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Review of Royal Mail Financial Report and 2009 Reforms *(REVISED)*

Year-end reviews or regular performance reviews are beneficial processes in general, so this two-part article on Royal Mail postal reforms will begin with new and recent topics (i.e., calendar year financial results) and review key aspects of UK postal reforms during 2009 without repeating topics already fully discussed in my prior articles on the subject ([Privatising Royal Mail – Part I](#), [Part II](#), and [Part III](#); [Beyond the Hooper Report – Part I](#) and [Part II](#); as well as [Royal Mail Missed Opportunities](#) and [EU Postal Reforms](#)).

The recent release of mid-year 2009 financial results by Royal Mail, as well as news of a stamp price increase, has renewed such topics as viability of Universal Service (the "USO"), modernisation efforts and back pension obligations, while concerns about continued industrial action persist. To begin, Royal Mail released financial data for the 2009 mid-year period April to September, to include operating profit of £184m (a 4% increase), revenues of £4.58Bn (a £73m decrease) and a cash flow deficit totaling £434m. All four Royal Mail groups (Post Office, Letters, Parcelforce Worldwide and GLS) reported profits, but overall, profit was down. The major participants in the privatisation efforts placed notably emphasis on the positive operating profit number instead of the more appropriate bottom line number—a cash flow deficit of £434m for the period.

Royal Mail and the UK government attributed the operating profit to the success of the modernisation efforts, while the CWU attributed it to hard working postal workers that delivered the gains and should therefore receive financial rewards. Which is it? The better question is, "*What are each actually claiming?*" For Royal Mail and Lord Mandelson, they are essentially saying any future financial reporting of less than attractive results (i.e., lower profit number, less overall revenue or greater cash flow deficits) means modernisation efforts are to blame (i.e., failure of some kind), since modernisation efforts are the reason for the "*operating profit*". In other words, expect and demand greater successes and profits as modernisation efforts continue. As for the CWU's claim, they are essentially saying postal worker's performance determines gains and losses. If the gains are due to hard work, then it is only logical to assess blame on poorly performing postal workers when losses occur. In other words, losses are due to postal worker's performance.

An actual look at the financials (still limited due to the sparsely available info) offers a slightly different view. First, only four groups were widely reported in the press, not all five. Excluded was the "*Other businesses*" category, which is only vaguely identified as Romec responsible for the majority of the revenue side, and Royal Mail Estates (property leases) responsible for the majority of the operating profit side. Excluding these ancillary businesses from the numbers

and operating profit falls from the reported 4% increase to just 2.9%, while overall revenues decline a total of £80m instead of £73m. Next, Parcelforce (EU wide express delivery) reported an operating profit gain of 75% for the period and revenue gain of 3.8% (the largest of the four main groups widely reported), and arguably little if anything to do with postal reforms. Finally, Royal Mail letters business only experienced a 4.4% increase in operating profit (in part due to 6% reduction in gross hours) on a 1.7% decline in revenues.

Clearly, both claims for the operating profits are mostly rhetoric. In reality, 5,000 fewer workers will improve most any business' short-term financials, so in that respect, modernisation efforts and hard work combined, did improve operating profits. Focusing on the more applicable numbers of less overall revenue (£-73m) and the huge cash-flow deficit (£-434m) for the period, and these numbers better reflect the issues facing Royal Mail Group going forward. Keep in mind, the decline of £73m in revenues is still a decline. Furthermore, there is still an estimated £10bn pension deficit, and very importantly, the UK government had to provide £2bn to Royal Mail for the first stage of modernisation efforts. Therefore, any claim of profit, from modernisation or postal performance, is simply a distortion of the facts. Moreover, requests for financial rewards are misguided and inappropriate, as is exorbitant executive pay given the state and progress of modernisation efforts.

Continuing, Royal Mail's CEO called the results "good" saying, "...seven years ago the company lost £1m per day." With a total deficit of £434m for the most recent six-month period, that equates to roughly a £2.4m shortfall per day. In terms of lost revenue (£73m) alone for the six-month period, it equates to losing £400,000 in revenues per day. Moving past the financial report, industrial action is a real possibility going forward, the majority of Royal Mail's postal workers were dissatisfied with Royal Mail management, the first stage of postal reforms are not scheduled to be completed until well after the full competition rules take effect, efforts to pass a bill to authorise the (partial) sale stalled, a finalised plan or strategy for Royal Mail to be self-sustaining does not exist, and the list continues. In my opinion, whether the timeframe is seven years, three years or last year, there is little to boast about. Rhetoric and opinion aside, Royal Mail modernisation is exceedingly slow, far from complete, highly fragmented, inordinately political, chaotically managed (union, management and political) and strategically misguided.

Next, the proposed UK postage stamp price increase has mixed results from the public and businesses, with many opposed to any price increase, while some reluctantly support an increase in the short-term, provided it leads to greater efficiencies resulting in long-term viability of USO. Roughly two decades ago, the United States Postal Service (USPS) began a modernisation effort to introduce efficiencies and automation into their business processes. The expected outcome was self-sustainability and an overall cost savings. Last year, the USPS reported an annual loss of \$3.4Bn (£2.1Bn), and over the last two decades, the USPS has continually increased postage rates, while failing to become self-sustaining because they simply do not understand their market or how to properly be competitive.

History shows it is not enough for postal services offering USO to automate, nor is it sufficient to eliminate inefficiencies, although both must occur along with truly competitive reforms. In a prior article, I explained in detail why USO is inherently inefficient, and therefore, must be a subsidised service (one way or another). Unfortunately, for most postal services, subsidisation is a combination of persistent higher postal rates and continued reduction in services. Of course, significantly better strategies exist (and not a single logical strategy involves eliminating desired services or selling, in part or in whole, postal services offering USO). It is completely illogical to follow the same general steps and processes as the USPS, while expecting a significantly different outcome when the respective and applicable markets—core letters businesses—and general circumstances are so alike so as to predict similar outcomes. Not to digress, but currently the USPS is "reviewing its business model" after reporting a loss of £2.1Bn. A review of their business model is required, but regrettably, what the USPS is

actually doing is reviewing its operations looking at services to eliminate or reduce in an effort to cut costs (i.e., continued reduction in services), while seeking further postal rate increases. That is not a business model review, but it does clearly demonstrate why the repetitive cycle of higher postal rates and reduced services exists and persists. A former USPS Postmaster General is also mistakenly advocating privatisation as a solution to a problem; however, a sale will not address or resolve the problems faced by the USPS, but rather, make them worse. Note, under the former USPS Postmaster General, inefficiency and bad business decisions led to the worsening conditions present today at the USPS, so advice from a contributor that failed to execute properly is unwise advice to accept.

Attempts at new UK postal reforms during 2009 were expensive and unproductive. In early 2009, the UK government claimed immediacy was required relative to new postal reforms, and thus aggressively pushed for passage of the Postal Services Bill (the "PSB"). By the fall, the PSB was withdrawn because there was no viable buyer, and nothing meaningful has happened since. The PSB legalises or authorises a sale of Royal Mail (partial sale), but the PSB does not specify the buyer(s), only the percentage allowed to sell. Therefore, a buyer is not required for passage of the PSB, and thus, arguments presented for withdrawing or postponing the PSB—*"no buyer and bad economy"*—are illogical. Furthermore, the Business Secretary's office incurred £3.4m in expenses related to a potential sale when the bill authorising the sale has yet to be legally approved. Since the PSB is a Labour party initiative, it is only fair to comment on Conservative party plans, which calls for the total sale of Royal Mail. The majority of the UK public does not support the sale of all or part of Royal Mail, and this has been consistent for some time. Past efforts to approve the sale of all of Royal Mail have failed. Furthermore, if the option was a full sale, it is likely the total number of Parliament members in opposition would grow to such a number that it would be impossible to get passage of any such bill. Whether the sale is all or part, there is sufficient opposition making such an approach moot. In short, the year produced substantial expenses and no results, where immediacy proved to be a costly and invalid claim (as predicted).

As for those opposed to a sale of Royal Mail, namely those in Parliament (i.e., signatories of EDM 428), success at halting the PSB without an alternative plan of any kind meant nothing happened at all (also as predicted), even though those in opposition totally agreed change is required, and needed sooner rather than later. So, who exactly won, and what kind of victory was it? Is it like winning a trivial argument only to lose a long-time, best-friend/-colleague in the process? Make no mistake, the arguments presented for selling all or part of Royal Mail were, and are, illogical, and will not produce the results promised (refer to Part-Privatising Royal Mail – Part II and Beyond the Hooper Report), but at the same time, doing nothing is clearly a much less logical choice given doing nothing insures failure. My detailed analysis of the subject pointed out, if those opposed to the sale believe something must be done, then their opposition must include proposing another plan or they must concede. That is, if change is agreed to be necessary, then it is better to receive as little as 1% of something, then 100% of nothing, so offer something rather than mere opposition alone.

Continuing, Lord Mandelson repeatedly argued, incorrectly and illogically (see proofs), that his proposed remedy was *"the only one"*, and combined with the position of the opposition, they set the stage for an *"all or nothing"* 2009 postal modernisation effort. It looks as if much of 2010, if not all of it, will be like that of 2009, noting full competition arrives in less than 12 months whether the UK is ready or not. Again, exactly who won and what did they win (excluding, of course, Royal Mail's future competitors, each of which gains as 2011 quickly approaches without substantive progress)? Note, for most problems, there exists a set of multiple possible outcomes (i.e., remedies + solutions) consisting of many that are below average (i.e., remedies) and a few that are average to above average (i.e., solutions), so the opposition was not without options if they wanted to find one (and several were offered), but Business Secretary Lord Mandelson's single remedy approach was erred from the start.

[Part II](#) of this article will cover the topic of political separation, one of the original proposed recommendations completely ignored; issues regarding the CWU, especially with pending national elections and the threat of industrial action; back pension obligation issues, including rejection of a plan that would have paid for a portion of the £10Bn deficit without raising taxes or imposing additional fees; a brief summary of how national elections will impact the privatisation plan; and analysis of two key players involved in the postal reform issue (not politicians, unions, management, competitors or regulators).

About the Author: Timothy Nestved is founder and president of Nestved LLC, as well as a principal consultant, with expertise in turning around firms in the delivery services industry, including distressed firms facing similar challenges to those of national postal service providers like the Royal Mail and USPS. Inquiries for Timothy may be submitted through the [Contact Us](#) page at Nestved, LLC.

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