children's allowance) at the counters are likely to also avail of other Post Office services, such as the Savings Bank). However such inter-dependencies are not readily quantifiable.

Over 60% of its costs relate to payroll and agency fees; these are set to increase substantially due to both PPF and pressures from the IPU

- The costing system basically represents a detailed absorption costing system, with most costs allocated by various volume bases. The system was developed approximately 10 years ago. Costs are analysed using a large number of detailed models and criteria. The appropriateness of these individual bases are reviewed at intervals of 3 months to one year.
- KPMG examined the methodology for the allocation of costs and revenues of An Post for the year ended 31 December 1999. In particular they reviewed the allocation of costs to the Post Offices division. KPMG were satisfied that the allocation methods were reasonable and do not attempt to bias the data in any way.
- Payroll costs consist of the remuneration costs of company employees based in the Dublin and provincial offices, College House and the GPO. It also consists of Sub Office postmasters who are paid an inclusive allowance (called a “Scale Payment”), related to the range and volume of service at the office for which they have responsibility.
- Company operational payroll costs have risen sharply in recent years, driven in large part by the impact of national pay agreements and increased overtime. In particular, the high operational pay levels in 1999 arose from a need to cover staff shortfalls on Provincial and Dublin counters through overtime.
- Management consider that the Division has surplus staff at present. However significant difficulties may be experienced in filling vacancies in certain locations, due to the highly unionised nature of the organisation. This leads to higher payroll costs in the form of overtime for existing staff.

Post Office Costs

Figures in IR£m	2001	2000	1999	1998
	Budget	Actual	Actual	Actual
Operational	22.6	21.4	19.8	18.9
Head Office/Central	12.5	11.8	10.5	10.6
Scale payments	24.6	21.3	21.4	20.8
Pension	4.7	4.2	5.7	4.1
Total payroll	64.4	58.7	57.4	54.4
Non-pay costs	27.4	29.5	22.2	23.8
Inter-service costs	4.5	2.2	4.6	5.0
Total	96.3	90.4	84.2	83.2

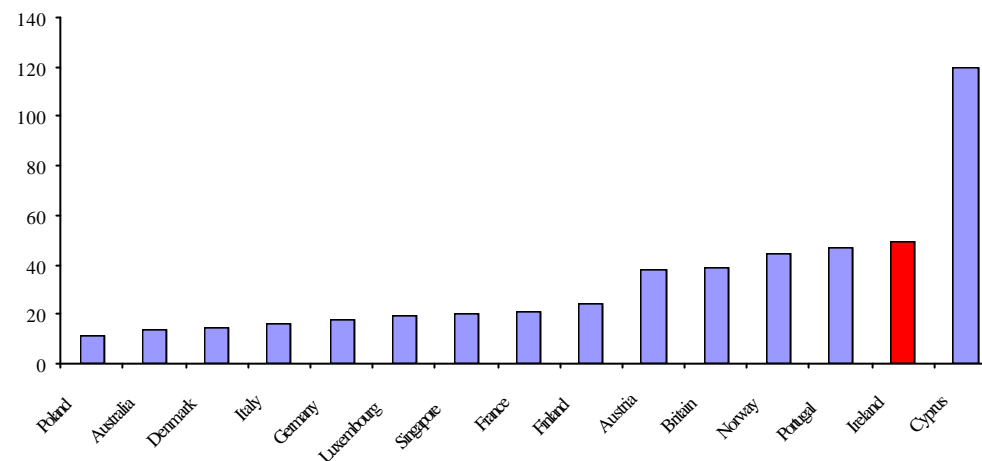
Source: Management accounts and 2001 Budget

- The basis of a postmasters remuneration is that it is an inclusive allowance called a Scale Payment related to the range and volume of service at the office. The Scale Payment is accordingly related to the measured volume of work performed at the sub Post Office by means of a system of units called unit credits.
- There are also minimum payments regardless of the number of unit credits earned. This leaves the scale payment cost relatively fixed for a significant element of the network (just under 50% of the network accounts for 96% of all transactions). The minimum averages approximately £4,500 at present.
- Non-pay costs in 2000 (and to a lesser extent 2001) were inflated by the euro changeover project.

The Post Office network has the largest retail network spread across the State

- The Post Office network comprises over 1,900 outlets (of which approximately 100 are Company staffed offices, with the remainder operating as agencies). This represents the largest retail network in the State. The network is heavily biased in favour of rural areas, with 82% of post offices servicing the needs of rural communities which make up slightly more than 40% of the population.
- In an international context Ireland has one of the highest post office coverage per capita, at approximately 50 outlets per 100,000 residents.
- Business volumes are measured in An Post by the time required to perform individual transactions (“counter units”). 96% of the Division’s revenues are generated by the top performing 1,000 outlets (just over half the network).
- Almost 80% of total counter units performed relate to the busiest 400 offices. The top 400 offices represent 21% of the total network, but account for 61% of automated positions.
- Many sub-post offices are located in poor premises, demonstrating signs of under investment in recent years.
- The population range reflects the postal distribution origins of the network, ranging from an average of 500 people per post office in Leitrim to 6,400 in Dublin. Excluding Dublin, the next highest figure is for Kildare (3,800).
- The average area served per post office is lowest in Dublin (500 hectares) and Louth (2,100) and highest in Kerry (6,000).
- Counties with the lowest post office coverage on a per capita basis are Dublin, Kildare, Wicklow, Louth and Waterford. This may not, however, indicate poorer service levels given that there is wide-spread under-utilisation of sub-post offices in rural areas.

Post Office Coverage per 100,000 Population by Country, 1997



Source: Universal Postal Union

- Counties with the lowest post office coverage on an area basis are Kerry, Laois, Offaly, Clare, Wicklow and Galway. This is a more reliable indicator of service quality, although it too needs to be considered in the context of other county-specific factors (public transport, road infrastructure etc).
- Finally, counties with the least intensive (not necessarily synonymous with poorest service) post office coverage on a combined indicator basis are Dublin, Kildare, Wicklow, Kerry, Laois, Waterford and Roscommon.

Internationally Post Office networks are facing similar issues

- Other countries' post office networks face similar societal, technological and financial pressures to An Post particularly as more transactions are being done by telephone or electronically. Another pressure is the EU liberalisation of postal markets leading to greater competition. **However, overseas post offices tend to be less reliant on government work** than An Post and in some cases such as Germany and Finland, do not undertake any work for the government at all.
- Overseas governments and post offices have responded to these common challenges to the traditional post office network in three different ways.
 - In Germany, the Netherlands, Sweden and Finland the government has decided to privatise and/or remove the monopoly from the post office, which has led to a remodelled and more commercial network.
 - In Australia, New Zealand, USA and Canada, they have tried to remodel the network.
 - In France, Japan and the UK they have tried to maintain the existing network.
- In an International context, Ireland has an extremely high post office coverage on a per capita basis. According to the Universal Postal Union in 1997 only the small island country of Cyprus had a larger post office coverage.
- Ireland had approximately 50 post offices per 100,000 residents, this compares with less than 40 for the UK (whose post office network comprises 18,500 outlets and is the largest retail network in Europe) and less than 20 for Germany, Italy and Denmark.

D - Options Available

Annual revenues are projected to reduce by £9.2m between 2000 and 2004, while payroll/agency costs are expected to rise by £16.2m

- A comparison of the 2000 operating loss of £2.9m with the loss of £27.7m projected for 2004 is set out opposite.
- Of the £24.8m increase in annual losses, the two largest single elements relate to:
 - Declines in third party revenues (£9.2m);
 - Increases in payroll costs (£9.0m) and scale payments to agents (£7.2m).
- The options available to reduce or eliminate these losses would appear to be as follows:
 - Increasing third party revenues, either from existing sources or through new initiatives;
 - Reducing the cost base (especially payroll/agency costs);
 - Re-organisation of the existing network:
 - Closure;
 - Revision of the current agency model;
 - Migration of Company offices to agencies;
 - Direct subvention;
 - Re-definition of part of the network along the lines of a Government service model.

Operating Profit - 2000 vs 2004 Projected

	IR£m
2000 operating loss	(2.9)
Third party revenue	(9.2)
Interest/other income	(1.0)
Payroll/agency fee related	
Scale payments to agents	(7.2)
Operational pay	(5.3)
Head Office pay	(2.4)
Pensions	(1.3)
Non-pay costs	0.9
Inter-service (non-mail)	(2.3)
ESOP transformation measures (non-network)	3.0
Projected 2004 operating loss	<u><u>(27.7)</u></u>

A number of revenue generation alternatives are being progressed

- A number of initiatives are being proposed to attempt to address the projected loss-making scenario. While individually these would not appear sufficient to address the financial problems at hand in isolation, they would help reduce losses in the short term.

Universal Bank

- Discussions with representatives of both Bank of Ireland and AIB Bank indicate that the Irish banks are broadly in favour of the Universal Bank proposal (an initiative to help address the issue of financial exclusion by making a basic bank account available to individuals through the network).
- A financial model is currently being prepared by An Post, although it is not expected to be finalised until late 2001.
- A similar initiative is being followed by the UK government. An Post management are proposing that the Irish model be basically self-funding (the UK model is at a more advanced stage, and is planned to be part-funded by the banks for an initial period of at least 5 years).
- However it is unclear to what extent the Universal Bank proposal will help offset the projected losses (the individuals targeted will tend to be from the more disadvantaged areas of society, and so cross-selling opportunities will be limited).
- An Post management consider that, in relation to the Universal Bank proposal, the related transaction costs could mitigate any interest on funds on deposit.
- **While the Working Group believes that the Universal Bank proposal should be explored, it does not consider it a solution to the problems facing the Division. In addition the question of a contribution from the main Irish banks should also be considered as part of the proposal.**

e-Government

- The size and nationwide profile of the Post Office network may have potential in the context of e-Government strategies. However the public service broker concept in particular is more a long-term vision.
- **In addition, the development of on-line and inter-mediated on-line services may limit the potential for the Post Office network in this area. The are also problems in this regard is the ability to measure both the costs and performance of such activities.**

Internet access

- A pilot scheme in 4 offices (Ballyheigue and Ventry, Co Kerry; Kilmihil, Co Clare; Loughglynn, Co Roscommon) was operated in the last year with PC access to the internet. Utilisation has been insufficient to justify further rollout, according to An Post.
- Third party self-service internet kiosks have been provided at the GPO and St Andrews Street, Dublin. Take up has been poor and it is management's opinion that this is not viable proposition. Internet cafes rely on low overhead and high charges on food and drink.
- **Certain Post Offices could be used as information access points, although the provision of this service is unlikely to be commercially viable and so would require direct Government subvention.**
- **In addition the existing opening hours of the Post Offices could be restrictive for this type of service.**

Revenue generating opportunities (cont'd)

Electronic Commerce

- SDS (the An Post parcel service division) is already targeting growth from the provision of delivery services relating to electronic commerce (it already has a nationwide delivery service obligation).
- Spar have recently reached agreement with CollectPoint (based in the UK) to provide such a service in its shops.
- **Post Offices could serve as collection points for goods ordered electronically. However individual office layouts are non-standard and so storage space is likely to be an issue in many (especially rural) offices.**

Internet/counter/postal Bill payments

Billpay.ie is the internet bill payment and presentment service available from An Post. Although a non-network activity, it is owned by the Post Office division. Revenue (£0.1m) is included under New Services. Income is projected to increase to £3.5m by 2004. The potential exists for Billpay.ie to expand its customer base through co-operation with the main banks.

- In April 2001, both AIB Bank and Bank of Ireland agreed to transfer their counter bill payments business to An Post. **An estimated 5m to 6m bills will be paid over post office counters following a three month phased introduction. However margins are expected to be only in the range of £0.2m to £0.3m.**
- The main banks have also entered into a joint venture with An Post to establish a national postal bill payment centre in Kilrush, Co. Clare. Although Post Office division management were involved in developing the business, An Posts involvement in this venture is likely to be through a subsidiary.

Licensing

- **The structure of the Post Office network, along with the increasing automation of the counters network, makes it suitable for many forms of licence fee collection.** However, excluding TV licence collection, the provision of such services is limited, with only approximately £0.2m per annum generated through dog licence sales.
- One potential area of growth which has not materialised in recent years, despite being targeted by An Post management, is the collection of motor tax. **Management estimate that (assuming 60% on average of payment market share for Vehicle Licencing, Parking Fine Collection and Driving Licence Issuance) revenue of £3.6m per annum could be achieved.**
- The collection of motor tax and local authority rents/payments could, in principle, be undertaken by post offices. This would, of course, be subject to any legal impediments being removed; necessary provision of hardware and software; and the ability of post office staff to provide the services (training would be required). The Department of the Environment and Local Government together with local authorities would be willing to explore this possibility in further detail in conjunction with any implementation group established to progress the recommendations contained in this report.

BillPay

- The ESB contract is currently out to tender. An Post have made an application and are awaiting the outcome in July 2001. Management estimate that 4.3m transactions could be obtained if the contract for receiving ESB bills at Post Office counters was obtained. **However the margin on such transactions is estimated at only 5p per transaction, which would result in an annual contribution of only £0.2m.**

Co-ordination of existing Government services through the Post Office network

- The second element of revenue generation may rest with the Government.
- Much of the concern about post offices closures is about the need for a formal Government presence per se in the community, rather purely about provision of a specific retail service that few people actually use. This concern could be laid at rest if Government were to give a commitment to fund into the future a **Government Services Outlet** in all rural communities. Such an entity could provide a range of services to local people, including:
 - Information and advice about all Government services;
 - Reception point for applications and assisted access to internet application mechanisms via the Public Services Broker;
 - Access to the internet;
 - Links to community development activities, family support services, Health board services, FÁS training and job referral services, etc.
- These outlets could be formed by existing post offices migrating to a new model, or contracted to other local agents, or run by community groups, or positioned within directly-owned and staffed Government Offices (where they exist already). Government already puts very substantial funding into community development projects, area-partnerships, Leader groups and indeed, Government Department and local agency offices in many rural areas.
- A mix of Government Office, commercial agent and community-based models might be adopted across the country. **Existing post offices would have the option of migrating to an agency model, migrating to a Government Services Office (or to both, combined), or a severance package** (An Post calculates £1m for every 100 smaller offices).
- Where an individual postmaster opted for severance, leaving that community without any Government presence, the guarantee of a Government Services Outlet would come into play. A lead Department or agency (the local authority seems obvious candidate) would need to be identified. Individual contracts would be between the local authority and the commercial agent or community group as may be the case, rather than An Post. This would ensure transparency in An Post's accounts and avoid any possible confusion between Government's funding of local access to Government services, with subvention of An Post's commercial business.
- This represents one element of a solution which is put forward for consideration by Government. However the proposal would need to be examined in detail. It needs to learn from and build on the rural one-stop shop pilots and similar work being undertaken within the local authority structure at present. If the Government considers this approach as offering a possible solution, then the way forward might be to charge a Department of Environment and Local Government led interdepartmental Working Group with responsibility for drawing up a detailed implementation plan and guidelines for local authorities.
- **The approach might be piloted initially in four representative rural counties and subject to evaluation after 24 months. The results of the evaluation would inform decisions about extension to other rural areas and possible modification to the approach in the light of experience.** The Working Group considers the way forward to be to charge a number of key Departments with the job of developing a detailed plan for the piloting and implementation of this proposal.

Subvention/cross-subsidisation

Direct State subvention

- A direct subvention from the Exchequer to An Post to fund the Post Offices division's projected losses would clearly be a State aid. As such, it would require prior EU Commission approval under Articles 87 and 88 of the EC Treaty. Assuming that such State aid has been notified in accordance with Article 88, the question is not whether it is lawful but whether the Commission considers it to be compatible with the principles of the Common Market.
- However direct State subvention would not seek to address any core operational issues currently facing An Post and would effectively remove any incentive on the part of management to do so.
- Any State subvention (if allowed) would have to involve separating the Post Offices branch network from the rest of An Post in terms of structure, management and accounting.
- Any proposed separation of the Post Offices branch network is for transparency. It is reasonable to consider that this would occur in advance of any subvention.
- Separate annual and monthly accounts would be produced as a result.

Cross-subsidisation

- This would involve the cross-subsidisation of the counters business engaged in by An Post by the profits of another activity of the Company.
- Again the issue of State aid arises.
- Cross-subsidisation of reserved areas (areas of the postal service which have been reserved for An Post in accordance with Directive 97/67) by profits from competitive areas would not appear likely to involve a breach of Article 82 of the EC Treaty. Such cross-subsidisation might be regarded as State aid, although it would probably be possible to persuade the Commission that such a State aid was, by virtue of Article 86(2), compatible with the EC Treaty.
- However it is important to note that either direct State subvention or cross-subsidisation cannot represent long-term options for the resolution of the problems currently facing the Post Offices network, as it eliminates any real incentive to tackle the underlying issues.

Reducing the existing cost base would appear to represent the most obvious solution to the problem at hand

- The reduction of the existing cost base of the Post Offices division would appear to represent the most obvious solution to the problem at hand.
- However the Division operates under a relatively inflexible cost base. Over 60% of its costs relate to payroll and agency fees, both of which are set to increase substantially due to both PPF and current pressures from the Irish Postmasters' Union (IPU).
- The situation is further complicated by the fact that over 50% of employees (based on management estimates) are former civil servants, who have certain statutory rights entitling them to the same rights and benefits in operation prior to the establishment of An Post as a semi-State company.
- What this effectively means is that it would seem to be extremely difficult to readily reduce employee numbers. There is a culture of a permanent job for life among An Post workers, with a strong pension on retirement.
- Difficulties are being experienced in filling vacancies in certain locations at present. This leads to higher payroll costs in the form of overtime for existing staff.

Closure option (907 offices)

- The financial aspects of closure, as assessed by An Post management, are set out below.
- The costs of such closures would have to be based on parameters agreed between An Post, the Shareholder and the IPU.
- In the event of closure some savings would be made on scale payments. Smaller offices tend to be on the lower end of the scale payments table - receiving minimum payments or high per transactions payments.
- Business is assumed to transfer to nearby offices. Per unit scale payment costs will be reduced owing to the regressive nature of the payment system. Management have estimated the effect of this assuming 100% of social welfare transactions transfer and the effect of other business transfers has no net effect. The redistribution of overhead allocated to the offices is not accounted for in management's workings. This is likely to worsen the results.
- Closure options in excess of 907 offices have not been quantified by management as detailed assumptions would be necessary in terms of business transfer and costs. Closures (and transfer of business) are assumed to take effect immediately. This is unlikely to occur in practice.
- **A solely commercial focus would most likely seek to significantly reduce the size of the existing network. However closure of part of the existing rural network could have severe social and cultural implications for the communities involved. A framework is therefore needed to recognise and protect the social role played by many (especially rural) post offices.**

Closure Option

Figures in IR€m	Profit Projections			
	2001	2002	2003	2004
Close 907 offices				
Status Quo 1-1,000 offices	(6.5)	(11.8)	(16.6)	(21.0)
Revenue transfer	2.8	2.8	2.8	2.8
Extra costs	(0.7)	(0.7)	(0.7)	(0.7)
Other (mainly general and euro)	-	0.1	0.9	(0.2)
Revised operating loss	(4.4)	(9.6)	(13.6)	(19.1)
Status Quo				
(1,907 offices)	(12.0)	(17.6)	(21.9)	(27.7)

Source: An Post, Projections 2000-2004 and discussions with management

Migration of Company owned offices to agencies

- Company owned post offices constitute a dis-proportionate element of the Division's cost base, especially in relation to payroll costs.
- Of the total post office network of just over 1,900 offices, approximately 100 offices are Company operated.
- The transfer of a Company office to a third party agency could reduce the operating costs of the outlet concerned by up to 40%, based on similar experiences in the UK.
- Such transfers have offered workable solutions in other countries, particularly the UK and New Zealand. While there tends to be initial resistance from the communities effected (due to the perceived status associated with a Company post office), this option offers the advantage of maintaining the network size. However findings in the countries where this approach has been adopted have demonstrated that in overall terms consumers are more satisfied with the revised agency offices, due to perceived improvements in the service levels offered.
- Another potential advantage of Company office migrations is that funds could be generated from the sale of the owned buildings in which the post offices operate (subject to finding alternative locations for other An Post activities, such as mail sorting, carried out in these premises). These funds could be used to improve the existing network infrastructure (such as the full automation of the network) or to buy-out Company employees.
- Another possible alternative would be the sale and leaseback of the Company owned offices (many of which occupy prime locations in the communities involved). This would free up significant capital up-front, although annual costs would increase in the form of rent payments.

Agency/reorganisation option

- An alternative means of providing sub-post office services is possible through a revised agency arrangement. This would allow a post office agency be offered to a suitable candidate based on a per transaction fee for all transactions carried out. In the first instance it would be expected that the present post office operation would be offered the agency. If they declined then it would be offered to a shop or suitable premises in the immediate locality. Post Offices division would provide an imprest to cover transactions. Reduced levels of administration and accounting are possible. Fees will decline in direct proportion to transactions.
- If An Post is freed of the burden of supporting an uneconomic network of post offices (effectively paid on a **retainer** basis), the Company has the potential develop a network of agents (paid on **fee-per-item** basis) as a commercially-viable business. This should also increase the level of incentive to the agents, which currently would appear to be restricted by the regressive nature of the scale payment system (rates per transaction reduce as activity levels increase). An agency approach allows An Post to develop postal services (sale of stamps, reception of letters, parcels) and payment services (to and from Government, other e.g. bill payments) as commercial propositions to be offered on an agency basis to a range of retailers and other business operations in rural and urban Ireland. Modern information technology opens up the possibility of any and every retail outlet in rural Ireland becoming a Post Office/Government payment agent, if the necessary service standards are met.
- **Allowing any approved (character and solvency grounds) retailer to be a virtual post office would do more to provide good quality and accessible services in rural Ireland than maintaining the existing network of under-utilised offices.** The Eircell and Retail Stamp initiatives show that An Post has the capacity to innovate and compete if it can get its cost and delivery structure right.
- Conversely, the Flynn report makes clear that the solvency of the overall company is jeopardised by the projections for Post Office Division losses in future years.
- Individual businesspeople taking on the An Post agency would, in effect, have an additional retail product to enhance the viability of their overall enterprise. At the margins and especially in rural areas, this could be significant in keeping shops and other rural outlets viable and consequently in maintaining the fabric of services in small rural communities.
- A pilot scheme of 26 Agencies has been agreed with the IPU as a result of the recent negotiations. However, no such agencies have yet been introduced, and the pilot scheme has not yet commenced.
- The benefit for the Post Master would be a “once off” severance payment. In addition they would be paid a “transaction” payment for transactions carried out. This payment would be at a reduced rate to the present scale payment rate.
- Another benefit to the Post Office operator is that they could open at hours to suit themselves. At present they are obliged to remain open for 5.5 days per week. With an agency agreement an agreed number of hours per day may be an allowable option.
- **A revised agency approach would appear to offer benefits to both An Post and the agents involved. The Working Group considers that this option be further explored, based on parameters agreed between An Post, representatives of the IPU and the Shareholder.**

Appendices
