



Annual Review 2004-05

Royal Mail Group plc



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Royal Mail Group is unique in reaching everyone in the UK through its mails, Post Office® and parcels businesses – which employ over 196,000 people. Every working day Royal Mail collects, processes and delivers around 84 million items to 27 million addresses for prices that are amongst the lowest in Europe; each week we serve 28 million customers through our network of 14,609 Post Office® branches and each year our domestic and European parcels businesses – General Logistics Systems and Parcelforce Worldwide – deliver some 285 million parcels.

This year sees the completion of the three-year Renewal Plan, which provides a platform to face up to competition in our mails businesses, continues to transform the Post Office® network and our domestic and European parcels businesses, provides an improved commercial return to our Shareholder and allows us to continue to invest in our people, our infrastructure and our service quality.

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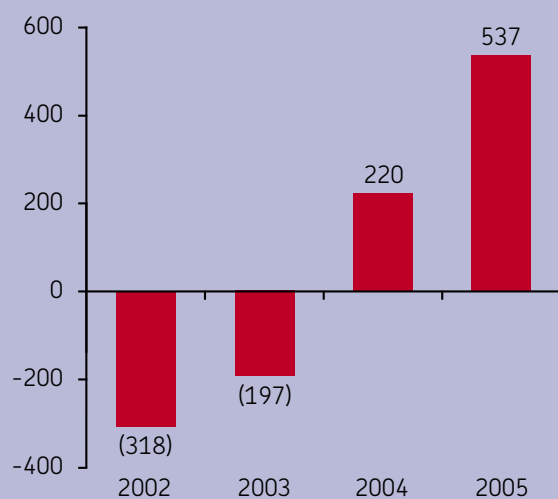
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Key Highlights

Royal Mail Group plc

Key Highlights

Group profit/(loss) from operations



- Quarter 4 quality of service for 1st Class mail was 92.8%.
Pre-Renewal Plan: in 2001-02 Quarter 4, 1st Class performance was 91.4%
- Profit from operations of £537 million is £317 million (144%) higher than last year.
Pre-Renewal Plan: in 2001-02 the Group lost £318 million
- Share in Success reward to our people of £218 million - £1,074 per eligible person.
Pre-Renewal Plan: no Share in Success
- 62% of our people believe Royal Mail is a great place to work.
Pre-Renewal Plan: we had no measurement
- Cash inflow of £140 million before Post Office Ltd working capital funding.
Pre-Renewal Plan: in 2001-02 the Group consumed £96 million of cash and was facing going concern issues
- Renewal Plan completed and progress delivered on all its objectives
 - improving customer service
 - making Royal Mail a “Great Place to Work”
 - return to profitability
 - cash generative

Chairman's Statement

Allan Leighton

“ Royal Mail's postmen and postwomen have achieved a fantastic turnaround ”



“ Everyone in Royal Mail is more **focused** on customers and more **committed** to achieving even better **quality of service** than ever before. ”

Royal Mail has had a remarkable year. By the end of 2004–05:

- quality of service was at its highest levels on record;
- postmen and postwomen had earned their biggest bonus – nearly £1,100;
- the £537m profit from operations in 2004–05 was a record with more than £200m going to the Company’s people in one of the biggest profit shares with employees in UK corporate history;
- the implementation of operational changes have been completed to give Royal Mail the platform it needs to take on full competition in the mail market from January 2006;
- mail volumes reached a record 84 million letters a day, a million more a day compared to the previous year, and the Group’s sales income was also a record at £8.9bn; and
- 15% efficiency has been achieved over the Renewal Plan, saving gross costs of £1.5bn, which have been reinvested in our people, our customers – including specific improvement in quality of service – and our infrastructure, beating the £1.4bn target set.

Three years ago, the idea that Royal Mail could achieve any of the successes above seemed far-fetched to many. In 2002, the Company was losing well over £1m a day on its operations, failing its customers, had one of the worst industrial relations records in the UK, and had an inefficient operation that was incapable of being profitable under the heaviest regulation in the postal world. It was in no position to embrace competition. Royal Mail could not have survived without modernisation. We had to change. But what’s really impressive about the 2004–05 results is the sheer scale of the progress the Company has made. Royal Mail’s postmen and postwomen have achieved a fantastic turnaround. It’s not just that we’ve made a decent profit but, above all, postmen and postwomen have significantly improved service to customers. Everyone in Royal Mail is more focused on customers and more committed to achieving even better quality of service than ever before.

The growth in letters volume was the biggest factor that fuelled record sales of £8.9bn – a 3.7% growth in revenue on the

previous year. Domestic mail price increases at below the rate of inflation also contributed to improved turnover, along with increased sales income from Parcelforce Worldwide and General Logistics Systems.

Crucially, the overhaul of Royal Mail’s frontline operations was implemented and the jobs of some 164,000 of our people have now been changed. This year saw the move to a single daily delivery to replace the two deliveries, which every other modern postal company had abandoned years ago. The Company had first considered making this necessary change nearly two decades ago. For our customers, the change was the most visible one we made as it meant a dip in quality of service during the spring and early summer of 2004. However, the service has since recovered strongly and we are now giving our customers unprecedented, high levels of service. We also completed this year the streamlining of our transport network and introduced more efficient working in our mail centres.



The productivity gains we've made have triggered pay increases for postmen and postwomen with basic, pensionable pay now at least £311.50 a week – more than £60 or almost 25% better than basic pay just before we launched the modernisation programme. It's our people who have successfully accomplished the operational changes that have delivered the profit from operations, and they are being rewarded, not just with better pay, but with a Share in Success gross payment of £1,074. If we had hit a £400m profit from operations, the pay-out would have been £800, but exceeding the target has led to an enhanced payment. Our people fully deserve their Share in Success payment because it's our people who have turned the Company around.

A further success this year has been the turnaround of Parcelforce Worldwide. It emerged from 2004-05 making a profit from operations in the second half of the year on its day-to-day operations. The business's radical restructuring, with a focus

on express, time-guaranteed services for business customers, is paying off. Its overall performance in 2004-05 was a loss from operations of £13m but this was an improvement of nearly 80% on the £54m loss the previous year.

General Logistics Systems, our European parcels business which delivers to customers in 34 countries, continued to perform strongly with a profit from operations of £61m – a £36m increase on the previous year, up 144%. The company increased its sales with growth in its core markets in Germany, France and Italy. This was also helped by tight cost controls, improved operational productivity and expansion of the GLS network in Italy. GLS has made excellent progress over the past three years and it now represents a significant contributor to overall Group profitability. Over this period GLS has also continued to strengthen its network providing Royal Mail with a strong presence in Europe.

Post Office Ltd continues to face some of the biggest challenges in the entire Group – indeed this year we again had some uncertainty as to whether it can be considered a going concern. It made a £110m loss from its operations, £7m worse than the previous year, although the result includes £18m of start up losses from Post Office Financial Services. Despite the loss from operations, the year saw the Post Office® network continuing to provide more than 28 million customers a week with its unique and valued mix of public service, combined with an expanding range of new financial services. Its biggest traditional source of income – handling the payment of pensions and child benefit by order books – was coming to an end in 2004-05 as the traditional benefits income continued to switch to direct payments into bank accounts.

The full impact of the change to direct payment of benefits into bank accounts, which has been worth some 40% of revenue every year and has now gone, will be felt in 2005-06. This is

“ Our people fully deserve their **Share in Success** payment because it's **our people** who have turned the Company around. ”

being partly offset by additional revenue from new services such as banking, car, and home and contents insurance, Post Office® savings products, mobile phone top-ups and the HomePhone service, which has won well over 60,000 new customers in the ten weeks since its launch. Post Office Ltd is already a market leader with its commission-free foreign exchange service along with travel insurance, which this current year, is expected to see sales in excess of one million policies. There remains an income shortfall between the loss of the benefits business and the revenue from new products. The challenge facing the network, therefore, is substantial. Post Office Ltd's goal of creating a sustainable and viable network remains stretching.

In fact, the Group faces challenges and pressures across its entire operation. It would be very foolish to think that having successfully transformed Royal Mail over the last three years, it's a job done and the Company can sit back while benefits pile up. The reality is that Royal Mail is going to have to focus even more intensely on further improvements to customer service, more efficiency gains and ensuring the continued commitment of all its people.

Competition is already biting but the opening of the postal market to full competition from January 2006 will make real the biggest challenge Royal Mail has ever faced. The Company is going to have to master – and fast – the ability to win and keep customers when they are being offered an increasing range of rival services. Competition is real – we all have to face up to that. This will mean

a culture change across the whole organisation. With the Regulator continuing to subject Royal Mail to tight controls, including our prices – on which we lose over £200m on nearly 90% of price controlled volumes which we are obliged to provide – Royal Mail needs to be even better at operating the virtuous circle of earning profits to pay its people and fund the investment in more technology to improve further the service to customers, and deliver the efficiency savings and sales that generate more profit. Royal Mail remains committed to ensuring its pension fund continues to meet its obligations in full but the £2.5bn deficit demands increases in the employer's contribution – and the best way to achieve that is by being more profitable. We need to remember that Royal Mail's return on turnover for its domestic letters business of 8.6% is much lower than the double-digit returns of two of our biggest competitors, Deutsche Post and TNT Post Group, 16.4% and 22.2% respectively.

Royal Mail's mission remains to become demonstrably the best and most trusted mail company in the world. The last three years have demonstrated that huge effort by all in the Company has resulted in major achievements in quality of service to customers, Company performance and reward for our people. The challenge now is to show how well and successfully a modernised and re-invigorated Royal Mail can compete in a market that will change forever from 2006.

Allan Leighton Chairman, 16 May 2005



“ Royal Mail's **mission** remains to become demonstrably the **best** and **most trusted** mail company in the world.”

Chief Executives' Statement

Adam Crozier

Chief Executive
Royal Mail Group plc

David Mills

Chief Executive
Post Office Ltd

“ Delivering even better quality of service remains our number one priority ”



“ The Company that was **losing** more than **£1m** a day and failing its targets has become a business **making** more than **£2m** a day... and now hitting key quality of service target levels. ”

This has been a milestone year for Royal Mail. It marked the successful completion of the programme to modernise its operations with one of the largest transformations of any UK industry over the last 25 years. For our customers, Royal Mail ended the year by delivering the best quality of service on record – including 1st and 2nd Class services hitting or exceeding their targets since July last year. The Company that was losing more than £1m a day and failing its targets has become a business making more than £2m a day – even after the significant investment in improving quality of service – and now hitting key quality of service target levels. Postmen and postwomen can be justifiably proud of what we have all achieved. They’ve done a fantastic job.

But 2004-05 was a milestone year in another critical sense. It was the last financial year in which Royal Mail had any protection from competition. From January 2006, the mail market will be fully open to rival companies, large and small. Everything Royal Mail has been doing over the last three years has been about getting the Company ready to compete. The modernisation plan was the greatest test Royal Mail faced in decades, for our very future depended on it. The challenge we will face as full competition becomes a reality will be even greater. There are tough but exciting times ahead.

In truth, competition has already arrived as last year saw several rival companies launch services to collect business customers’ mail and then pass it to Royal Mail for our postmen and postwomen to deliver over the final mile. As competition intensifies, Royal Mail must work even harder to put the customer at the heart of everything we do. That will represent a huge change in our culture and will affect everyone who works for the Company, but it is essential if Royal Mail is to compete successfully. We’ve got to ensure that our customers choose us because Royal Mail is delivering the consistently high quality service they need at great, value-for-money prices. The challenge is to keep our customers and win new ones. If we don’t, we risk losing volume and revenue to competitors. This in turn means declining profitability and not enough investment for our people and our infrastructure.

The key to winning and keeping customers is to provide a consistently high quality of service for our customers. That has been a top priority for everyone during 2004-05 and it’s at the heart of our strategy moving forward. In service terms, last year had two very different and distinct parts. The spring and early summer saw the most intensive period of operational change in decades and as a result, service to customers dipped. We

established a single daily delivery of mail in our 1,400 delivery offices, introduced more efficient working into our 71 mail centres and eight regional distribution centres, and streamlined our nationwide transport network through a new national distribution centre. But a huge effort and commitment across the whole Company saw service recover strongly by early summer. By the end of the year we had hit or exceeded target levels for 1st and 2nd Class mail, Mailsort and Presstream bulk mail services, and Standard Parcels, which in total represented around 80% of the daily mailbag. Crucially, 1st Class, the benchmark service, hit the highest level on record for quarter 4 by a significant margin of nearly 1%. This was despite atrocious weather in January which closed down the air network, which carries 1st Class mail in Scotland and Northern England, and heavy snow in the South East in February and March which prevented some deliveries. 2nd Class exceeded its 98.5% target for the whole of the year. These are world-class performances, delivered at a time when mail volume is at a new record high of an average 84 million letters a day, and with the added bonus for customers of almost the lowest postage prices in Europe.

The scale of change we have undergone, and the speed in which we have been able to bed those changes in, whilst maintaining our one-price-goes-anywhere service to the UK's 27 million addresses, is a testament to the hard work and commitment of our people. They are crucial to our success in the future. To recognise their achievements and dedication, we are making a gross Share in Success payment of £1,074 to the majority of our people who have been with the business during the final year of our Renewal Plan. The £218m of profit from operations that we are returning to our people is one of the largest profit-share payments to employees in UK corporate history. Royal Mail also continues to offer a final salary pension scheme to most of our people, which is a key benefit. With a current funding deficit of £2.5bn, Royal Mail has already contributed £271m in two years over and above the regular contributions to ensure the fund can meet its obligations to our people. Clearly, the best way to safeguard Royal Mail's continuing contributions is for the Company to continue to make a profit.

Basic pay for our postmen and postwomen is increasing again – up by £11.50 from 1 April, which is 3.8% on top of the basic, pensionable pay of at least £300 a week our people are already getting. We want them to keep sharing in the success of the Company and under a new bonus scheme, postmen and postwomen have the opportunity to earn up to 50% of any savings above budget made by their unit and a further 10% if we hit the new 1st Class target of 93.0%. It is also significant that industrial relations have improved. At the onset of our Renewal Plan, barely a day passed without some form of disruption. Last year was one of the calmest in almost a decade, and the improved, constructive relationship with our union produced a pay deal for 2005–06 more quickly and smoothly than in any year that anybody could remember – a win-win for all.

All that sounds terrific – and it is. But the challenges we face are formidable. Not only will Royal Mail have to generate sufficient profit to pay off the £2.5bn pension fund deficit, it currently makes losses



of over £200m on nearly 90% of its price controlled volumes which it has to provide under its universal service obligation. Also, the 14,609 strong network of Post Office® branches made a loss on its operations last year of £110m. The rural network of 8,000 branches is uneconomic and needs an injection of £3m a week to survive. The current annual Government funding of £150m is due to end in 2008 and Post Office Ltd cannot be expected to absorb extra costs at this level. Meanwhile, Royal Mail also lags behind its major rivals on automated sorting technology and we need to make a several billion pound investment if we are to compete successfully – that means being profitable in order to invest.

We will fundamentally change what we do and how we do it. That means as well as investing in automation we also need to develop a set of products and services that really match the needs of our customers. We are working on that and we expect to be able to tell you about them this summer. At the same time, we are shaping a whole new sales and marketing strategy with the kind of customer focus which a modern postal business needs but which we have never had in the past.

“ As competition intensifies, Royal Mail must work **even harder** to put the customer at the **heart** of **everything** we do.”

This customer focus is also at the heart of Post Office Ltd, which has 28 million customers visiting more than 43 million times a week. One of the largest retail networks in Europe, Post Office Ltd is at the heart of communities and is committed to providing products and services that are important to our customers simply and at a profit.

Replacing lost revenue remains our biggest and most important challenge as we face a future without the traditional benefits payments, which has historically represented some 40% of our revenue. Turning around the £71m loss making directly managed branches and determining the future of the uneconomic parts of the rural network, which are costing us some £3m per week on an annual basis, will also be key.

This year has been a time of radical change for Post Office Ltd with the introduction of a competitive portfolio of financial services and products which will help to replace the income previously provided by benefits payments and develop the commercial profitability of the business in the future. Post Office Ltd provides more than 170 different products and services, but those which are key both to our customers and our future are banking, mails, telephony, travel and financial services.

Our banking services are particularly important to our customers because we have opened up access to banking in communities where the big banks no longer have a presence. We have formed partnerships with Alliance & Leicester, Bank of Ireland, Barclays, Cahoot, Clydesdale, Co-op, First Direct (Scotland only), Lloyds TSB and Smile, and discussions continue with others. Crucially, Post Office Ltd plays a key part in increasing financial inclusion as customers with basic bank accounts can access their money in a friendly environment in which they feel comfortable and secure and can talk to people they trust.

We have also reorganised to make sure we've got the right people in the right places doing the right things and we've recruited some first class managers who have proven track records from the financial services and retailing world to help guide, coach and support our people.

Ensuring customers know all about Post Office® products and services is a key part of our recovery strategy. Our advertising aims to increase our sales by introducing customers to our new products and services and encouraging them to reappraise our existing ones.

The year has also seen the completion of the urban Network Reinvention programme ahead of schedule and under budget. The programme has been a major step towards making the network viable and the Post Office® more attractive for subpostmasters by reducing overprovision, and providing more modern branches for customers which will safeguard access to services for all, particularly the vulnerable. Having consulted extensively with the public and subpostmasters, the programme has seen the closure of 2,500 branches in total.

Rural Post Office® branches play a pivotal role within the economic and social fabric of their communities. However the majority cost more to run than the income they generate and as a result there is a question about their long-term viability. The Government has already released funds of £450m from the Group's reserves of

historic profits to support parts of the network, which are not commercially viable, and in 2004 it announced that a further £300m would be released to extend that support to April 2008, subject to EU State Aid clearance. This money will allow us to continue to pay rural subpostmasters' wages, provide support services to the network and crucially continue to pilot activity on different ways to provide services to the rural network. We have already started to develop and test different approaches including Post Office® branches carrying out work on behalf of the Police service. These pilots will inform the Government's decision about the future of the network post 2008.

In the UK parcels market, Parcelforce Worldwide has been successful in turning around its business and is now a key player in the competitive express parcels industry, continuing to improve the quality of service provided to customers, particularly in terms of its time-critical products. It has dramatically cut its losses from operations by 76% over the past 12 months, from £54m in 2003-04 to £13m this year, and it has generated profits from operations in the second half of 2004-05. The challenge it now faces is to build on these improvements and to deliver profit from operations for the next full year.

In Europe, our parcels business, General Logistics Systems, has significantly increased its revenue over 2004-05 – with a remarkable 144% growth in its profit from operations to £61m. This has been driven by growth in its markets in Germany, France and Italy, together with tight cost control, two new acquisitions in Italy and consolidation of its operations in Poland. GLS has made excellent progress over the past three years and it now represents an important contributor to overall Group profitability. Over this period GLS has also continued to strengthen its network. It has strong positions in its core markets and provides Royal Mail with a significant presence in Europe. It will continue to focus on strengthening its European network and securing operational efficiencies.

We have now completed our three-year Renewal Plan and Royal Mail is back in profit, delivering an improved quality of service to customers and investing in our people. All our stakeholders have benefited from the transformation. Customers are receiving unprecedented, high levels of quality of service while our prices have fallen in real terms. Postmen and postwomen are better paid. The Company is profitable again and our willingness to embrace competition in January 2006, ahead of the original liberalisation date of April 2007, also means customers are getting more choice in the market 15 months earlier. It is vital that we now make the cultural change needed for us to be successful as a commercial business and be the postal operator of choice for customers in an open competitive market. Our vision remains to be demonstrably the best and most trusted mail company in the world. With the dedication and commitment of our people, we are confident we can achieve that goal.



Adam Crozier
Chief Executive
Royal Mail Group plc
16 May 2005

David Mills
Chief Executive
Post Office Ltd
16 May 2005

Annual Review

2004-05

“ We need to change and modernise operations to improve service to customers and keep ahead of the competition ”



“ Royal Mail had a **remarkable** year, and ended it with the **best quality** of service performance for the majority of mail products in a decade. ”

This year saw more operational changes implemented in Royal Mail than in any other year for many decades. It was also the year when significant competition became a reality with several competitors establishing mail services based on access to Royal Mail's sorting and delivery network. However, despite these changes, the challenges the business faced and the sheer scale of the operational change, Royal Mail had a remarkable year, and ended it with the best quality of service performance for the majority of mail products in a decade.

Improving customer service

To enable us to compete successfully in the UK postal market in the future we have undertaken a huge transformation of our operations to provide our customers with a consistent high quality of service and to make Royal Mail a great place in which to work for our people. This has transformed the jobs of some 164,000 of our frontline people – probably one of the largest changes in UK industry over the last 25 years. Throughout 2004–05, improving customer service has been our top priority and we have made real progress. By the end of the year, 1st Class, our benchmark service, was above its target of 92.5% – the best final quarter performance in a decade – and 2nd Class exceeded its 98.5% target for the whole of the year. The majority of our bulk business mail products also performed well with Mailsorts

2, 3 and Presstream 2 achieving the best annual performances in the last ten years. Delivering consistent, high quality service is essential for Royal Mail to compete successfully in a market open to full competition from January 2006.

The transformation of our distribution network was put to its real test over Christmas, always the busiest time for Royal Mail as we deliver Christmas cards, parcels and presents across the UK and around the world – a time when we handle up to 60 million extra items per day, taking the average daily mailbag to 140 million items. We proved we were more than capable of meeting that challenge, delivering everything that was posted by the recommended last posting dates in time for Christmas. Overall, the business recorded its strongest trading performance, with a 10.6% increase in revenue and an £80m increase in sales in the four weeks to 25 December – one of the best performances announced by a large UK company over that period.

Protecting the integrity of the mail

Every letter is important to Royal Mail and we are determined to do everything we can to protect the integrity of the mail and to ensure the security of the letters and parcels entrusted to us for

delivery. The vast majority of our people are scrupulously honest and the huge bulk of mail (99.92%) arrives at its correct destination safe and sound. Whilst our aim is to ensure customers get the service they expect from Royal Mail, in handling around 84 million items a day, sometimes things go wrong. If they do, we want to compensate customers quickly and fairly. This has seen us pay some £60m back to customers whose mail was delayed last year. We offer better service protection for our customers than almost any other company, and are one of the very few postal operators to compensate for delay. We sent a leaflet to the 27 million addresses across the UK in January 2005 to provide answers to some of the frequently asked questions about mail deliveries, the service customers should expect from Royal Mail, and who to contact if things go wrong.

As we expect the highest standards of integrity from our people, employees joining Royal Mail are now vetted to ensure they are not attempting to conceal any past criminal convictions. This adds an important new layer of security to our operations and means that customers can post their mail with even more confidence than before.



The number of casual employees taken on by the business has dropped significantly over the past year, from over 20,000 to around 2,500. Where we do need additional support to cover busy periods, we have been working to create a pool of high-calibre temporary employees. This involves issuing new recruits with a passport-style ID card, carrying details of the training and work experience they have had in Royal Mail, even if they have worked in different offices and have moved in and out of employment with the Company.

Our people, our greatest asset

The scale of change we have undergone, and the speed with which we have been able to bed those changes in whilst keeping the service going, is a testament to the hard work and commitment of our people. To recognise this, we are making a Share in Success

“The scale of **change** we have undergone is a testament to the hard work and **commitment** of our people.”

payment of £1,074 to the majority of our people who have been with the business during the final year of our Renewal Plan. At £218m, that is probably the largest profit-share payment to employees of any UK company. We have also improved basic pay for postmen and women, taking full-time basic pensionable pay to over £300 a week, and moved from a six-day to a five-day working week whilst deliveries continue six days a week.

Over the past 12 months we have continued to root out bullying and harassment because any such incidences will not be tolerated at any level. We undertook a Company-wide diversity training programme that ran throughout the year to show how everyone must be valued and respected for their contribution to the organisation, what types of behaviour are unacceptable and where to go for help if there is a problem. In recognition of the efforts the business has made in tackling these issues, the Race for Opportunity, in its report on race and ethnicity across a number of different business areas named Royal Mail Group the most improved organisation in its sector.

We have also made huge strides in tackling absenteeism. New initiatives to provide better support to people off sick and reward those people with a good attendance record were introduced last summer. In a prize draw that was open to our people who did not take any time off sick between the beginning of August 2004 and the end of January 2005, 37 people won a brand new car, 75 people won £2,000 in holiday vouchers and over 90,000 people won £150 in holiday vouchers as a thank-you for their contribution to customers and the business. In that six-month period, postmen and postwomen's daily attendance levels increased by almost 11% compared to the same period in the previous year – equivalent to an extra 1,000 postmen and postwomen at work collecting, sorting and delivering mail on any particular day.

Other initiatives included maintaining closer contact with people who need to take time off because they are ill to ensure they are getting the right level of support to help them return to work as soon as they are able, and cover gaps without any loss of service to customers. We also improved the support available to anyone who is off sick. It is now easier and quicker for our people to get treatment that is more closely matched to their needs, a new medical helpdesk will assist referrals and there will be better access to physiotherapy and occupational therapy services for those who need them.

There are other ways in which we have been helping support our people by negotiating special deals on their behalf. Through the Learning for All initiative, around 26,000 people now have a computer at home with internet access, costing around 40 per cent less than comparable systems on the high street. Over 30,000 people have taken advantage of two 20% discount weekends at Homebase, and around 300 people have so far taken the chance to save up to £5,000 on a new Vauxhall car, under a deal reached between GM Motors and Royal Mail.

Internet shopping

Internet shopping is proving to be tough competition for high street retailers, with online retailing currently representing around 6% of retail sales and set to reach 15% by 2010, a market worth over £40bn. Over Christmas 2004, Royal Mail delivered 55 million items ordered online – 15 million more than the same period in the previous year. Books, videos and DVDs remain the favourite low-ticket items, but clothing and bigger-ticket items are becoming more popular, with clothing now accounting for 10% of total online sales. This growth has also driven up sales of postal orders at Post Office® branches by 6% – with a high proportion of customers in the 16 – 24 year age group – as they provide a secure and trusted form of payment for customers without a bank account.

We estimate some 445,000 eBay sellers are also mailing 650,000 items via our Post Office® branches each week, with 23% of these items going overseas.

We work closely with retailers to ensure they are well-placed to capitalise on this new retailing channel and can deliver the items to their customers. Following an agreement with US e-commerce solutions provider Marketworks, Royal Mail can now help companies who want to start trading on eBay.co.uk by managing all aspects of the operation – from store-front design, order management and online marketing activities to product warehousing and goods fulfilment. The partnership enables retailers to use eBay as a channel to complement other core sales activities, especially for trading overstock, refurbished items or goods that have been returned because they were unwanted, rather than damaged. We are also working to encourage retailers to take up our Local Collect service, whereby the retailer can offer to deliver a customer's items to their local Post Office® branch for collection if that is more convenient for the customer.

Helping small businesses

Royal Mail's online postage system SmartStamp™, launched last year, allows small businesses to add a professional look to their mail by printing a customised message or company logo alongside the postage impression directly from their own computers. This has proved a popular alternative to traditional stamps amongst small businesses across a range of sectors.

Some 13 million SmartStamp™ items have been sent to date, helping the 15,000 registered users to really make their mail stand out from their competitors, as well as saving them time. And the innovative postage system was also recognised at the National Business Awards last year, at which Royal Mail picked up the Best Use of Technology Award.

Additional advice on how small businesses can save time and money on their mailings can be found on Royal Mail's dedicated online information centre on our website – www.royalmail.com/smallbusiness. The Small Business Centre helps small companies to quickly and easily access information on everything from how to better manage mail costs to finding new customers and building lasting business relationships. It is also a forum for sharing experiences and successful tactics with other similar-sized companies.

1st Class People Awards

Our people are our greatest asset and to recognise the extraordinary efforts they go to as they deliver everyday to the UK's 27 million addresses, four postmen and postwomen were chosen from 30 regional finalists to receive this year's 1st Class People Awards. Tracey Smith and Karen Cowling were named





“postman and woman of the year” for their heroic support to flood-stricken Boscastle, in Cornwall. The pair’s unique local knowledge proved invaluable after devastating flash floods hit the historic village in August 2004. Both Karen and Tracey worked 20-hour days in the immediate aftermath of the disaster to help the emergency services and to ensure the mail continued to be delivered to villagers.

Steve Lyon, a Chippenham postman, was recognised for his brave rescue of an 18 month-old boy who fell into a fast flowing river whilst feeding ducks and was being swept towards a dangerous weir, and Watford postman Mohammed Younis was named Royal Mail’s “fundraiser of the year” for raising £250,000 over the past 20 years to build a hospital for the residents of Pindi Bhattian, a remote area in Pakistan where medical help is currently over five hours away.

Being a responsible company

Royal Mail’s business is large and we inevitably have a significant impact on the world around us. We take our corporate social

responsibility seriously and in September 2004, we published our first full Corporate Social Responsibility (CSR) report. This sets out our commitment to deliver our business in the right way for our people, our customers and our communities, the programmes we have developed to drive improvement and the targets we have set ourselves.

The report confirmed some very positive progress – our safety performance has improved and we are on track with the majority of our environmental improvement targets. Our approach has won recognition from many sources, including being recognised as European Best CSR Programme in the European Risk Management Awards 2004. During 2004–05, the number of reportable accidents in the business has continued to reduce, down over 23% to 5,598. Over the course of the Renewal Plan, we have seen reportable accident rates reduce by some 40%. This downward trend is the result of our investigations into all major accidents and many less serious incidents to help us identify areas where improvements can be made.

Young letter-writers

Royal Mail’s young letter-writers competition has attracted over 5 million entries since it began 28 years ago, making it the biggest letter-writing competition of its kind in the UK. Primary school children throughout the UK are invited to enter the competition and this year, the competition challenged the nation’s young letter-writers to “Write to their 1st Class Hero”.

Celebrations through stamps

Royal Mail’s stamps celebrated a wide range of anniversaries and occasions over the past year. The courage of the soldiers who fought in the Crimean War 150 years ago was marked by a set of stamps issued last October.

In the first ever national television stamp poll, viewers of ITV1’s This Morning voted to decide which ITV programmes from the past 50 years should appear in a specially commissioned set of Royal Mail stamps. The winner, Emmerdale, beat stiff competition from Coronation Street and The Bill, and will be seen on letters and parcels from September.

The most famous stamp in the world, the Penny Black, made a comeback this year, 163 years after its original issue, to mark the 250th anniversary of the Royal Society for the encouragement of Arts, Manufactures and Commerce (RSA). It was shown on the 1st Class stamp, one of six issued to mark the RSA’s unrivalled contribution to innovation and creativity over two and a half centuries.

Post Office Ltd – changing focus for the future

The change to the way benefits such as pensions, child benefit and job seeker’s allowance are paid has been a catalyst for change at Post Office Ltd. Faced with the prospect of losing some 40% of its historic income from benefit payments as the direct transfer of money has replaced the previous paper-based

system, the Post Office® is undergoing a huge culture change as it strives to become a more sales and customer-focused organisation to compete with other high street retailers and retain the 28 million customers who visit a Post Office® branch every week.

In its efforts to stem this loss of revenue, Post Office Ltd has launched a number of new products and services over the past 12 months. The launch of car insurance, Growth Bonds and Guaranteed Equity Bonds has extended the portfolio of Post Office Financial Services and two new banking partners – Clydesdale Bank and the Bank of Ireland – now mean that more than 26 million people can withdraw cash free of charge over the counter at any Post Office® branch.

The challenge now facing Post Office Ltd is to become better at selling its wide range of products and services if it is to stem its financial losses in the coming year. Its future will ultimately depend on its ability to sell its products and services.

Post Office Ltd also entered the fixed telephone line market in January with the launch of Post Office® HomePhone. Over 60,000 customers signed up in the first 10 weeks, and the challenge that faces the Post Office® is to maintain this level of take-up if it is to reach its target of signing up 1million customers by 2008.

In the travel sector, the Post Office® established itself as a leading provider of foreign currency exchange services – where it is now number one in the market – and travel insurance policies. Around 2,000 on-demand Post Office® branches are now selling commission-free foreign currency – with the remainder of the branch network offering a next-day delivery pre-order service.



Towards a viable and sustainable network of Post Office® branches

The past year has been a time of great change and some new thinking for our network of Post Office® branches. The restructuring of our urban network of Post Office® branches is now complete and, as we predicted, we remain at the heart of the community with more than 99% of the population in urban areas remaining within one mile of a Post Office® branch. Work is underway with our subpostmasters to improve the facilities and smarten up urban branches.

We remain committed to preventing avoidable closures of rural Post Office® branches. They play an important social role in everyday rural life and in recognition of this, we welcomed the

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“Parcelforce Worldwide has **improved** its financial position at the same time as continuing to improve the **quality of service** provided to customers.”

Government’s announcement that it will continue its funding of £150m per year until 2008. In addition to keeping rural branches running, the funding includes investment for new and innovative ways to provide Post Office® services to customers in more remote areas. As a result of the work of our dedicated team of rural transfer advisors, Post Office® branches can now be found in village halls, pubs and churches amongst other locations. We have teamed up with Norfolk Constabulary in a pilot to offer information and advice on Police matters as well as Post Office® products and services from a number of Norfolk branches. In Cumbria, a mobile Post Office® branch comes to customers, saving them a journey to a nearby town, and provides the same online banking transactions and wide range of other products and services as a permanent branch.

Going from strength to strength in the parcels business

In the parcels market, Parcelforce Worldwide has improved its financial position at the same time as continuing to improve the quality of service provided to customers, particularly in terms of its time-critical products. Over the past year it has grown its volumes and revenue, and continues to win significant business. It has also been named as European Express Parcel Carrier 2005 by the Institute of Transport Management in recognition of its high performance levels in delivering to customers, its use of sophisticated track-and-trace technology and its customer-focused employees.

Now in its 12th year, the Parcelforce Worldwide Small Business Awards again recognised excellence amongst small businesses and their contribution to the economy. Sheffield-based Blue Chip Feed Ltd was named Small Business of the Year 2004. Judges praised the company, which supplies top quality horse

feed, for its passion and success in creating a market for scientifically advanced horse feed products – Blue Chip Feed enjoys a 55% share of this specialist market.

Parcelforce Worldwide delivers to over 240 countries and territories worldwide and is the UK partner of General Logistics Systems (GLS), our European parcels business. This comprises a network of companies in 15 countries that deliver on average one million parcels per day across 34 countries for some 180,000 customers.

We have come a long way since the start of our three-year Renewal Plan but as Royal Mail now faces full competition from January 2006, in the UK mail market, our challenge is to further improve service to customers and invest in our people so we are the company that customers choose.