



### **Global Postal & Parcel Industry News**

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### **Review of Royal Mail Financial Report and 2009 Reforms – Part 2** *(REVISED)*

This instalment continues with a discussion of operating profit, followed by a discussion for the 2009 calendar year period from October to December, as well as continued performance assessment of UK postal reforms during 2009.

Referring back to [financial results for April to September](#), Royal Mail reported an overall increase of £7m in Operating Profit as compared to the prior year's period, and £3m of the £7m was actually from "Other Businesses" versus one of the four core operating groups (Letters, Post Office, Parcelforce and GLS). With the majority of the £3m attributable to Royal Mail Estates (leases portfolio property to Royal Mail Group), the Operating Profit from core businesses is just £4m. Continuing, Operating Profit excludes exceptional items, which are nonetheless still incurred items (i.e., costs, expenses, et cetera), so the true bottom line number is a deficit cash-flow of £434m (a loss).

Operating Profit is absolutely a useful financial reporting figure, but the accumulated total, in this case £4m (or £7m if you insist), is merely quantitative and requires accurate analysis of detailed qualitative data for explanations as to cause and effect. As mentioned in [Part I](#), the released financials lacked detail, especially relating to expenses. Detailed expense reporting will better indicate past and future efficiencies, including results of modernisation efforts. Case in point is a rough estimate of the financial benefit of 5000 fewer workers for the period, or roughly a savings of £90m for a full year considering salaries only, which averages out to £22.5m for the April to September period. In other words, Royal Mail saved on average, excluding all employee benefit cost savings, £22.5m in people costs over the year ago period, but only reported a £7m (really £4m if you exclude real estate) in operating profit. In short, a conservative £10m (£22.5m – operating profit – £5.5 more) in savings due to labour cost reduction still exceeds the £7m reported in operating profits. More over, Royal Mail received £197m payment from the government for modernisation efforts for the period, as compared to only an £81m payment for the year ago period, producing a net increase of £116m to Royal Mail for the period. Without the workforce reduction (and presumably the extra £116m), there was no positive operating profit. Variables and Formulas: 5000 employees, a low overall workforce average salary of £18,000 per year or £9,000 for the period, allotting £0 for benefit costs per employee and averaging of the six month period resulting in a .25 multiplier for the yearly salary is  $5000 \times ((18000 + 0) \times .25) = 22.5\text{m}$  for the period; and  $5000 \times (18000 + 0) = 90\text{m}$  yearly.

With almost two-thirds of Royal Mail's costs attributed to *People Costs*, a work-force reduction of 5,000 for the period improved Royal Mail's financials. In addition, sources of earnings

come from revenues (i.e., revenue based product/services), and revenues continue to decline (decreased £73m from the year ago period). After all the cost cutting measures are completed, revenues must sustain the business, and there is historical evidence cost cutting, efficiency gains and automation are not nearly enough to result in self-sustainability in the case of postal services offering universal service. That is, without a plan to stabilise and then grow revenues, and there is still no plan at all, universal service is threatened.

During the months from October to December, there were numerous postal strikes affecting Royal Mail's financials for the period, but more importantly, those businesses that permanently switched to one of Royal Mail's competitors represent a long-term loss for Royal Mail. On the positive side, there was a seasonal increase in volumes due to the holidays, which will likely offset a portion of the losses due to strike action. By definition, "*seasonal increase*" means the seasonal event is the reason for the increase, so consider that if and when participants attempt to distort the facts with obscure unsubstantiated claims. It is likely Royal Mail's current period (October to March) will deliver even less overall profit than April to September and another deficit cash-flow bottom line number (presuming all inflows and outflows are properly accounted for), which means yet another negative financial result. Keep in mind, when facts are allowed to be distorted or intentionally misrepresented, underlying problems and root causes go unaddressed and actual problems persist/enlarge.

Moving beyond the period's financial report, the next issue is political separation, or lack thereof. Although the Hooper Report contained numerous errors, its recommendation that Royal Mail be separated from UK politics was (and is) completely valid. As long as Royal Mail is tethered to the government, it will fail to operate as a self-sustaining entity. Furthermore, it is near impossible for any business to be competitive, efficient and innovative if political interference permeates the day-to-day business decisions and business operations. Two current events make the point: public complaints of long post office queues prompted a politician to demand Royal Mail investigate and add more staff to please constituents; and public complaints against scheduled post office closures (valid or not) prompts political pressure for a reversal of the decision. If the desire is to control Royal Mail, then get fully involved and solve its problems (with viable solutions); otherwise, step aside. Note, Labour and Tories both refer to the Hooper Report whenever it suits their need, but with respect to political separation, both parties ignored the recommendation completely, which in itself justifies the claim political separation is essential. Furthermore, Labour, Tories and the CWU each received either a proposal or "*draft/working outline*" that addressed the political separation issue, and all elected to ignore the proposed solution completely. In summary, progress on the issue of political separation is nonexistent, and more accurately summarised as, a complete failure.

The next open issue is Royal Mail's back pension obligation. It is important to note the continual non-payment of pension obligations in prior years led to the current large deficit problem, and furthermore, the UK government was responsible for all non-payments occurring prior to 2007 (and arguably 2007 to the present as well). First, there is the issue of ultimate responsibility. The UK government (i.e., Labour party) has stipulated no action will take place on the payment of the back pension obligation until a buyer is secured, and Tories appear to agree on that issue. With no buyer, the problem remains unresolved and lacking any plan. But, Labour stated they would not seek privatisation of Royal Mail prior to the last election, so it is unclear if any claim to take responsibility really means take responsibility in the end. Second, the valuation of the obligation itself has not occurred. The last valuation was £3.4bn and the most quoted estimate at the start of 2009 was near £10bn. It is unrealistic to address a problem of which the magnitude is unknown, especially when there exists no resolve to claim ultimate responsibility. Therefore, progress is nonexistent, resulting in another complete failure.

Continuing with the back pension issue, the problem will not resolve itself, nor will it diminish

over time, so no action in 2009 meant a missed opportunity to begin the process of paying down the huge financial obligation that exists. Furthermore, with the obligation near £10bn (and possibly £12bn to £15bn), it is unlikely Royal Mail will ever be able to satisfy such a large obligation, so the only viable entity to resolve the issue is the UK government. Therefore, the matter should have received due attention and consideration, to include a plan of action, sooner rather than later. The ideal situation would be selection of a plan proven to work (i.e., has raised significant funds) in many places across the global "*[that] raise[s] significant funds for the back pension obligations without imposing any new UK taxes or requiring the UK government to expense or disperse any cash reserves*".

Surprisingly, the concept of just such a plan was presented to each of the major participants, but not one of them (nor any of their staff) is able to state, recite or describe the plan, even in vague summary terms, concluding the plan was completely ignored without any consideration for its applicable merits and ability to resolve the daunting £+10bn pension obligation issue, with communications at least twice in early 2009 to PM Gordon Brown and at least once to Ms. Geraldine Smith MP (author and introducer of EDM428, which officially established Parliament's opposition to part-privatisation of Royal Mail, although the opposition proposed no other plan or solution), and mid-year communications to the Mr. Billy Hayes (CWU) and Mr. David Cameron MP (leader of the opposition party, the Conservative Party-Tories). Proceeds from the proposed plan were estimated (unverifiable) at billions of Pounds. I contend, even if the proposal only generated a paltry and pitiful £100m, it is still £100m more than any other proposal, making the decision by participants to do absolutely nothing an act of total irresponsibility, while demonstrating their inability or lack of desire to seek solutions and work towards resolving one of the most serious UK reform issues.

If those responsible for implementing a solution (i.e., elected officials, RM chairman/hired employees at the executive level, et cetera) do nothing or only listen to their own positions, ignoring the input of others and rejecting viable options, in whole or in part, while pursuing their own (or their party's) agenda without concern or consideration for truly understanding all of the pertinent underlying issues and future consequences, thus passing up the opportunity to devise a comprehensive and logical solution formulated via discussion and constructive compromises, then the resulting outcome will always fall short of success and be predicated on the condition of "*dominant*" wins, even if dominant ultimately means doing nothing. Dominant does not necessarily correlate to knowledge, understanding, wisdom, thought, ideas, innovation, success,... That is, "*dominant*" is great in circumstances like wars, but not really applicable for situations requiring successful problem solving and good governance. In the case of Royal Mail, failure to seek, consider and implement best possible solutions demonstrates why the lone plan is the (unnecessary) "*sale of a State asset*", resulting in no or little improvement in the modernisation effort to achieve the goal of self-sustainability and continued affordable universal service.

Viewing events throughout 2009, it is apparent the Royal Mail modernisation effort is not about solving the problem, but rather, each participant taking a hardened position and engaging in verbal "*rhetoric*" attacks (and strikes in the case of the CWU) against their "*opposition*", accomplishing absolutely nothing constructive. As examples, Royal Mail CEO Adam Crozier telling CWU to "*shut up*" the eve before negotiations, or the CWU demanding (with threats of further strikes) to be involved in management decisions relative to job cuts and pay increases. (Digressing, when it takes two management teams to run one company, maybe both need replacing). Or, take the infamous exchange between Gordon Brown and David Cameron in the House of Commons on the subject of the Postal Services Bill (the "PSB"), where applicable members and backbenchers (collectively referred to as "*Supporters*") applauded upon perceiving their side won a verbal rhetoric attack.

Select Details: Cameron claims the PSB was withdrawn because of Labour backbench opposition, and his Supporters shout and applaud, but their plan (full sale) has even more

opposition, and such a plan has historically never passed. In response, Brown claims the reason for withdrawing the PSB was because there was no buyer, and his Supporters shout and applaud, but there was a buyer (they just weren't willing to pay an over-rated price for a declining asset). In short, the whole of the House of Commons is somehow happy there is no buyer for one reason or another, when in fact, both party's plans require a buyer. Furthermore, both sides speak of opposition as if their plan has none, when in fact opposition is the reason for every failure, past and present (for both parties). So, what exactly is all the happiness about? Where is the victory? Where is the solution? Where is the leadership? Where is the governance? There is no real end to asking such similar questions. Is it really just about you or your party winning, while everyone loses? Fact is, everyone has contributed to the problem and all are essentially equally to blame, so the logical plan of action is to work together, stop focusing on blame and opposition, and solve problems. Last year produced many delays and no solutions, and as a result, postal reform progress was a failure.

The postal letters business represents a distressed global industry, and distressed markets differ significantly from traditional or normal markets. A year ago, there was speculation that whatever direction the UK government decided on for Royal Mail—which at the time was privatisation—many other EU postal services would follow suit. Because of my firm's applicable experience, plus our specialisation is strategy formulation, turnarounds and distressed industries, we knew privatisation was not the only solution, and certainly not the best choice. We also understood the market dynamics well. Moreover, most of the arguments, justifications, reports, and conclusions presented/used relative to UK postal services modernisation by the major participants were either incorrect or misguided. So, we agreed to volunteer by sharing our expertise and offering alternatives (solutions). Furthermore, it was clear the decision to enact full postal competition rules within the EU would jeopardise survivability of postal services offering universal services by expanding the distress market situation beyond just the letters business (realising most fail to see the connection and therefore disagree). However, it is clear after one year's time that there is more interest in opposition, domination and "*rhetoric*", then in recognising and understanding the threats, and finding and implementing solutions.

For postal services in general, the primary problem is postal services have always been aligned with communications, and therefore, most persons incorrectly believe postal services are in the communications market. Before, when postal markets were protected, it did not matter that the market was incorrectly identified. Now it matters. In my first article ([Privatising Royal Mail – Part I](#)), I provided a detailed proof of the market misconception. Unfortunately, even with the definitive proof, most still adhere to the misconception that postal services are in the communications market. In short, failure is inevitable when a firm targets the wrong markets or does not understand their primary market. Relative to Royal Mail, the major participants still refer to Royal Mail as competing in or operating in the communications market, indicating progress has been nonexistent.

My series of articles relating to postal reforms (not just UK specific; ([Privatising Royal Mail – Part I](#), [Part II](#), and [Part III](#)) and Royal Mail's modernisation efforts ([Beyond the Hooper Report – Part I](#) and [Part II](#)), as well as one article on [EU Postal Reforms](#) overall (because the UK seemed insistent on learning "*by accident*") were mostly taken as providing a different perspective or offering a challenging viewpoint. By the mid 1400's—the time of Christopher Columbus—it was still common for people to believe the Earth was flat, and if you went too far, you fell off. Prior to the 1400's, those that stated the Earth was round were considered mentally challenged, while those offering proof were ignored or declared incorrect, or offering unique and innovative perspectives. In 340 BC, Aristotle provided sufficient evidence that the Earth was not flat, but round. However, widespread misbeliefs illogically drowned out reality, as well as concrete facts, for over 1,700 years. Respectfully, if all I possessed were differing perspectives, I would not have contributed or written anything, for differing perspectives are like multiple opinions, everyone is free to accept that which they wish without

regard to fact or validity. That is, opinions, by definition, are not necessarily correct or accurate. My articles provided definitive proofs and historical facts supported by evidence, which are most definitely not opinions.

I closed each article with statements meant to focus participants on the actual issues and challenges, trying to emphasise there is always more than one solution, and the task is not to claim the win, but to develop and deliver the best possible solution given any applicable constraints. Implied in each article is the statement that facts do not care if you interpret them correctly or even if you understand them, but unless you understand the facts and interpret them correctly, your outcome will likely fail. Additionally, if one's basic premise is flawed, it is likely all subsequent decisions will inherently contain flaws, thus compounding negative consequences. The articles offered numerous examples as proof, including both the USPS and DP-DHL.

There are four ways of learning and three actionable ways to execute (ordered by precedence): by example (learn from somebody else's action), by action (do it yourself) or by acquisition (read/listen or obtain by some other means, but still requiring action), and by accident (self-explanatory). Continuing to volunteer expertise and solutions is futile, as participants seem insistent on learning by accident, while pursuing courses of action that defy logic and at only one of two speeds, either the speed of light or dead stop.

In summary, UK postal reforms in 2009 failed to progress in a productive manner—unless of course, you consider continued opposition, no buyer for a buyer-based remedy, or postal strikes, to name three, as progress.

## Notes

1. It is prudent to exclude a discussion regarding the threat of industrial action considering the 22 Jan deadline passed without an agreement.
2. UK National election is really a 2010 topic, so it too is excluded.
3. As for the analysis of two key players not widely reported on, they are important to the overall subject of Royal Mail modernisation and postal reform in general, but excluded as well.

**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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