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A NEW DIRECTION FOR THE POST OFFICE

Peter Warry

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Summary

This paper outlines a method for introducing competition and incentive into the Royal Mail. It is based on franchising the service provided by the Royal Mail's existing 64 postal districts, with each postal district franchise being won on the basis of the lowest cost offered for a pre-set level of service. Costs to the public of sending letters will be the same or less. The seamless service from John O'Groats to Lands End will continue, whilst financial penalties may actually cause standards to improve. Most of us will see little change in the Posts operations -- except that the Postman who delivers the mail may now also read the electricity meter.

Parcelforce and Post Office Counters will also move into the private sector, without any loss of service and perhaps with some improvements.

Introduction

As the Royal Mail passes the 150th anniversary of the first 'Penny Black' stamp it seems timely to consider an appropriate structure for the next fifty years. Many advances have occurred within the Royal Mail over the last decade, not least the recent improvements in the standards of service. Great strides have been made towards dividing the major businesses of Mail, Counters and Parcels into separately managed and separately accounted operations. Some of the minor businesses, such as IT and catering, have also been separated.

In the 80s increasing traffic volumes and the introduction of the bulk discounted 'mailsort' business generated modest trading profits, whilst the effective absence of any dividend allowed cash surpluses to build. The 90s already look different - costs are growing faster then revenue, causing profits to shrink. Indeed, if the Royal Mail had not taken a £132M pension holiday, its latest accounts would have shown a loss for the year. Most of the loss (£131m) is attributable to Parcelforce with the Royal Mail and Counters reporting small profits. However, if the Royal Mail accounts are adjusted for their share of the pension holiday and the interest on the accumulated cash surplus removed then they too would have made a loss before tax.

More worrying, for the last two years the Royal Mail has been unable to fund even half of its capital expenditure out of retained profits and depreciation. With £1½ billion expenditure programme planned for the next five years, calls on the tax payer look increasingly likely.

A business employing two hundred thousand people, with two thirds of its costs in wages, will always have a struggle to achieve flexibility and incentive. So long as the business resides behind statutory protection from competition and an implicit guarantee from the tax payer it will be difficult to drive it efficiently.

The Government has already intimated its intention to introduce more competition to postal services, but perhaps a more radical solution should be contemplated.

1.

A new direction for the Royal Mail

Each of the Royal Mail's 64 postal districts deliver an average of almost one million letters a day. The letters are collected from hundreds of post boxes, sorted for delivery to other postal districts, and loaded onto lorries. At the other end they are sorted into thousands of delivery rounds and delivered to tens of thousands of homes.

The letter coming from rural Surrey to London costs much the same as the letter coming from Liverpool town-centre to London. But the letter *going* from London to rural Surrey costs a lot more than the letter going from London to Liverpool town-centre. This, of course, is because the unit cost of collecting hundreds of letters from a post box at a single go is relatively small, wherever that post box is sited. But the unit cost of delivering a single letter to an individual address is much greater -- and will rise as the density of population falls. Nor does the distance between Surrey & London and Liverpool & London make much overall difference, as tens of thousands of letters will be packed into each lorry; so again the unit cost will be relatively small. Thus in looking at any new system for the Royal Mail the focus must be on final sorting and delivery, where the bulk of the resource must be committed.

Each postal district collects the mail within its own area, sorts it and then despatches the majority of it to other postal districts for ultimate delivery. In return each postal district receives mail from other districts for delivery to its area. If each postal district were set up as a separate business, then each district could receive the full (stamp) value for all the mail it collected within its district and a fee for all mail it delivers within its district on behalf of other postal districts, and in turn make payment to the other postal districts for mail it despatches from its area to theirs. Each postal district would have a Profit & Loss Account that showed revenue from collecting mail from within its district and for delivering mail from other districts and, on the other side, costs for paying other districts for delivery of its mail, together with the physical cost it incurs of collecting, sorting and delivering the mail in its area. In this model the postal district would also need to pay for the transport delivering its mail to other districts.

The figures would not be identical for each postal district because not only will the traffic volumes be different, but some districts are purely urban and some are almost totally rural. Thus it is possible that a rural district may only need to pay the urban postal district, say, 6p for final sorting and delivering of the mail, whereas the urban district may have to pay the rural one, for example, 12p per letter for delivery. Collection costs will also vary between the urban and the rural postal districts, but these should be a relatively constant proportion of the delivery costs -- rural areas having more widely spread post boxes serving fewer houses, and urban areas having a more compact spread of post boxes serving a higher density of housing. So whilst the Profit & Loss Accounts of postal districts will differ, each will be fundamentally characterised by the delivery charge. This then provides the basis for the franchise bidding system.

2.

The bidding system

The 64 postal districts employ an average of 2,500 people each, which makes them realistically sized business units for control and a sensible basis for any franchise system.

Bids will be invited for each postal district to run a postal service for a period of five years. Bidders will be asked to indicate the price per letter at which they would be prepared to deliver mail throughout their postal district. The operators that offer the lowest priced service in each postal district would be the successful ones.

A Director General of Posts would be appointed to supervise the bidding process and to establish service standards against which each bid would be made. The Director General would also publish in advance the average relationship between collection costs and delivery costs that he is going to assume (e.g.. that for all districts collection costs are, say, 25% of delivery costs) and the amount that he intends to allow per letter for the transshipment costs between postal districts. Then, once all the bids have been made, and the lowest for each postal district selected, the Director General can calculate the volume weighted average delivery price across the 64 postal districts. To this he will add the already announced percentage allowance for collection costs and the transshipment cost per letter to produce a total cost from collection to delivery throughout the country per letter. He will then round the calculation to the nearest integer and this will become the stamp price.

As the franchise will last for five years the Director General will also have announced in advance the price escalation he intends to allow over that period. Adjustment of the timing of future price increases will compensate for any rough justice in the fixing of the initial stamp price to the nearest integer.

The generation of increasing volumes of traffic has been crucial to the Royal Mail's recent financial performance and will continue to be so under the new system. It is therefore essential that the system promotes traffic growth. To this end the Director General will publish, in advance of the bidding, a matrix showing the traffic volumes to and from each postal district to each other postal district, based on the previous 12 months' experience. These will become the 'standard' traffic volumes. Following consultation, the Director General will publish a discount formula for reducing the delivery price charged as the volume rises above the 'standard'. He will also establish an equivalent penalty or premium charge as the volume falls below the 'standard'. This would encourage all districts to generate new business. It would also accommodate Mailsort.

Mailsort (now part of Royal Mail Streamline) is the bulk discount scheme offered to large mail users in return for the user pre-sorting the mail into delivery destinations. Some 25% of all mail is now covered by Mailsort. Most of the savings are obviously at the collection end and the collecting postal district would have the freedom to discount for the business in whatever way it thought fit. However, the added volumes also help to recover the delivery postal district's overheads and thus discounts for volumes above standard levels both reflect economic benefit to the delivery district and send the right incentive to the collecting district to generate more such business.

This bidding system may superficially appear hazardous because no potential bidder knows what the ultimate stamp price will be in advance of bidding -- this can only be calculated from the aggregate of the successful bids. In principle the whole of a bidder's revenue looks to be at risk, but in fact it is by no means so serious.

For example consider a bidder who had estimated delivery costs in his district at 12p per letter, collection costs at 3p and transport at 2p (profit recovery being included in these figures). The bidder assumed that it was a very typical district and therefore guessed that the stamp price would equate to the sum of its costs i.e. 17p. Now to make life simple this particular district exports all of its collections (there is no local mail!) and these exports are exactly matched by imports both at the rate of ten million letters a week. Then its weekly budget estimate would be as below.

Revenue	£M
Collection at stamp price	1.7
Receipts for delivery from outside districts	1.2

	2.9

Costs

Collection (and sorting) of mail	0.3
Transport	0.2
Delivery (and sorting) within district	1.2
Payments to other districts for delivery	1.2

	2.9

Thus our bidder, having allowed for profit recovery in his costs, is confident of making its budgeted margin provided his guess of a stamp price at 17p proves correct. But what if all the other districts were actually able to offer a cheaper delivery service than our bidder anticipated, such that when all the successful bids were aggregated the stamp price was not 17p but only 14p, equivalent to an average delivery cost in other districts of only 9p? Does this undermine our bidder's calculations? In fact not -- they still balance as is shown below.

Revenue

	£M
Collection at stamp price	1.4
Receipts for delivery from outside districts	1.2

	2.6

Costs

Collection (and sorting) of mail	0.3
Transport	0.2
Delivery (and sorting) within district	1.2
Payments to other districts for delivery	0.9

	2.6

The reduction in the estimated stamp price is matched by a corresponding reduction in the estimated external delivery charge. So despite the incorrect guess at the stamp price the economics of the bid are unaltered.

Of course this example is simplistic. All districts will have local (internal) mail, and exports are unlikely exactly to match imports. Although when the above example is reworked with an imbalance on imports/exports the result is unchanged, local mail *does* affect the result because there is no off-setting reduction from external delivery charges to put against a reduction in stamp collection revenue. Nevertheless, unless the district traffic is dominated by internal mail the effect will be small, and no greater than forecasting margin on many other variables, not least the normal business issue of predicting one's own costs.

Thus although the stamp price is unknown, the system remains entirely practical for potential bidders and the business risks are no greater than in any ordinary commercial venture.

The idea of selling 64 district franchises might appear daunting, although it is far less than the number of local authority contracting out tenders and it will, of course, occur in a single bidding round. It is nevertheless tempting to think of fixing the franchises on larger segments -- for example the nine divisional business centres that the Royal Mail are in the process of establishing. The system could certainly work on this basis. It would, however, give each franchise a stamp turnover approaching £400M and nearly 20,000 employees. This would exclude many of the smaller potential players whose diversity would create more opportunity for different approaches and better service. Once established these small players would form an experienced pool of talent who could also provide competition to 'authorised' franchises.

3.

The first 'privatisation' bids

The very first round of bidding for franchises will also need to incorporate the privatisation of the assets and employees of today's Royal Mail. The first franchisees will be required to take on all of the current employees within the postal district for which they are bidding, together with their acquired rights through length of service and pensions. Thus the initial bids will be made on the basis that the bidders will not only contract to deliver mail at their bid price, but will also take on the employees and pay the Royal Mail the written down book value for the assets within the postal district.

The tender round will be carried out as previously described, with the successful lowest bids for delivery being aggregated to yield a stamp price. However, in the unlikely event that this yields a stamp price higher than today's stamp, then the price paid for the assets will be reduced with a compensating reduction being made to the bid price for the delivery service (based upon a present value discounting formulation) to a point that allows today's stamp price to be maintained. Each franchisee will have the same percentage reduction applied to the delivery price -- which will not, however, necessarily yield the same percentage reduction in asset price, since this will depend upon the relationship between the value of the assets and the assumed traffic volumes[1].

When the franchises come up for their first retender the assets acquired on privatisation will, with the exception of property, be close to being fully written down. Any pre-privatisation property assets will have an alternative use value, whilst any new equipment purchased by the first franchisee, if wisely chosen, will have a good resale value to any postal district. Thus, in the event of a transfer of a franchise, there will not be any overriding case to compel a subsequent franchisee to take on the assets of the losing franchisee from the first round. The probability is, of course, that the

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1. For example, take a district with annual stamp income of £50M and assets with a book value of £25M. If, say, a 2% reduction in delivery charges was necessary to maintain the stamp price then this would require a £1M reduction in this district's projected stamp income. £1M foregone in each of the five years of the franchise period has a present value of approximately £3.5M if an interest rate of 15% is assumed. Thus the price paid for the assets would need to be reduced from £25M to £21.5M in order that the franchisee is fully compensated for the £1M of income foregone. For this district this represents a 14% reduction in the price paid for the assets; other districts will have a different ratio of assets to stamp income and thus produce different percentage reductions in assets whilst using the same basis of calculation.

winning franchisee will strike a deal with the former franchisee to buy all of the property, plant and equipment.

There is a greater difficulty over employees when a franchise is lost. It would make poor economic sense, as well as being inhumane, automatically to cause the redundancy of all the postal district's employees on the transfer of a franchise. On the other hand, it would be wrong to burden the new franchisee with over-generous terms agreed by the former franchise holder, which in part may have caused the loss of the business. The compromise proposed is that the subsequent franchisee should be under no obligation to take on the employees of the former franchisee, but that he would be required to pay the old franchisee *statutory redundancy* for that proportion of the former franchisee's employees to whom he does not offer contracts. The former franchisee will, of course, be responsible for making any payments over and above the statutory redundancy that are due. This system would encourage the subsequent franchisee to take on the bulk of the employees, without writing a blank cheque for the former franchisee.

4.

End to end control

One school of thought believes that end to end control of a postal system is essential -- that the customer would have no confidence in handing his letter to an operator if that same operator was not also going to be responsible for ensuring its ultimate delivery to the addressee. Manifestly the same postman who collects the letter in London will never personally deliver it in Liverpool, so the issue is one of control: whether there is greater confidence if the letter passes through the various stages of collection, sorting, transshipment etc. under a single organisation, but with no publicly stated standards of service in between these various stages, than if some of the stages are split between different operators but with clearly identified performance standards at each handover? Or does it matter at all, provided the letter gets there on time?

The answer must depend upon the particular level of service the customer is seeking. When a Londoner buys electricity he is not normally interested that it was generated by National Power in the Midlands, transmitted through the National Grid and distributed and sold to him by London Electricity. Likewise when a commodity is purchased at the shops, the customer is not normally interested that the raw material came from overseas, and went through several processes in Britain before being purchased from the shelves of their high street store. In both cases the consumer is relying upon the quality controls inherent in the system and operated by their supplier to ensure that the service or goods they purchase are fully fit for the purpose -- that the electricity is at the right voltage and frequency or that the commodity is safe and meets the required British standards.

Of course for some purchases the intimate involvement of the supplier at all stages is essential. If one went to an expensive restaurant only to discover that the master chef had bought in the dessert from the local supermarket one would rightly be disappointed. Some premium mail services require similar involvement and control. If a merchant bank sends highly valuable and secret documentation through a courier service to its client it does not expect the courier service merely to slip the package into the nearest public letter box.

However, this sort of premium service where the customer requires end to end control is a rarity. With most mail the customer wants the same assurance as he does on his electricity or commodity purchase -- that the goods will arrive at the right destination and on time -- but he doesn't need that special personal touch supplied by the master chef or express courier service. The key is to ensure that there are publicly declared performance standards audited by the Director General for traffic between each franchise. Given the confidence which these controls should generate there would be no need for end-to-end control for the vast majority of ordinary mail. Moreover, as all the individual franchisees operate under the Director General's permit and to his performance standards, the Royal Mail 'branding' could continue, thereby reinforcing the concept of an integrated service.

5.

Competition and the first class stamp

In an ideal world one would doubtless remove all regulation and encourage totally free competition for postal services. But this goal could be achieved only if all the players in the game were unencumbered by statutorily introduced cross subsidy. In this proposal we have not produced an entirely level playing field, but have said as a matter of **policy** there will be a uniform nationally priced service. This produces constraints which necessarily modify the goal of free competition.

Any system that demands uniform national pricing is bound to contain elements of cross subsidy; and this system is no exception. There will be cross subsidy between urban areas and rural areas, between mail going short distances and long distances, and between mail being sent to large businesses and individual homes. Any competition that is permitted with the 'authorised' franchises must not be allowed to feed off the cross subsidies that the uniform national pricing system imposes. However, provided this constraint is not breached, competition and therefore consumer choice should be encouraged.

The existing embargo on private mail services costing less than £1 would go. Any operator wishing to provide a service in any area of the country (or nationally) would be allowed to do so, providing that service was offered to **all** addresses within the area, and for so long as the size of the area was not so narrowly defined as to 'cream skim' an urban area without also servicing the surrounding rural population. Any premium service, e.g. a courier service, would automatically be permitted, as would any service between prearranged addresses, however narrow the geographic area -- such as the Lexis legal mail service.

There is, however, one further area of cross subsidy; that between first and second class post. Second class post incurs precisely the same costs as first class in collection, sorting, transport, final sorting and delivery. The only extra cost attributable to first class is overtime for processing -- which for second class can wait until the following morning. For such a minor difference in costs a premium of nearly 30% for first class mail seems excessive; here might be an opportunity for an 'unauthorised' competitor to offer a cheaper first class service only -- and no second class service.

When second class mail was introduced it obviously helped smooth the peaks and troughs of mail traffic and thereby allowed the overall mail system to run at a more even and therefore more efficient pace. Today traffic is almost evenly divided between first and second class, making the discrimination in favour of first class more difficult. However there is a new opportunity -- using the 25% of mail traffic accounted for by the bulk discounted Mailsort for balancing the flow.

Most Mailsort is not urgent, so it could be used to even out the ebbs and flows of the traffic. This would see the end of the distinction between first and second class mail and enable all mail (other than non-time-critical Mailsort) to go first class.

As so much mail is already first class (with the infrastructure to support it) to incorporate second class should not add too much to costs. Indeed, by eliminating a sorting process between the two classes, it may even help! Certainly with a single class of mail the bidding process for franchises will be easier.

6.

The Director General of Posts

Part of the role of the Director General has already been described. He will be responsible for organising and administering the franchise bidding, for striking the stamp price and for price reviews. He will be responsible for establishing the 'standard' traffic volumes and for auditing the actual volumes achieved. All the bidding process will need to be conducted with strictest confidentiality, not least in keeping secret who and how many bidders come forward for each franchise (highly valuable financial information which sadly become public in the TV franchise auction).

The Director General will also be responsible for the entire system of postage stamps and franking machines: for issuing stamps, for their onward sale and the overall security of the system: for the Post Office Philatelic Bureau (which one may hope will contribute greatly to the cost of the Director General's operations). And he will also be responsible for administering the payment flows between the franchises.

The maintenance and improvement of standards of service lie at the heart of any regulator's responsibility. The Director General will be responsible for setting the initial standards of service which each franchise bidder contracts to deliver, as well as monitoring and adjusting standards during the franchise period. These standards will be backed up with monetary fines to penalise poor performance, with the ultimate sanction of opening the franchise to unfettered competition, or calling for a new franchise bid for persistent non-performance. These sanctions are immeasurably sterner than any likely to be applied to the existing Royal Mail; so one may hope that they will ensure continuing improvements. (The present criminal law against theft and delay of the mails will, of course, continue in force.)

The role of the Post Office Users National Council will inevitably be altered by the franchising of the postal districts. Some users' body, however, will still be needed; and this should report through the Director General who has the powers to enforce standards of service etc.

The financial viability of franchisees is essential. The Director General will be required to vet the viability of all bidders in advance of the tender and to seek such assurances (by way of guarantees etc.) as he deems fit. Whilst a franchise is in operation, he will call for regular reports on franchisees' financial soundness and, if necessary, should exercise the power to require them to seek further funding, or ultimately to merge their operations with another franchisee, or to have the franchisee rebid.

The Director General will monitor 'unauthorised' postal operations to ensure that they operate within the limits discussed above; and that, if they seek to provide a general delivery service within a postal district, this *does* offer a service to all addresses within that district and is not simply cream-skimming areas of denser population. If he finds breaches to regulation, he will have the power to stop the breach. He will also be responsible for supervising relations between franchisees, and in particular the transfer of employees on the change of ownership of any franchise following the quinquennial retender.

Although the initial franchises will be based upon the existing postal districts, these may not always represent the best long-term arrangements. The Director General will have the power to consider submissions from interested parties wishing to amalgamate or split districts at the next franchise review; his decisions will be based upon the overall benefit to the public (obviously splitting and merging two districts would not be beneficial if it left an unviable splinter of a district with no realistic chance of satisfactory service).

There will, of course, be pressure to amalgamate franchises prior to the initial bidding; larger players will want to obtain larger territories. Nothing can stop a single organisation bidding for half a dozen (or more) franchises provided it puts in a separate bid for each franchise, but it would be anti-competitive to permit them to make a single bid for a group of franchises and exclude smaller parties. If the larger player was interested only in securing a group of franchises then he would need to make very competitive bids indeed in each of them to be sure of winning -- missing one, he would have to negotiate to buy that franchise from the successful bidder.

An alternative system would be to allow conditional bids, i.e. to put in separate bids for half a dozen franchises but to allow them to be accepted only if <u>all</u> the bids were successful. This could work, but the rules would need to be clearly defined when it came to choosing between overlapping conditional bids.

The Director General would also have the power to review the duration of future franchise periods at retendering, as there may be arguments for extending the period (e.g. a major capital programme). Indeed the initial franchise periods might also be varied, some ending after four years, some after five, and some after six. By spreading the subsequent renewal over three years this would ease the Director General's workload and make the retender round less of a 'sudden death' for multiple franchise holders.

Although this paper assumes that the franchises would all be offered simultaneously on initial privatisation, it would be possible to offer for privatisation only some of the postal districts -- the remainder staying within the Royal Mail, but being required to operate within the eventual delivery price. This would allow the private sector to see how such franchises operate, and might generate keener bidding when the residue of franchises was thrown into the ring. But this would be asking the Royal Mail management to oversee a major change in their operations, with little incentive to see it succeed. The Director General would be deeply involved in negotiations with the Royal Mail during such a transitional period, and the strains may not ultimately be worth it.

It may also be (one hopes not) that on initial privatisation one or two franchises receive no bids. These would then need to be re-auctioned to the best -- probably neighbouring -- bidder. In the interim the existing Post Office management would continue to run the district(s). (There will in any event be an interregnum between bidding and franchise startup to allow for an orderly handover).

The Director General will also have other, smaller areas of responsibility.

International mail. International mail is governed by the Universal Postal Union. Under this system countries do not pay for all their mail but merely pay a delivery charge for their excess of exports over imports to any country. The Royal Mail international business is already established as a separate business unit -- Royal Mail International -- employing 3,000 people. Given that the system of payments is already similar to that proposed in this paper, this business could be offered as a franchise along with the postal districts. But because of the UPU relationships the Director General's role will need to be more prominent.

Transport. The Royal Mail runs a fair-sized transport operation. There are benefits in running an integrated transport system which would allow loads from neighbouring districts to be aggregated, return loads to be organised, and the use of intermediate transshipment points (if justified). For this reason the transport operation should not be divided amongst the 64 districts on privatisation but be retained as a coherent unit to bid for work from the districts (and from third parties). Districts would be free to use other transport operators or to create their own in-house facility, but probably most of the contracts would remain with the Royal Mail transport operation. Privatisation of the transport business might follow some six months after the privatisation of the districts when it could demonstrate the amount of mail business retained and the profits being earned.

Property. All Royal Mail properties are already subject to regular revaluation to market figures. Inevitably development opportunities on some sites will generate 'windfall' gains. There should not, however, be many such cases; and, on purely economic grounds, where an asset can be put to a better use it should be encouraged. It is not, therefore, suggested there should be any special clawback provisions on property sales. But the Director General may need to be involved in splitting shared properties, particularly between Post Office Counters and the Royal Mail.

Central functions. The Royal Mail has established a number of central functions which supply services to the principal businesses at what are intended to be fair rates. These include Quadrant (catering), RoMEC (building maintenance), CashCo (secure transport), IT, R & D, Purchasing & Supply and Recruitment & Training. Each of these would be offered for sale to the private sector by the Director General and would then sink or swim on their own merits.

TV Licensing (new-established as Subscription Services Ltd). This would be offered to the BBC or established as an executive agency.

The Director General would also be responsible for the privatisation of Post Office Counters and Parcelforce; and these are now considered.

7.

Post Office Counters

Post Office Counters provide a valuable service administering the delivery of payments of pensions, driving licenses, social security, national savings, TV licenses, passports, Giro Bank etc. They also provide (as a minor part of their duties) service to the Royal Mail and Parcelforce. With almost 21,000 offices, Post Office Counters has nearly as many branches as all the Banks and Building Societies combined.

It is this coverage, especially in the rural areas, that gives Post Office Counters its edge. If the Department of Social Security wants a system for paying pensions or benefits that has such almost universal coverage, then it has no real present alternative to the Post Office. Likewise few high street organisations can match the clerical capability for handling such a diversity of administrative documentation.

This service has little to do with the Royal Mail. Post Office Counters negotiates arms-length handling fees with all its clients; and the Royal Mail and Parcelforce account for less than a quarter of its revenue. There is no need for the Counters to remain either as part of the Post Office or indeed as part of the public sector. Counters does, of course, handle many valuable and confidential documents, but given the right controls there is no reason why this duty should be more securely performed in the public than in the private sector.

It is obviously right that these services should be allowed to pass into the private sector, where freedom should be granted to them to add extra services and restrictions be lifted (such as on hours of opening) that have made some rural offices unviable.

It is argued that the 10,000 rural offices are a burden on the Counters business which has to subsidise them to the tune of £30 million per annum (£3000 per rural post office) just to keep them open. But this is only one part of the story. As already mentioned, it is Post Office Counters' near universal coverage which gives it its major competitive advantage. If there were no rural post offices then the DSS might as well pay benefits through building societies, who could probably do it cheaper. (Two-thirds of the 'non-mail' transactions performed by post offices are pensions and allowances.) Once part of the business is lost, not only does overhead recovery suffer, but fewer customers will visit the offices and a downward spiral could start.

So it is in the commercial interest of the Counters business to retain the rural network. Nevertheless it would no doubt be politically expedient on the sale of Post Office Counters to stipulate that there must be no reduction in the overall numbers of offices for at least the first five years. (There should be no obligation to keep exactly the same offices open as this would freeze the business at the time it is sold and allow no opportunity to respond to demographic and commercial changes.)

There should be no restriction on competition. Any organisation that wants to compete in part or in whole with the Counters business should be allowed. Likewise its clients must be free to place their business where they will. However, the real competition would be not in selling stamps, but in providing the administrative service to the major clients such as the DSS, Home Office and DVLC. This would be viable from the clients' point of view only if the new competitors were to offer a full regional or national coverage -- a 'spot' service would be inadequate.

In a limited sense the Post Office Counters' business *is* a franchised operation. There are 19,500 agency offices and only 1,100 crown offices staffed by Post Office employees. A steady stream of crown offices are being converted into agency offices and the 1990 Post Office Annual Report itself says that this is happening 'without loss of service to customers. Indeed there is improvement, in many cases, in hours of opening.' This trend would need to continue even if the overall business were not sold.

The existence of the agency offices does, however, raise one intriguing possibility for competition. The constraint on new competitors is the need to supply very extensive regional or national coverage. If instead of concentrating on the opening of new offices the new operators were to persuade agency offices to transfer allegiance from Post Office Counters to their operation, then at a stroke the extensive coverage could be achieved. Indeed, following this process through, it is possible to envisage a time when two or more service networks might comprise a mixture of existing agency offices plus additional ones to fill out their coverage. Customers could end up with more choice, better service and more offices.

Such a free for all, however, might prove disruptive and the Director General would need to supervise the franchise terms for agency offices to ensure that they were both reasonable between the parties *and* facilitated the opportunity for other service providers to compete. For example franchises should not be for longer than 5 years and should terminate on common dates.

8.

Parcelforce

Parcelforce is established as a separate business within the Post Office, with its own workforce of nearly 13,000 people. There are still some areas of overlap with the Royal Mail and total end-to-end control is not expected to be established before 1993.

Last year the business was reported as being marginally profitable. This year's accounts report a loss of £131M on turnover of £527M. These figures would have been somewhat better but for an exceptional provision made for restructuring the business, but against this, the figures have benefited from the pension holiday and interest receipts.

Not all this huge loss represents a turnaround from the previous year, because it transpires that last year's revenue was overstated by a mis-allocation of revenue from the Royal Mail to Parcelforce. No precise figure is given for this but the accounts report that the error this year would have been £60M on the same basis.

This means that Parcelforce probably lost £60M last year and considerably more this year -- losses in excess of 10% of turnover. Worse, their response to the losses does not (yet) appear to include a cutback in their operations; average staff numbers have increased by 650 over the year to 12,800, whilst the physical volume of traffic has *fallen*.

This cannot represent fair competition with the private sector which not only has no ultimate fallback on the taxpayer but also has to pay interest or dividends on the capital it employs. Parcelforce offers little more than the dozen private parcel delivery firms, but by subsidising competition the state is putting the private sector operations in jeopardy.

There is no need for Parcelforce to remain in the Post Office or indeed in the public sector. It is essential that the problem is quickly resolved by sale to the private sector on whatever terms can be achieved.

Conclusion

On the back of rising traffic volumes the Post Office has performed well throughout the '80s, but is showing a deteriorating financial performance in the '90s. Calls on the taxpayer for new funding look increasingly likely. Now is the right time to explore different approaches to the business.

Post Office Counters and Parcelforce are already established as separate businesses and should therefore be sold. In the case of Counters most Post Offices are already privately run agency offices and the remaining Crown Offices should follow suit. More important, the administrative organisation which manages the Counters' 'franchise network' should also now be released to the private sector. In the case of Parcelforce this is a loss making business competing head on with the private operators -- this is unfair. There should be an early sale to the private sector at the best price obtainable.

Much the biggest issue in terms of both size and complexity is the Royal Mail. Privatising it as a single unit would merely transfer the monopoly from the public to the private sector. However, franchises based upon the Royal Mail's existing 64 postal districts would produce sensibly sized business units and would open up the system for competition. Bidding on the basis of lowest delivery charge should ensure that stamp prices are maintained or become lower, whilst contractually binding standards of performance should cause service to improve.

A Director General of Posts could supervise the overall system still using the Royal Mail 'branding' and ensure a genuinely seamless service from pillar box to doormat throughout the country. The uniform national stamp price would continue although competition may necessitate the upgrading of all private mail to first class (but at the second class price).

Breaking the monopoly would not only help release the potential of the Royal Mail staff but would also act as a safeguard against strikes. It would give many budding entrepreneurs an opportunity to participate in management buy-outs of their districts. It would also allow other businesses already involved in servicing households (such as the utilities, mail order companies and parcel operators) to exploit synergies and extend their business.

Overall, a franchise system would be entirely practical, and promise the customer an economically priced, uniform, national postal service with rising standards and greater choice.