

First-Class Mail and the United States Postal Service



Future Strategies for This Time Honored Medium

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EMA Foundation for
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The EMA Foundation for Paper-Based Communications

The EMA Foundation was established in 1997 as a 501c(3) arm of the Envelope Manufacturers Association. The purpose of the EMA Foundation for Paper-Based Communications is as follows:

- *to identify and analyze major trends affecting the industry, especially the health and future of postal administrations in both North America and throughout the world.*
- *to develop key relationships with academic institutions and allied industry partners to monitor and support focused research in a variety of countries relating to paper-based communication and its inter-relationship with electronic media.*
- *to encourage career participation in the paper-based communications industry by those most likely to excel at such work. To improve and develop the capabilities of the current and future workforce through local education and global industry promotion.*
- *to position paper-based communications as a key participant in the information age. To give this industry—both country by country and collectively—the ability to determine the shape of its future and to address it aggressively and positively.*

This paper was written by Maynard Benjamin, CAE, President and CEO of the EMA Foundation for Paper-Based Communications, and is based on presentations given at the Foundation's Institute for Postal Studies Summit on the Future of First-Class Mail.

First-Class Mail and the United States Postal Service



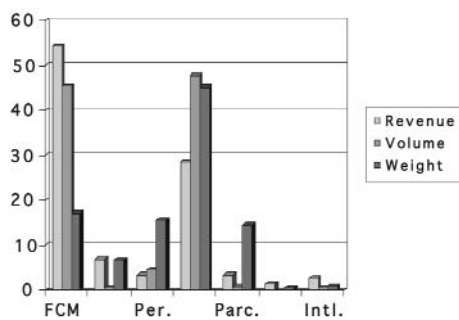
Future Strategies for This Time Honored Medium

The Institute for Postal Studies of the Envelope Manufacturers Association's Foundation for Paper-Based Communications¹ is honored to offer this discussion paper – the result of a recent summit meeting of former postal leaders and mailing industry leaders. During the course of this summit, an overview of the current state of First-Class Mail was presented, strategies for looking at the future of this class of mail were examined, new ideas were discussed and barriers to implementation of these ideas examined. It is our hope that this discussion paper will be widely circulated and that additional comments will be provided. It is also our intention to brief the contents of this paper and the presentations made at the summit to the leaders of the Postal Service and the Postal Rate Commission. The goal of this process is only to promote additional discussion and a sharing of new ideas, as well as an open discussion of their significance. We encourage your comments and ideas. Information is provided at the end of this document as to where to submit your input.

Setting the Stage

First-Class Mail is vital to the current and future health of the United States Postal Service. It is an important communication channel between mailers and their customers. Yet, this class of mail is challenged by costs and competition from other communications technologies, so as we look out a decade or more we find the time is now to reinforce the value proposition of this class of mail and take some deliberate steps to ensure that First-Class Mail's contribution to postal costs can always be depended upon.

Some Perspective on the Mailstream
What Does \$69 billion and 212 billion pieces mean?



(Source: USPS Annual Rep. In % terms)

It is interesting to set the stage for this presentation on First-Class Mail by examining the structure of First-Class Mail in comparison to the other classes of mail. As can be seen, First-Class Mail and Standard A Mail lead all other classes in terms of revenue, volume and weight processed and delivered. Both of these classes of mail convey the financial resources that are needed to sustain postal operations. Especially important is the contribution that First-Class Mail makes to institutional cost, the primary reason why its slight decline is of such concern to postal management.

Also significant as we look at the structure of the mailstream in 2005 is that the number of pieces of Standard A Mail has exceeded the number of pieces of First-Class Mail and with every month, they are growing more distant. This sets about a number of significant changes for the USPS in that it takes approximately three times as many pieces of Standard A Mail to equal the same

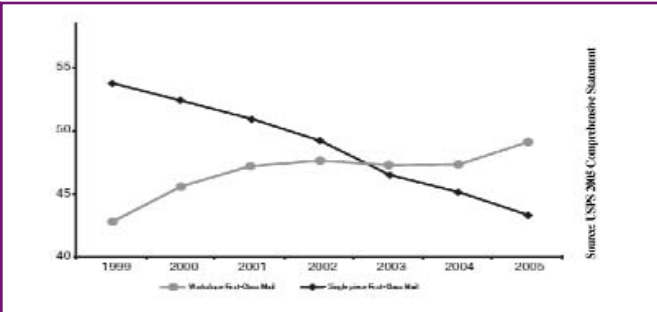
revenue contribution and coverage of costs as First-Class Mail pieces. Add to this the challenge of fewer pieces of mail being delivered to an increasing number of delivery addresses and the challenge of controlling costs becomes even more compelling.

¹ The EMA Foundation for Paper-Based Communications was founded in 1997 and is a related business entity of the Envelope Manufacturers Association founded in 1933. The Institute for Postal Studies is a subsidiary of the EMA Foundation and has developed a number of studies and educational information to support the process of postal reform and an improved understanding of postal issues. Materials can be found on the Foundation's web site at www.emafoundation.org.

Former CFO Richard Strasser offered the following comment in 2003 in the USPS's Annual Report:

“While our strong financial performance is grounds for celebration, it masks long-term trends negatively affecting the viability of our business model...Although we have historically depended upon high contribution First Class Mail to finance the growth of our delivery network, its decline means we can no longer depend on this contribution.”

There is another important issue to consider as we begin this discussion of the future of First-Class Mail. That issue is the volume shift from First-Class single piece to First-Class pre-sort. Consider the following:



As you can see from the chart above, First-Class single-piece mail volume fell below workshared mail volume (presort) in mid-2002. This was an event little noticed outside postal circles, but has major implications on the future financial health of the USPS and emphasizes the need for a great deal more thought given to the value proposition for First-Class single piece mail. A few mailers explained this shift in small businesses working with presort houses to co-mingle more mail and take advantage of the presort discounts. Others saw the impact of electronic bill payment in these statistics as it gathered steam. It was also interesting to note that this shift became more dramatic after postal rates were stabilized through the passage of Public Law 108.18 and the three retirement payments that did not have to be made could be used, in part, to avoid rate increases and pay down the postal debt.

So, if rate stability did not drive this change and technology is driving some of this change, what is driving the rest of it? Are we finally seeing a consumer preference to communicate by other than mail for other than social occasions? How much of this single piece loss are businesses shifting bill presentment and payment to the Internet to lower costs? How much of this shift is consumer preference related? Charts presented further in this paper will address this issue and several ideas will be presented in the body of this paper that might offer some new value for single piece First-Class Mail. So, how do we alter this future scenario? Is First-Class Mail doomed to a long period of decline or can something be done to slightly alter this picture and potentially offer a new vision for an important medium? Such was the purpose of the Institute for Postal Studies Summit and the contents of this discussion paper.

² Same as 2, p. 4-5.

³ Same as 2, p. 13.

Looking at Future Mail Volumes

In trying to understand the future of First-Class Mail it is important to understand the value proposition for First-Class Mail today and the value proposition that is expressed by those who pay for this delivery service. After all, according to data compiled from various sources by IBM Corporation at our summit, the approximate cost difference between a First-Class billing transaction and an Ebilling transaction is \$3 in favor of the Ebilling transaction. So, why would mailers pay \$3 more for the mail?

David Treworgy of IBM would argue that it is a function of the job the business wants to get done targeting the most effective communication vehicle to get that job done. He reported that only 64 percent of Americans use the Internet at home and that 23 percent still do not have any Internet access at all, even with recent growth in broadband access. It was also pointed out that Internet usage at home was growing now at about 1 percent per year, a fairly flat growth curve indicating that the penetration of Internet access has matured.²

It is also interesting to note that household adoption of electronic bill payment is starting to slow according to data provided by Forrester's Consumer Technographics® North American Benchmark Study of 2005. In 2002, the number of households paying bills online increased by 29 percent (representing 13.7 million households). However, this growth rate is forecasted to slow to 18 percent in 2006 and then to 10 percent by 2010.

Mr. Treworgy offered an interesting assessment of trends affecting online bill payment and what factors might offset those trends:

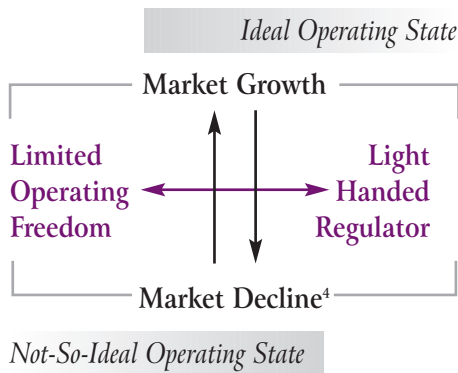
Trends	Possible Offsetting Factors
Eventual elimination of traditional invoice format	Increasing value of paper bill by adding advertising message
Businesses charging customers for paper bills	Customer resistance
Electronic providers ensuring delivery and home printing growth that keeps bill tangible	Customer preferences for existing processes
Banks offering free online bill pay in tandem with postal rate increases	Continued online security issues and enforcement of mail security
Electronic formats that allow for e-mail confirmation	Provision for confirmation services for mail customers and new products that allow faster processing of mail payments ³

Robert Reisner of Transformation Strategies argued that three factors need to be considered when looking at the future of First-Class Mail:

1. The market economics that can define growth trends.
2. The growth in substitute technologies.
3. Future regulatory policy.

Mr. Reisner argued that the shift in mail classes that occurred in 2005 could create a much different Postal Service in the future. As the revenue inputs change with the change in mail mix the cost factors become an even much larger issue to address in the future and the USPS could have less flexibility with which to address them. Add to this the loss in contribution margin through the shift in single piece First-Class volume to work sharing volume and the revenues generated by the USPS could be much different in less than a decade.

Mr. Treworgy’s analysis talked about a relatively static technology shift. But, what happens if innovation in the mail does not occur at a rapid enough rate to offset the increase in electronic bill payment into presentment as greater security and personal identity issues are resolved in the future? If bill payment gets more reliable and better and postal rates get higher and service and products limitedly change due to restrictions on revenues or regulatory controls, then we could see a much different future for the USPS according to Mr. Reisner.



Mr. Reisner offered the diagram above to emphasize the choices facing the Postal Service with regard to First-Class Mail. If current postal legislation offers a stronger regulatory environment that limits operating freedoms, then the USPS will not have the ability to introduce new products and services, will have greater restrictions on rates and revenues and market decline for mail volume could be the result. If current postal legislation results in greater operating freedom, a lighter handed regulator, then it is possible for a greater number of new products and services to emerge with more market growth and greater revenues. However, how much would have to change for market growth to be secured? Why has the Postal Service not shown a greater propensity to introduce new and innovative services up to this point?

⁴ Reisner, Robert A.E. Looking at Future Mail Volumes, February 28, 2006.
⁵ Nolan, John, The Financial Significance of First-Class Mail, EMA IPS, February 28, 2006, p. 3.

Mr. Reisner quickly makes the point that there are many factors that impact innovation and introduction of new products and services, not just the regulatory environment. But, a regulatory environment that is more conducive to ease of product and service introduction could become a platform for future market growth. He further stated that much of the regulatory environment around the telecommunications industry is currently such that technologically innovation is somewhat limited. He used the example of local telephone service and the lack of choice that consumers have, limits on who can repair what service/ product and even the breadth of service offerings that are available.

Mr. Reisner offered an interesting suggestion. He asked what if regulations were drafted such that for a limited and well-known period of time, a rate authority would have strong regulatory controls and that those controls could be relaxed as time went on and service standards and cost controls were met? He stated that a much more flexible regulatory environment with adequate controls might be an answer that would give more definitiveness to the opportunity to grow revenue in the future.

Paul Van Coverden echoed some of the comments made by Mr. Reisner. He saw the future regulatory environment in which the USPS must operate as a definitive factor in its being able to develop new products and services. He also felt that no single piece of legislative reform could hope to be all encompassing enough for the future. He advocated forming a more permanent coalition of customers and the post that would avoid the overlap that exists in a number of mailer organizations and focus more on how to move forward in a more coordinated and thoughtful way.

Examining the Financial Significance of First-Class Mail

Up to now this paper has briefly covered the financial issues around First-Class Mail. We felt that it would be an interesting approach to examine the views of two former postal officers, one of the leading postal attorneys and an accomplished postal historian.

John Nolan indicated that in FY 04 the USPS had total costs of \$66 billion of which \$37.6 billion were costs directly attributable to specific products and \$28.4 billion where covered by product “contributions.” He further stated that First-Class Mail represented about \$20 billion of the \$30 billion in total contribution. Each 1 percent drop in First-Class Mail volume reduces that contribution by \$200 million. He further stated that it now takes 2.5 pieces of Standard A Mail to equal the same contribution of one piece of First-Class Mail.⁵

He indicated that at current volumes, Standard A rates would have to more than double to cover the loss in contribution from First-Class Mail.

He offered several examples of the contribution by mail class:

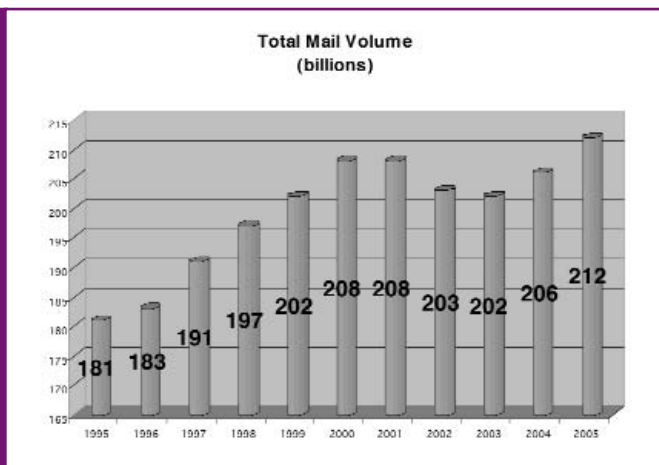
CLASS	PER PIECE	TOTAL (\$B)	PERCENT
FCM	0.202	19.8	219.5
Priority	1.891	1.6	157.0
Express	7.474	0.4	190.2
Periodicals	-0.005	0.0	98.0
Standard	0.081	7.7	174.2
Parcel Post	0.663	0.2	125.1

Mr. Nolan went on to discuss various scenarios that might occur if there was a 20 percent volume loss and a 40 percent volume loss in First-Class Mail. A 20 percent volume drop would equal a \$4 billion loss in contribution assuming static volumes for the rest of the classes and no elasticity impact with contribution ratios unchanged. Clearly, on a cursory basis, this loss could result in a much different Postal Service. He also indicated that “contribution” impacts universal service and shared use of resources. For example, the total non-volume variable related costs for 2004 were \$30 billion per year. This is how these costs break out:

- 37% is delivery-related (\$11B)
- 16% is clerk/mail handler-related (\$5B)
- 13% is Postmaster and Supervisors/ Techs (\$4B)
- 13% is Building and Custodial Services (\$4B)
- 6% is Transportation (\$1.75B)
- The residual are R&D, Administration/Area Operations and Other⁶

He stated that the drivers of these costs are service standards, universal delivery and retail network requirements.

Richard Porras then picked up where Mr. Nolan concluded with some additional statistics:



⁶ Same as 5, p. 6

⁷ United States Postal Service, Cost and Revenue Analysis, FY 2004, various pages.

He presented the chart above that showed the growth in total mail volume from 1995 to 2005 and even though there is a steady upward trend since 2003, there are factors in play that could impact these trends in the future. He mentioned the growth in “below-the-line” costs for health care payments and military retirement costs that could reverse this growth trend significantly as higher costs impacted communications choices, a point made earlier in this paper. He also indicated that shift in customer expectations and improvements in technologies, without related improvements in mail technology, could have a major impact on the financials of the USPS.

Mr. Porras further defined the change in mail mix over the last five years as First-Class volume has declined by 5.9 percent and Standard A volume has increased by 12.1 percent with other mail volume dropping by 11 percent. So, even though the total volume of mail is 212 billion pieces, up from 208 billion five years ago, the mix of that mail has some significant financial implications for the Postal Service.

The first factor to consider is that First-Class Mail is generating 3.5 percent less revenue to cover postal operations while Standard Mail is generating 4.4 percent. But, remember the issue of contribution margin, the USPS is not better off with more mail contributing less. Mr. Porras showed that between 2004 and 2005, First-Class Mail sustained another 1.2 percent revenue drop while Standard mail generated a 1.2 percent revenue increase. He also reported that First-Class Mail covers 219 percent of costs while Standard mail covers 174 percent of costs. Again, this change in mix has a significant impact on the future financial health of the USPS.⁷

Mr. Porras summarized by stating that the change in mail mix must be addressed through a stronger working relationship between the USPS and the customer base that is focused on increasing revenue overall and improving operating efficiency.

James I. Campbell took a slightly different perspective to the financial significance of what is happening with postal volume. As a postal historian he suggested that the best way to look at the data is to go back more than just a decade to 80 years and examine the volume. Campbell feels that when you examine the long-term trends the only time mail volume has taken a serious dip has been the Great Depression and the time period after 2001. So, as a historian he has to wonder if other factors were in play that were not in existence before. He stated that one thing that explains this change is the analysis of First-Class Mail and per \$1000 of GDP for the time period 1927-2017. He stated that after 1977 the value of First-Class Mail per \$1000 grew faster than First-Class Mail per capita. He also stated that in 2001 the Statistical Abstract of the United States reclassified the Postal Service from a communications service to a transportation service. He stated that the Postal Service needs to take a look at

a number of new financial models that may provide a better platform for dealing with the longer term shifts the USPS is going through. In essence, it was his view that we must look beyond three or five years for the real answers to what organizational form can best fit the resources that will be available. We still have enough revenue to transform our operations, but will that revenue be available in the future to structurally transform to meet the market of the future? He used the example of the railroads and telegraph service. He reported that you either have the ability to purposefully transform and renew yourself or you have the option of public life support – The Amtrak system.

New Product Ideas

So far this paper has provided a great deal of background on the volume and revenue trends concerning First-Class Mail. We have examined the issue of competing technologies. We have looked into the area of cost growth, but what about the issue of mail volume growth? If our goal was to grow First-Class Mail volume, how could we do it? What products would be put forth? To answer these questions, a panel of four leading thinkers was challenged to put out several new ideas. They were Mike Boswell of Stamps.com, Pat Deck of Capital One, Gene DelPolito of PostCom and Ian Siveyer of Pitney Bowes. Each was given the factors we described earlier and was told that they had to consider those factors in coming up with their ideas.

PHOTOSTAMPS

PhotoStamps in their simplest form are personalized and customized postage. Since the mid-1990s the Postal Service has been experimenting with information-based indicia and through that work was able to promote technology that allows stamps with authorized two-dimensional indicia to be available through logging onto an Internet site. As laser and inkjet technology became more sophisticated, picture file technology improved and security software was available to protect revenue and safeguard images.

The picture post industry began to improve. Three years ago Australia Post launched their version of picture post technology that allowed personal images to be placed on First-Class postage. Postal patrons would go to kiosks, have a picture taken and that picture would be merged with postage. About the same time, Kodak and others developed similar postage concepts that allowed information to be embedded in stamps and a personalized image to be used. However, the United States moved into this area several years ago and the photo stamp business in North America took off.

PhotoStamps were officially launched on May 17, 2005, and since that time have grown significantly. Research has shown that personalization drives increased interest in the mail, it creates a sense of ownership with the mailpiece and it establishes a connection of the younger generation with the mail, according to Stamps.com.

USPS market research suggests that 10 percent of the consumer-to-consumer stamp market could convert to PhotoStamps in the short run.⁸ PhotoStamps had over 150,000 customers last year and the customer list is growing.

On January 5, 2006, an amendment to 18 USC Section 475 cleared the way for advertising on US postage. In the future, notices and advertisements could appear on stamps that were accepted as an obligation of the US government for purposes of image protection. A new opportunity has opened up for business mailers to use images, logos or other information on First-Class Mail. According to Stamps.com, new opportunities exist for business mailers to create new business models for use of personalized or customized postage. The following opportunities were presented:

- Sponsored postage – Advertisers could sponsor postage for transaction mailers who use First-Class thus providing outside the envelope visibility for their product or service offering or merely offering their brand image.
- Targeted cross-marketing – Companies can cross market their products through complementary offerings and marketing through the PhotoStamp itself.
- Fundraising – Charities can use dedicated fundraising stamps wherein the charity receives a proportion of the proceeds from the sale of their designated stamps.

USING THE EXISTING RATE/REGULATORY STRUCTURE TO CREATE MORE MAIL

Businesses are under constant pressure to create more value for their customers in today's mailing market. This value has taken the form of decreased cycle time, decreased cost, increased complexity and greater innovation. Since an average of 65 percent of a First-Class letter package is postage, there are opportunities to make a difference. They were put forth as follows:

- De-averaged First-Class – The idea is to allow businesses rather than the USPS to optimize their product by making the communications channel more efficient and to also increase demand for their product. The concept is to take apart some of the cost components of First-Class Mail and offer a la carte pricing that would be focused on the following: delivery timeframe; forwarding; UAA information; and PLANET Coding. The idea is to offer a no additional services discount, a step above Standard Mail and then allow the customer to choose among a la carte services.
- Radius Based Pricing – The idea of radius base pricing is to base pricing on distance transported from the origin versus a flat rate that allows for the industry to solve the USPS transportation costs. Today, for example, mail produced in Philadelphia costs the same whether it's going to Los Angeles or Chicago.

⁸ Boswell, Mike, *PhotoStamps® for Business*, Stamps.com, February 28, 2006, p.10.

- Imaging services – The USPS could consider moving into imaging services to provide a value added service for customers and reduce USPS costs or increase revenue. One idea would be to image the outer envelope and send it electronically to the customer. This could be used in remittance applications or to transmit a postmark promise for posting payment dates. Finally, a service could be offered to open, extract and image mailpieces. This could also have marketing and customer management applications, save transportation costs and provide a reduction in business cycle time.
- Better leverage the outer envelope real estate – USPS current requirements prohibitively restrict the amount of space mailers have to utilize on an outer envelope that destroys some of its value. Co-branding stamps as presented earlier, co-branded indicia, no return address, a reduction in advertising requirements and invisible inks are all examples of new product values that could be placed on the envelope to leverage the real estate.⁹

These ideas were provided by Capital One through their Enterprise Operations as areas in which additional research could be accomplished to prove out these ideas in more detail. They, like the other presenters, feel strongly that as we move forward it will be new ideas and concepts for adding value to the mail that will make mail more relevant and useful to consumers and businesses in the future.

BUSINESS-CLASS FIRST-CLASS MAIL

Several additional ideas were discussed which built on ideas generated previously and were centered on the creation of a new Subclass of First-Class Mail. The following concepts were discussed:

- First-Class Lite – Related to the de-averaging concept presented earlier is the idea presented of First-Class “Lite.” This service would offer no forwarding, no return and just offer speed and a sealing against inspection. It would be part of a new First-Class Business Subclass or “Lite” service.
- Flexible Drop Services – Related to a new Business Subclass could be an electronic dropship service or an all dropship service.
- Modify the old standard parcel return services – Potentially a new rate could be created to make parcel returns a more cost-effective service or a bulk parcel return service.
- A Bulk Business Reply Mail Service – Why not more aggressively price bulk rate return mail so that it provides an incentive to the mailer to use BRM. Most specifically, eliminate the single-piece surcharge.¹⁰

MAKING FIRST-CLASS MAIL AS ATTRACTIVE AS FIRST-CLASS TRAVEL

Pitney Bowes has long focused on creating more value in the mail by adding more information content to the mail. Research they

have accomplished has shown that the Internet stimulates the use of mail. The number of pieces of mail received by households with Internet access is greater than that received by households with no access.¹¹

Ian Siveyer, the presenter from Pitney Bowes, offered some interesting assessments of First-Class as a medium. He indicated that you cannot look at First-Class Mail in the aggregate and hope to understand what is happening to the class. You have got to take it apart by end user and channel to understand the value propositions involved. He echoed the comments made by IBM and Transformation Strategies that we have already seen a maturation of the Internet as a competitive medium and the trend of diversion have slowed. He referenced a comment made by Luis Jimenez, senior vice president of Pitney Bowes that the easy jobs have already been accomplished by the Web and it is the harder functions that are more difficult to replace. IBM said something similar in their comments.

Pitney Bowes rightly states that the enhancement of First-Class Mail is all about creating more value for the service and creating that value involves four steps: identifying user needs, developing enabling technology, building value packages, and increasing awareness. But again, enhancement has to be looked at as a series of smaller increments rather than large sweeping changes given the complexity of the transactions that surround First-Class Mail.

The concept of intelligent mail is that every mailpiece (letters, flats, and packages) is provided a unique and trackable capability. The Postal Service has already begun to implement their OneCode™ vision through the creation of a four-state barcode for business mailers and an IBI lite code for meter and pc/postage mailers. Thus, there is data on every mailpiece that creates uniqueness about that mailpiece which can be used for a wide variety of purposes.

These unique codes would allow “visibility” of the mailpiece throughout the entire processing and delivery cycle from the moment the mailpiece was created through delivery. The information value of this data is very significant for mailers who are targeting other media to the receipt of a designated mailpiece, legal entities that need physical delivery services and confirmation that is electronic and a host of other uses. The following features could be offered:

- Date certain delivery
- Customer acquisition
- Cancellation prevention
- Predictive services
- Auto redirect services

Besides these customer-useful features the USPS would benefit with service tracking on any mailpiece and a system that feeds its internal operational initiatives.¹²

⁹ Deck, Patrick, *First-Class Product Ideas*, IPS Summit, February 28, 2006.

¹⁰ Del Polito, Gene A., PhD, *Ideas for Enhancing First-Class Mail*, PostCom, February 28, 2006.

¹¹ United States Postal Service, *Household Diary Study 2003*.

¹² Siveyer, Ian, *Is There a Future for Mail?* Pitney Bowes, February 28, 2006.

The other issues that were discussed around Intelligent Mail include a discussion of the software and hardware that comes together to increase the utility of the information that is created. This includes data features, process applications, and new technology that can be deployed into a variety of channels.

Pitney Bowes also presented its own customized postage application through a partnership with Zazzle that allows postage to be created on the Internet or through other devices that is personalized, meaningful and carries all of the intelligence that was outlined earlier. There are many applications that can be created through merging document intelligence with mail processing applications.

Barriers to Implementation

For every new idea there is a challenge to be overcome and understanding some of the barriers to getting new ideas implemented is important in being able to not only recognize and try to overcome the barrier, but also structure the new idea in a manner that can be more acceptable given the barriers that do exist.

One of the panelists offered the following quotation from Ralph Waldo Emerson:

“As long as man stands in his own way, everything seems to be in his way.”

There are three barriers to all new products and services:

- Structural – The statutory and political environment.
- Scale – The sheer size of the problem.
- Imagination – The innovation environment.¹³

All organizations have the same barriers although the components differ from organization to organization. The issue is how innovation is handled by the organization that determines what barriers must be overcome. There are various stages of innovation that must be considered when you examine the constraints an organization has:

- Ideation – Too few ideas, too little potential and/or the customer does not want or need.
- Selection – The organization or team cannot select the best idea, the timing is wrong, too many to get through the screen or too few.
- Development – The organization can’t afford the development costs, they quit too soon because of a lack of will, they lack the capacity to develop or competitors beat the organization to the market.
- Commercialization – Poor adoption rates, the organization’s design inhibits execution or it has a lack of market credibility.

- Cycle-wide – The organization is not well positioned in the industry, it has a lack of growth in current domains or the idea-to-profit cycle is too slow.¹⁴

All organizations in the postal marketplace suffer from one or more of these constraints. The issue is how do you overcome them so that you can achieve an acceptable measure of innovation so you do not fall behind or fail because you do not meet the expectations of your customer(s).

There are many ways to overcome innovation barriers. Here are several that were proposed:

- Top management led – It is the fastest way to get things done when top management believes in the product or service.
- Internally networked – Innovation can grow with strong cross-functional ties.
- Distributed – Innovation can be maximized when it is driven down to the individual employee.¹⁵

There are also ways to innovate that exploit the value chain. They include:

- Supplier-driven – Best when you want rapid, low-cost innovation.
- Partner-intensive – Processes can be opened to external partners to achieve better results when there are intra-organizational barriers.
- Competitor-driven – Innovation can come from competitors and the organization then adopts rather than taking the lead.
- Customer-driven – The most profitable sources of innovation come from a deeper understanding of the customers’ needs.¹⁶

Looking back at the Postal Service, what are the constraints that are more unique to the Postal Service that need to be addressed?

- The Information Age – Today, the USPS has competitors that it did not have a decade ago. As a result mail and mail related services must work within a more competitive communications marketplace than ever before. Mail volume growth will be more flat and related product innovation will be more challenging.
- Databases of the USPS – As a government agency, the USPS has certain privacy requirements that go beyond the private sector. It cannot use its information resources freely.
- Data does not equal business growth – The data the USPS does have might supplement the retention of mail volume, but it cannot be a substitute for mail volume loss. Loss of mail volume is loss of data about mail volume.
- The National Change of Address system also has inherent limitations.

¹³ Coughlin, Michael, *Barriers to New Products/Services*, Accenture, Inc., February 28, 2006

¹⁴ Same as 13, pp. 5-6.

¹⁵ Same as 5, p. 7

¹⁶ Same as 5, p. 8.

The other factors of interest include the issue of competition. Panelists felt that for every new product or service, the USPS faces considerable barriers because it is in a monopoly position. In many cases it is resource or regulatory constraints that limit the Postal Service from truly meeting customer demands for services or products. It is the constraint of the monopoly that will always be a limiting factor. For example, the USPS is the only post at the Universal Postal Union where its national representative is another government agency – the Department of State rather than itself. This represents a global constraint on its options to innovate.

Other barriers to implementation were also considered. A breakeven requirement for all new products and services is extremely difficult in an age where many competitors can lose money for longer periods of time as they perfect the product or service offering. Another barrier is the focus of the enterprise all together. Who is the customer of the Postal Service? Is it the consumer? The mailer? Both? There are different products and services for each and consumers or mailers do have a choice, they can just not mail.

Several other barriers were discussed from a mailer's point of view. First, considerable investment is required to be a mailer today. Communication with mailers on future intentions is a must. When the post says one thing to a mailer and then another entity of the post says another thing, mailers are frequently confused over what are the future directions. This was especially evident in recent communications that the Postal Service had concerning future rates and postal reform legislation. Second, innovation is possible in transportation networks to ensure that the USPS can continue to meet time sensitive delivery requirements of customers at a cost it can afford. There are opportunities through deeper worksharing discounts that take advantage of the transportation infrastructure already in the hands of mailers that could be leveraged into the USPS delivery network. The mailers have made these investments and they could be used even further.

One interesting barrier that mailers felt a challenge is the automation program itself. The current automation program has bred a certain amount of standardization as it relates to address size and placement and the size of mailpieces. This limits creativity, impacts response rates and also adds revenue for mailers. In an attempt to get highly automation compatible mail the needs of the mailer can sometimes be ignored through a rigorous and sometimes misdirected attempt to get high quality mail at all costs. The USPS must continually balance the needs of the customer against its own requirements to ensure that it does not become a barrier instead of a gateway.

As the Postal Service implements new barcoding technology, it must also keep in mind the downstream costs to mailers. Wal-Mart found out quickly that it could not demand immediate performance with all vendors to place RFID on every container and/or package

because the costs of implementation were so high the vendor saw limited advantages other than volume. A more phased and vendor-centric implementation process emerged where there was more cooperation and sensitivity to the costs.

Panelists suggested phasing more discounts to implementation of cost saving technology would be one answer to overcome barriers. In addition, understanding that some processes mailers adopt require them to remain competitive in First-Class Mail, such as co-mailing and co-palletization. Mailers are very concerned over the future of worksharing discounts and are hopeful in the new regulatory environment that they will prevail.

Transportation and delivery service barriers were also discussed quite often. Participants indicated that fuel costs and driver shortages have an impact on service and for First-Class Mail service that is critical. These shortages also boost rates and the rate for service issue becomes more important. Facility access and shipment tracking for First-Class Mail were also discussed and it was felt that it should be for drop shipped or not dropped ship.

Finally, the new network design was discussed. At the end of the day, proximity to the customer is everything, so would the new network offer fewer or more destinations and how. In addition, as a more shape-based network is created, how will this impact various classes of mail in terms of delivery times/service standards? The challenges are always in the details.

Participants felt that Negotiated Service Agreements needed more work. Costs are very high, litigation is lengthy and the disclosure of proprietary processes can be significant. How can the process be made more user-friendly and less expensive?

The final item discussed had to do with offering discounts to stimulate volume during slack mailing periods. Participants fully understood that these slack mailing periods occur because people are not at home, but they also felt that some mailpieces are not as time sensitive and maybe this issue of discounts for slack time delivery could be considered again.

Every one of the participants felt that there are recognizable barriers to overcome, but a culture in the Postal Service that is more receptive to new ideas also needed to come forward. Communication between the Postal Service and mailing industry leaders was the first and foremost barrier that participants felt needed to be overcome. Participants also felt that the Postal Service needed to use more cross-functional teams to consider new product ideas more quickly and that an attitude is needed that is more accepting of these ideas rather than only accepting ideas that have an operational significance for the Postal Service.

Participants all reported that they were ready to put more emphasis on First-Class Mail.

Future Legislation

The final subject area of the summit was a discussion panel on future legislation as it related to First-Class Mail. Attendees' reaction to the opportunity to grow First-Class Mail under the current legislation was mixed. Quite a few felt that the powers given the new Postal Regulatory Board may be such that it will be very difficult or cumbersome for the Postal Service to launch new products. Many of the ideas in expanding NSAs, radius based pricing, de-averaging First-Class and a business-class for First-Class Mail could be offered under new legislation, but at this point, and having limited information on how the regulations would be developed, panelists were in a difficult position to determine if there would be more barriers than opportunities or more opportunities than barriers.

Panelists discussed the long and cumbersome legislative process and how many aspects of the current legislation differed from the original pronouncements of the President's Commission. Others indicated that it was the passage of time and different circumstances that accounted for many of these differences. Still, others stated that it was the vetting process that resulted in many provisions of the bill that are significantly different than the original intent outlined by the stakeholders.

All involved concluded that the process has its pitfalls, but the bill at hand has been passed by the Senate and a different bill passed by the House and compromises will have to be reached in the Conference Committee. The future of First-Class Mail in its current form may very well rest with the compromises that are met that trade flexibility in product development and pricing for regulatory oversight.

There was a brief discussion about the issue of funding healthcare and retirement costs and the president's requirement that the final bill not add to the budget deficit. There was great concern that mailers had already funded these benefits and how funding was being asked for again. One comment suggested that the Postal Service had been singled out for treatment far more harsh than any other federal agency with the same unfunded liabilities and yet the cost would be directly borne as a tax on postal ratepayers for use of the system. It was mentioned that higher prices will have a detrimental impact on volume, thus causing the Postal Service to ask for even more money and with each price hike, volume will continue to drop.

It was a conclusion of this group that the legislation is far from perfect and there may be more legislation in the long run that corrects many of the deficiencies of the current legislation. It was felt that the long term obligations would not go away and the issue of future funding of escalating healthcare and retirement costs would come back again and legislation would have to be developed to correct these funding short falls or a new course of ownership chosen for the Postal Service if the government could no longer afford the service and stamp revenues would not support those benefits. All felt that neither S. 662 nor H.R. 22 would solve the reality of the unfunded benefits predicament. The issue will come back again.

The final thoughts of the panel centered on the issue of being better off or worse off under new legislation. The response was mixed because there are still too many unknowns. All felt that the more the future regulatory environment pushes prices higher, the more First-Class Mail may need a total transformation in order to keep it as a medium. Many concluded that the problem was not what would happen today or tomorrow, but what would happen five or ten years in the future.

Summary

This paper shows that the future of First-Class Mail can be a very complicated subject, but also an opportunity in the making. The mailers who provided input have suggested that there are quite a few new opportunities for First-Class Mail so that the future does not have to be one of volume decline. It is the hope of the Institute for Postal Studies that this paper will create some new debate and a few new scenarios for the Postal Service, legislators and regulators to consider. The message of this paper is that First-Class Mail still has some untapped potential, but like any mature medium it will take more hard work to bring it forward.

The Institute for Postal Studies appreciates any comments or new ideas generated as a result of reading this paper. Please forward them to Tonya W. Muse at: twmuse@envelope.org.

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