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Article Series

FORMULATING STRATEGIES FOR GLOBAL SUCCESS

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**Part-Privatising Royal Mail – Part 2** *(REVISED)*

In Part I, two fundamental errors in the Hooper Report were identified, and the former buggy whip industry was used as an example. This part, Part II, identifies the industry interlink between the internet and postal services, which helps in uncovering additional errors.

Recalling from the proofs in Part I, postal services are physical delivery services, and not communications services or services increasingly competing with the internet, broadcasters and telephone companies. The internet is comprised of a host of online services representing many different industries, but the internet itself is not in all those industries any more than Royal Mail (or any other postal service) is in all the industries in which it physically ships items (e.g., medicine, documents, music, food items, et cetera). Some internet services are actual written and voice communications services, for example, email and VoIP (voice-over-IP or internet calls), but most services are not communications services. Therefore, a non-technical common denominator shall properly identify the industry's classification.

Although it would be technically correct to state the internet uses various telecommunications mediums to transport electronic data (digital data), industry classifications are not based on technical definitions for the most part. Communications is an incorrect industry classification for the internet, not to mention confusing. The proper classification is electronic delivery services. Internet companies offering email or VoIP require electronic delivery, and the same electronic delivery is the primary service offered (primary-primary). Internet companies not offering communications services, for example a bicycle store, require electronic delivery for catalog, order and confirmation web pages, while the product itself is not delivered electronically (primary-secondary). Viewing the internet as an electronic delivery service reduces any potential error of misidentifying actual competitors and relative markets.

The link between the internet and postal services is clearly established, as both are in the larger category of delivery services (noting Royal Mail still does not compete against the internet), with the internet in virtual or electronic delivery, and postal services in the real world or physical delivery. The clarity helps show why the internet's disruptive technology caused an indirect impact in Royal Mail's business model, even though the two are not competitors.

Because Royal Mail's underlying industry and competitive landscape was misunderstood, the Hooper Report failed to properly identify market and product strengths, instead focusing on declines and volume alone. The report correctly stated declining volume in letters mail, increasing volume in fulfillment mail, and profit margins for fulfillment mail exceeds letters mail, while providing a host of data relative to the letters volume decline. There was little to no data on the fulfillment mail or associated analysis. Believing postal services are in the communications industry, the report's emphasis on letters mail and declines was understandable, but erred. Royal Mail has more market opportunities relative to fulfillment mail, so emphasis should be placed on understanding these markets, which are absolutely essential to the future profitability of Royal Mail.

Likewise, the concern over drastic reductions in volumes seemed to take precedence over net profit margins. That is, Royal Mail's letters business is a low-margin, declining business that does not directly compete with email and other internet-based communications mediums, while package fulfillment side of the Royal Mail's business is high-margin, increasing and an active market for Royal Mail (i.e., the bicycle sold online needs physical delivery). Clearly, letters mail is secondary to fulfillment mail in the new business model, and volume changes alone are irrelevant (i.e., 50 of anything at £0.30/each with increasing demand is better than 100 at £0.10 with decrease demand, so volumes along with margins as a whole are important). The errors exposed here likely would not have occurred had the markets been properly identified and understood. As for the strategy of increasing prices in a declining demand situation, it is sufficient to say it is an established weak strategy presenting side effects counter to the desired objective.

Faced with continued declining sales, many buggy whip producers of the day did not drastically cut back on production, and instead, opted to offer "better" buggy whips (higher quality, cheaper cost, et cetera) to increase sales, which accelerated the industry's decline because the efforts and their associated costs did not turn former customers into buyers of the "better" buggy whips. That is, automobile owners had no need for buggy whips regardless of cost, quality or any other attribute. With the advent of the internet, postal services today are repeating the same type of fundamental errors that the buggy whip industry employed with the advent of the automobile, a disruptive technology that they did not properly understand.

Next, the Hooper Report claims, *"Royal Mail is the only company capable of offering universal service in the UK"*, and makes the subsequent claim that it is *"unlikely a competitor will provide national network coverage any time in the foreseeable future"*. It is incorrect to therefore conclude Royal Mail performs a market function that others cannot offer. First, universal service is not a profit generating service. Second, for-profit firms will avoid universal service, especially in geographically disperse regions, unless mandated by law or adequately compensated financially. Therefore, it is unlikely another provider would take on universal service, for there are inherent inefficiencies in visiting every address on a daily basis. For Royal Mail, universal service must be viewed as an asset with market potential, rather than a liability. That is, formulate business, product and service strategies that capitalise on the unique differentiation, and then focus on how best to implement modernisation efforts given the strategic plan. If cost reductions and efficiencies are set as modernisation priorities (most common approach), then resulting strategic plans forego inclusion of the full scope of profitable market opportunities that exist. An irrefutable example can be provided for any true skeptic of the statement. Keep in mind, cost efficiency operational decisions represent a daily business objective and are not something only executed in "downturns".

Continuing, the Hooper Report states universal service is under threat by the explosion of digital media, specifically the internet, email, mobile text, et cetera, emphasising that the threats have prompted an unprecedented decline in the letters market of basically 5% to 7% per year. The statement of declines is not in dispute. From Part I, it was shown that the declines are beyond the control of Royal Mail, that is, Royal Mail does not offer any competing service to gain or regain those lost customers due to the internet. Therefore, accept the reality of continued declines and focus the modernisation efforts on the business' strengths (what can be offered)—physical delivery. That is, accept the letter volumes decline as part of the new business model, and stop focusing on what cannot be influenced or changed. As a result, modernisation of the letters business needs to focus solely on actual customers, and not on obtaining sales from "forever lost" customers similar to the failed strategy of the buggy whip producers. It is essential to establish realistic projections on actual future letter volumes before engaging in modernisation, where short-term under capacity in a declining market is preferable to the alternatives.

For any postal service, universal service requires a daily expenditure of physical resources in order to visit every physical address every day, which makes postal services more in line with national defense and less like utility companies or railroads. Universal service for the telephone industry involved building out infrastructure, and once the build-out was complete, maintenance and upgrades are the only major expenses to continued operations. Telephone calls travel along the infrastructure with no need for personal physical delivery (i.e., is completely automated). As a result, a government telephone operation that completed build-out of the network can be sold off and still provide universal service. The same is true for Network Rail, except the infrastructure does not go to every house/business. When expansion is required, the cost can be distributed across the entire network. With postal services, there is no infrastructure build-out allowing for automated delivery at every address, and until a disruptive technology is introduced, both letter and small package delivery shall remain a labor-intensive, daily, repetitive delivery service. National defense is a daily, labor intensive and costly enterprise that cannot be fully automated either; nor is it best suited for non-government to operate. It has already been established universal service is not a profitable service, nor is it automatable; therefore, the business model is best suited for a government to operate, unless of course a business is financially compensated for performing the service (bad idea, but not substantiated here).

In the end, universal service is not threatened by letters volume declines or by the internet, telephone companies or broadcasters as the Hooper Report contends. Universal service, like national defense, is not a for-profit service. Any decision to offer universal service, or the threat to discontinue the service, is dependent on social and political factors, of which the cost of offering the service weights in against its perceived benefits. If the service is offered inefficiently or costs exceed benefits, then an argument to discontinue the service is valid. An understanding of the postal services' primary market, its competitors, future markets and dying markets are essential to modernising Royal Mail into a competitive enterprise able to sustain universal service in the future. The Hooper Report contains a number of errors in addition to those disclosed here and in Part I, and the Postal Services Bill likewise contains errors. Building any type of future on such erred material is unwise.

The only true threat to continued universal service is poor decisions based on erred assumptions and conclusions, offering nothing short of a remedy guaranteed to require a more costly solution (or another remedy) sometime in the future. Postal services must recognise the full spectrum of their true strengths and develop business strategies that capitalise on those strengths, recognising a new business model (not to include partnering as referred to in the Hooper Report) requires more from automation and modernisation than just a surface overall.

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

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