Subsidy Advice Unit Report on the Post Office (Future Technology Portfolio 2025-2026) Subsidy

Referred by the Department for Business and Trade

23 April 2025

Subsidy Advice Unit

Part of the Competition and Markets Authority

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1. The Referral

1.1 On 4 March 2025, the Department for Business and Trade (DBT) requested a report from the Subsidy Advice Unit (the SAU)[1] in relation to its proposed subsidy to Post Office Limited (POL) for the Post Office Future Technology Portfolio 2025-2026 Subsidy (the Subsidy) under section 52 of the Subsidy Control Act 2022 (the Act).[2]

1.2 This report evaluates DBT's assessment of compliance (the Assessment) of the subsidy with the requirements of Chapters 1 and 2 of Part 2 of the Act.[3] It is based on the information and evidence included in the Assessment.

1.3 This report is provided as non-binding advice to DBT. It does not consider whether the subsidy should be given, or directly assess whether it complies with the subsidy control requirements.

Summary

1.4 The Assessment uses the four-step structure described in the Statutory Guidance for the United Kingdom Subsidy Control Regime (the [Statutory Guidance]) and as reflected in the SAU's Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit (the [SAU Guidance]).

1.5 In our view, DBT has considered in detail the compliance of the Subsidy with the subsidy control principles. In particular, the Assessment:

(a) clearly sets out the intended policy and equity objectives of the Subsidy, which are well explained and evidenced (Principle A);

(b) demonstrates that DBT has considered other ways of achieving its policy objective and explains why the Subsidy was the most appropriate option (Principle E); and

(c) clearly demonstrates and evidences how design features of the Subsidy contribute to minimising any negative effects on competition and investment within the United Kingdom (Principle F).

1.6 However, we have identified the following areas for improvement:

[1] The SAU is part of the Competition and Markets Authority.
[2] Referral of the proposed Post Office (Future Technology Portfolio 2025 to 2026) subsidy by the Department for Business and Trade - GOV.UK
[3] Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.

(a) the Assessment should provide more reasoning to demonstrate that the Subsidy is the minimum level necessary to achieve the policy objectives (Principle B); and

(b) the Assessment should consider the impact that IT upgrades will have on POL's ability to compete, compared to the counterfactual, in both the short- and long-term (Principle F).

1.7 We discuss these areas below, along with other issues, for consideration by DBT in finalising its assessment.

The referred subsidy

1.8 Post Office Limited (POL) is a public non-financial corporation, which is wholly owned by the Secretary of State for the Department for Business and Trade. Through POL, UK government ensures the provision of a network of Post Office branches, by way of Services of Public Economic Interest (SPEI), delivering essential services to customers across the UK. The Subsidy is one of a number of subsidies to POL, including a network subsidy to provide the SPEI.[4]

1.9 POL carried out a Strategic Review in Summer 2024, which highlighted the need for a coherent technology strategy that was aligned with its longer term in-branch technology strategy. This led to the development of POL's technology transformation plan, known as its Future Technology Portfolio (FTP). The core part of the FTP is the replacement of POL's current IT platform (Horizon) and conducting a phased exit from the current Horizon contract arrangements with Fujitsu.[5]

1.10 The Assessment explains that Horizon is POL's core IT platform and interface used by postmasters and trading partners. It has four main functions: serving customers and taking payments; branch management and accounting; communication and information (Horizon is a communications tool between POL and its branches); and integration with enterprise services by enabling back-office processes (such as settlement and reconciliation of customer accounts with clients).

1.11 DBT is proposing to award POL a grant of £136 million, to allow POL to ensure that the current IT system remains functional and continue to develop the longer-term transition away from Horizon. The Subsidy will enable POL to enact the first

[4] For example see Referral of the proposed (Remediation Unit and Horizon IT Inquiry) subsidy to Post Office Limited by the Department for Business and Trade - GOV.UK and Referral of the proposed network subsidy to Post Office Limited by the Department for Business and Trade - GOV.UK
[5] Horizon has been operated by Fujitsu since its launch in 1999.

year of the FTP for financial year (FY) 2025/26, and will facilitate further activities in subsequent financial years as part of following phases of the FTP.

1.12 DBT explained that the Subsidy is a Subsidy of Particular Interest because its value exceeds £10 million.

2. The SAU's Evaluation

2.1 This section sets out our evaluation of the Assessment, following the four-step structure used by DBT.

Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use

2.2 Under Step 1, public authorities should consider compliance of a subsidy with:

(a) Principle A: Subsidies should pursue a specific policy objective in order to remedy an identified market failure or address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and

(b) Principle E: Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.[6]

Policy objectives

2.3 The Assessment states that the policy objective of the Subsidy is to ensure that POL's current IT system remains functional, while conducting work to continue to develop the longer-term transition away from Horizon. It states that it will fund modernisation and replacement of in-branch IT services, both software and hardware. The Assessment goes on to explain that the Subsidy will ensure that POL branches can continue to functionally operate through the FY 2025/26.

2.4 The Assessment further sets out that the purpose of this subsidy is to enable POL to deliver the first phase of its Future Technology Portfolio (FTP) technology transformation plan, developed following a strategic review of the Post Office in summer 2024.[7]

2.5 DBT explained that while maintaining POL's IT system does not directly deliver a SPEI, the Subsidy enables POL to continue to deliver its services and daily operations across the branch network and thereby is indirectly essential for SPEI provision.

2.6 In our view, the Assessment clearly describes the specific policy objective of the Subsidy.

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[6] See Statutory Guidance, paragraphs 3.33–3.58 and the SAU Guidance, paragraphs 4.7–4.11 for further detail.
[7] This replaced the previous intended approach to addressing POL's IT strategy - see Referral of the proposed subsidy Post Office IT Interim Funding by the Department for Business and Trade - GOV.UK

Equity Objective

2.7 Equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.[8]

2.8 The Assessment states that 'the criteria this policy objective is using for subsidy justification is primarily related to addressing equity concerns'. It states that POL operations address regional disadvantage, social difficulties and distributional concerns. It explains that the Subsidy directly supports POL's IT replacement and transformation activities, and will strengthen its operations in the following activities which have equity implications:

(a) Postal services – these services have social and economic value and are designated as a SPEI. It states that without POL providing this, certain regions and businesses could lose access to these essential services, creating inequality.

(b) Basic cash and banking facilities – it states that certain groups who are more likely to rely on cash would be disproportionately affected without access to cash and banking services currently offered by POL.

(c) Payment facilities for public utility services – it states that these services are especially important for those such as older individuals and in lower socio-economic groups who rely more on in-person services.

(d) Services provided on behalf of central and local government – similarly it states that a loss of access to services including pensions, tax credits and benefits would disproportionately impact people who rely on in-person services and for whom an alternative may not be available.

2.9 The Assessment indicates that a lack of ability to provide these services would have a disproportionate impact on specific groups, including rural communities, vulnerable customers and those who are digitally excluded.

2.10 The Assessment states that POL branches require in-branch IT services to carry out their daily operations. It explains that the Subsidy therefore ensures that POL can continue to deliver its services across its branch network, helping to prevent social inequalities that may arise from POL's inability to provide adequate services in the future.[9]

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[8] Statutory Guidance, paragraphs 3.51–3.55.
[9] The Assessment explains that to ensure all citizens have equal access, Government requires POL to maintain a network of at least 11,500 branches, and to adhere to geographic access criteria to ensure a national spread of Post Offices across the UK and to maintain access in particular areas, such as rural and urban deprived areas.

2.11 In our view, the Assessment clearly describes and evidences the equity objectives that the Subsidy seeks to address.

Market failure

2.12 Market failures arise where market forces alone do not produce an efficient outcome. When this arises, businesses may make investments that are financially rational for themselves, but not socially desirable.[10]

2.13 In addition, to addressing an equity concern, the Assessment also describes a market failure of positive externalities related to the wider economic and social benefits arising from the provision of POL services.

2.14 The Assessment sets out that these positive externalities consist of:

(a) providing access to postal services, in particular for SMEs and micro-businesses that rely on postal services to access international markets; and

(b) providing access to basic cash and banking facilities and universal payment facilities for public utility services.

2.15 In our view, while argued as a market failure, at least some of these benefits could also fit into an equity objective argument. To the extent that DBT wish to rely on a positive externality argument, the Assessment could describe the additional economic spillovers created by the provision of POL services and explain why these are not reflected in the market outcomes. These could then be distinguished from benefits that address disparities between different groups or areas in society - such as the reduction of geographical inequalities - which would not necessarily lead to improved market efficiency and would be better framed as an equity argument.

Appropriateness

2.16 Public authorities must determine whether a subsidy is the most appropriate instrument for achieving the policy objective. As part of this, they should consider other ways of addressing the market failure or equity issue.[11]

2.17 The Assessment sets out several alternative means of funding the planned programme of work that DBT considered in order to achieve the policy objective. They include:

(a) the capacity for POL to self-fund the costs of Horizon replacement activities;

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[10] Statutory Guidance, paragraphs 3.36–3.50.
[11] Statutory Guidance, paragraphs 3.56–3.58.

(b) an examination of potential cost reductions;

(c) loan finance; and

(d) loosening the Government requirements for POL to provide certain services to UK customers.

2.18 The Assessment explains that POL has historically reinvested net funds from its commercial operations in the Post Office network and its broader infrastructure. Moreover, POL is under significant financial pressure, meaning it cannot self-fund the FTP. It explains that although POL has provided some previous investment in Horizon replacement activities alongside other recent costs, due to a range of factors POL requires funding from HMG for Horizon replacement related activity.

2.19 The Assessment lists several steps POL has identified and is taking to reduce its overall costs. The Assessment also explains that the DBT Investment Committee[12] scrutinised the activities to be funded by the Subsidy put forward by POL on cost and value for money considerations. It concludes that given this scrutiny, alongside the assurance that the Subsidy will be paid based on actual costs, there is no scope for further cost reductions.

2.20 The Assessment states that DBT considered loans as an alternative to the Subsidy, but concluded they would not be viable in this case as the relevant costs are not considered a commercial proposition. The Assessment explains that the FTP activities funded by the Subsidy are not intended to generate profit, and will therefore provide insufficient return to finance repayment.

2.21 Finally, the Assessment states that DBT considered reducing the Government's SPEI requirements for POL by modifying the access criteria for branches and/or reducing the minimum branch number that POL is required to maintain. The Assessment explains that this option is not appropriate for multiple reasons: savings generated by this option would not be realised before the end of FY 2025/26; the changes would require public consultation for which, due to the timing of the Government's forthcoming Green Paper, there would not be sufficient time available; the changes would likely not generate the profitability required for POL to self-fund FTP activities; and there would be a significant one-off cost which Government would likely need to fund through subsidy.

2.22 In our view, the Assessment demonstrates that DBT has considered other ways of achieving its policy objective and explains why the Subsidy was the most appropriate option.

[12] The DBT Investment Committee leads on investment decisions related to high value or high risk projects and programmes in DBT's portfolio.

Step 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change

2.23 Under Step 2, public authorities should consider compliance of a subsidy with:

(a) Principle C: Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change should be something that would not happen without the subsidy and be conducive to achieving its specific policy objective; and

(b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.[13]

Counterfactual

2.24 In assessing the counterfactual, public authorities should consider what would likely happen in the future – over both the long and short term – if no subsidy were awarded (the 'no subsidy' scenario).[14]

2.25 The Assessment notes that any truly 'do nothing' scenario becomes politically unviable for Government. However, it sets out a counterfactual scenario where, in the absence of the Subsidy, several activities would not be funded beyond March 2025 and the activities might need to stop or move to a different delivery trajectory with a longer timeline. It sets out that this would have a material impact on the ability of POL's branches to trade and on provision of the SPEI. It explains that due to various factors, including wider funding pressures, it would be unable to self-fund IT investment activities, while diverting funds from other business-critical operations could lead to adverse operational consequences; it notes that separate BAU Network Investment subsidy funding is already earmarked for investment in business-critical operations and infrastructure.

2.26 The Assessment describes the time horizon as follows:

(a) Immediate Impacts (to end-March 2026): POL's plans to maintain the core IT system and deliver essential infrastructure upgrades would be at risk. It is assumed POL would maintain the minimum level of service to keep within contractual obligations and to maintain in-branch technology. However, the IT platform would operate sub-optimally at increased risk and cost and would also likely impact on POL's day to day operations in branch, and negatively impact back-office functionality and accuracy of reporting. This would have a direct negative impact for POL and its relationships with sub-postmasters.

[13] See Statutory Guidance, paragraphs 3.59–3.73 and the SAU Guidance, paragraphs 4.12–4.14 for further detail.
[14] Statutory Guidance, paragraphs 3.62–3.64.

(b) Long-term Impacts: POL's ability to replace the core IT system beyond a minimum level replacement/upgrade would be reduced. Even the minimum viable 'do nothing' option (maintaining the existing system) would require significant investment without meeting needs, and so would eventually require further subsidies.

2.27 Consequently, the Assessment concludes that in the immediate term the lack of replacement of end-of-life in-branch technology and infrastructure could risk branch operations, and consequently branches could be forced to close. It also expects that in the medium-longer-term, the inability to complete foundation work in FY2025/26 could impact the longer-term plan to transition Horizon away from Fujitsu. Consequently, it considers that the SPEI would not be delivered, with branch closures and impacts on POL's overall viability.

2.28 In our view, the Assessment clearly describes what would be likely to happen if this particular Subsidy was not awarded, and how the policy objective would not be met.

2.29 However, while recognising the complexities and sensitivities of the FTP, the Assessment could be improved by more fully exploring and evidencing the range of potential scenarios for funding this work in the counterfactual, reflecting the difficult choices faced by POL, and by better explaining how it has concluded that the chosen counterfactual is the most likely outcome absent the Subsidy.

Changes in economic behaviour of the beneficiary and additionality

2.30 Subsidies must bring about something that would not have occurred without the subsidy.[15] They should not be used to finance a project or activity that the beneficiary would have undertaken in a similar form, manner, and timeframe without the subsidy ('additionality').[16]

2.31 The Assessment explains that the Subsidy will change POL's economic behaviour by allowing it to implement the FTP to focus on ensuring its current IT systems remain functional, while funding specific technological upgrades and changes. It states that the Subsidy ensures POL can continue to deliver its commitment to provide the SPEI across the UK.

2.32 In our view, the Assessment clearly explains how the Subsidy would change the beneficiary's economic behaviour and that the Subsidy brings about changes that would not have occurred and/or would have occurred in a longer timeframe absent the Subsidy. The Assessment also explains why POL cannot self-fund the FTP,

[15] Statutory Guidance, paragraph 3.66.
[16] Statutory Guidance, paragraphs 3.65–3.69.

and thus, the Subsidy will not compensate for the costs that POL would have likely funded without any subsidy.

2.33 However, the Assessment could provide better evidence of the additionality and the need for subsidy. Further evidencing of the financial constraints detailed in the Assessment would particularly help to explain why budgets cannot be reallocated to fund the FTP while cutting back on other areas. For example, this evidence could be provided through detailed financial statements (eg balance sheet, profit and loss accounts and cash flow statements), budgets, and/or profitability calculations with risk assessments, accompanied by a clear articulation of the types of business-as-usual costs ordinarily self-funded by POL and why the FTP falls outside these.

Step 3: Considering the distortive impacts that the subsidy may have and keeping them as low as possible

2.34 Under Step 3, public authorities should consider compliance of a subsidy with:

(a) Principle B: Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it; and

(b) Principle F: Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom.[17]

Proportionality

2.35 The Assessment considers a range of different methods for achieving the policy objectives, including alternative subsidies to a grant such as subsidised loans and other non-subsidy options.

2.36 The Assessment states that the entire cost of the first year of the FTP investment will be covered by the Subsidy. While the Assessment sets out that the full subsidy is £136 million, with this being the amount determined as the appropriate amount of spend that could be allocated in order for POL to successfully achieve the policy objectives, the Assessment does not provide detailed explanation as to why this is the case. In addition, the Assessment does not evaluate proportionality of support with reference to the full costs over the entire FTP programme life.

2.37 In our view, the Assessment should provide more reasoning to demonstrate that the Subsidy is the minimum level necessary to achieve the policy objectives.

[17] See Statutory Guidance paragraphs 3.74–3.110 and the SAU Guidance, paragraphs 4.15–4.19 for further detail.

Design of subsidy to minimise negative effects on competition and investment

2.38 The Assessment states that the funding provided to POL will be for maintaining and replacing IT infrastructure only and is limited to FY 2025/26. This will give time for both the completion of the Spending Review and the approval of the Outline Business Case for the programme, providing greater clarity for longer-term funding requirements. It states that it is not appropriate to extend the Subsidy to other businesses providing similar services to POL, as only POL can fulfil the SPEI requirements of Government.

2.39 The Assessment explains how the Subsidy will be subject to ongoing monitoring to ensure that funds are not spent on unnecessary activities and details that Government will have scrutiny over POL's spending, with the funding requirement being reviewed on a monthly basis.

2.40 In our view, the Assessment clearly demonstrates and evidences how design features of the Subsidy contribute to minimising any negative effects of the Subsidy on competition and investment within the United Kingdom.

Assessment of effects on competition or investment

2.41 The Assessment sets out four markets that POL is active in: mails, banking, government services and bill payments. The Assessment states that the Subsidy is focussed on supporting critical maintenance, upgrades and forward planning to POL's existing IT system. It will not therefore directly alter POL's market share in the markets in which it operates as it is not increasing or improving the number of services POL offers.

2.42 The Assessment discusses the potential for a distortive impact from the Subsidy, as other operators within the markets have to self-fund their IT maintenance. It explains that under normal market conditions, this would distort the way markets operate. However, it explains that competitors are not required to deliver the SPEI, a driver of both the complexity of POL's IT architecture and its inability to self-fund. Competitors are also unlikely to face the same level of IT infrastructure challenges, given the unique historic and ongoing issues with Horizon.

2.43 The Assessment concludes that, by keeping POL in the market, the Subsidy could distort competition in parts of the network where alternatives to POL are available. It goes on to explain that if POL were to collapse, competitors could potentially benefit by seizing a greater share of the market.

2.44 The Assessment does not consider the impact that an improved IT system will have on POL's ability to compete in the markets within which it operates, despite it listing a number of benefits that the upgrade is expected to deliver.

2.45 In our view, the Assessment clearly considers the markets that POL operates within, and provides some reasonable arguments as to why there may be minimal impact on competition. However, the Assessment should consider more rigorously the impact that IT upgrades will have on POL's ability to compete, compared to the counterfactual, in both the short- and long-term.

Step 4: Carrying out the balancing exercise

2.46 Under Step 4 (Principle G), public authorities should establish that the benefits of the Subsidy (in relation to the specific policy objective) outweigh its negative effects, in particular negative effects on competition or investment within the United Kingdom and on international trade or investment.[18]

2.47 The Assessment sets out that the Subsidy will deliver the policy objective of the current IT system remaining functional, replacement of hardware, software and back-end infrastructure and processes where necessary, and capability-building in respect of the longer-term transition away from Horizon. It explains this will ensure that POL and its individual branches can continue to trade.

2.48 It highlights the indirect benefits that arise from the Subsidy, including that it will:

(a) enable POL to continue to deliver its commitment to provide the SPEI across the UK, thereby ensuring reasonable equality of access for UK consumers to these services and addressing the inequality whereby vulnerable customers who rely on these services, and rural and deprived areas, are disproportionately affected;

(b) ensure POL's continued operations create social value and spillovers for high streets and SMEs, including to the uncommercial parts of the network;

(c) enable Royal Mail to deliver the regulated Universal Service Obligation;

(d) enable banks to provide reasonable access to cash across the UK as required by the Financial Services and Markets Act 2023;

(e) enable UK government to provide 'face to face' services;

(f) enable continuation of POL branches as an anchor for the high street, helping to support postmasters' retail businesses, generating footfall that benefits other local retailers and allowing people to continue to transact in cash at a time when banks are closing their branches;

[18] See Statutory Guidance, paragraphs 3.111–3.119 and the SAU Guidance, paragraphs 4.20–4.22 for further detail.

(g) enable continuation of the POL network as an enabler for small businesses by allowing them, regardless of their location, to access national and international markets from close to where they are based; and

(h) facilitate benefits to the, mainly small, businesses which host a Post Office.

2.49 The Assessment provides some quantification of the overall social value of the POL network (estimated at £3.8 billion to consumers and almost £1 billion to SMEs annually).

2.50 The Assessment sets out some potential negative impacts on competition and investment, including that the Subsidy:

(a) could give POL a competitive advantage relative to competitors, who would need to self-fund any equivalent spend, and while the Subsidy is specific and focussed on maintaining POL's status quo service provision ability, it is possible that IT service updates could enable provision of new services and products in branch; and

(b) could distort the market by continuing the existence of POL when it may have otherwise exited the market. It identifies that the Subsidy could thus prevent or disincentivise competitors from seeking to expand or invest, particularly in the bill payments markets.

2.51 The Assessment sets out that any negative competitive effects would only occur in relation to services and within geographic parts of the network where alternatives to POL are available.[19] The Assessment sets out that the negative effects of the Subsidy on competition would therefore vary from service-to-service but claims that overall these are likely to be minimal. The Assessment also explains that the Subsidy will only impact on the UK as POL does not operate internationally.

2.52 In conclusion, DBT acknowledges that the Subsidy may lead to possible negative impacts and distortion of the market within the UK but has determined that the benefits of achieving this subsidy's policy objective, enabling POL to maintain its status quo service provision and subsequently ensuring the continuation of SPEI services and the equity of access to services, outweighs the potential negative impacts.

2.53 In our view, the Assessment clearly sets out the positive effects of the Subsidy in relation to the policy objectives, but it could more clearly set out how all of the benefits included as part of the balancing exercise relate to the specific policy objective.[20]

[19] For example, in some rural areas it is unlikely that some services provided by POL could be offered on a commercial basis.
[20] See Statutory Guidance, paragraph 3.113

Other Requirements of the Act

2.54 DBT confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act apply to the Subsidy.

23 April 2025