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Part-Privatising Royal Mail – Part 3 (REVISED)

If modernisation of Royal Mail is to be successful, then the core recommendations and proposals contained in the *Hooper Report* (the "Report") must be correct and logical. The first two articles ([Part I](#) and [Part II](#)) discussed industry classification and market identity errors relative to postal services. This article first examines the proposed process for modernisation of Royal Mail, followed by, analysis of several of the recommendations presented in the Report.

For Royal Mail, the Report defines modernisation as comprising two distinct phases: first transformation, followed by diversification, stating "*transformation is the priority*". "[First,] *Royal Mail must change the culture of the organisation, improve efficiency and reduce costs. Secondly, that will enable the company to diversify, finding new sources of revenue either by providing related products or expanding to cover a wider geographical area.*" Although the two sentences seem plausible, the approach contains a number of common errors in strategy formulation and problem solving, which result in either disaster or less than obtainable outcomes. Since both are avoidable, there is no excuse for either.

There is no argument that the changes listed (i.e., culture change, efficiencies, et cetera) are required, but the proposed process is incorrect. In fact, between the Report's Transformation and Diversify phases, if one must be done first, it is most definitely Diversify. Consider a fictional, simplified family vacation as an example (employing terminology from the Report). Transformation is first and includes defining limits/expected behavior from the kids (culture change), as well as selecting a fuel-efficient rental car over the family gas-guzzler (efficiency and cost savings). Diversify follows and includes identifying the vacation spot and activities to enjoy (new or expanding opportunity). While reviewing the vacation spots, a great cruise is eliminated because a rental car was already secured, and the same problem eliminates all air travel (opportunities) and locales too far to travel by car as well. Note, within the example, the concepts are the important part, not the vacation specifics.

In short, successful problem solving requires a complete and correct understanding of the problem set, including all internal and external factors, employing strategy formulation to successfully evaluate options and alternatives leading to the development of a comprehensive well designed solution. That is, for both personal and business matters, knowing or defining where "you" are going (Diversify) is paramount, but a full understanding of both the problem and viable options is required in order to arrive at the best solution without first eliminating or degrading opportunities. That does not mean "how" is not important, only that "how" should not dictate or eliminate opportunities. Furthermore, execution of the comprehensive,

well-planned strategy ("how") is performed next, generally in steps or stages. Nothing precludes minor changes in advance of a full plan, but anything major or broad is undesirable, as it likely shall result in duplication and waste, or elimination of otherwise viable options.

Having firmly established the error in the modernisation plan proposed in the Report, next is an examination of actual modernisation recommendations. The categories covered mimic those in the Report: *Commercial Confidence*, *Access to Capital*, *Access to Corporate Experience*, and *Diversify*.

Under *Commercial Confidence*, the Report states the need for political separation; however, the Report offers no such proposed solution, and neither does the Postal Services Bill (the "PSB"). In fact, the Report, and presumably the PSB, expands the role of the regulator to include involvement in the business/operational decisions of Royal Mail, which increases political involvement. A regulator should never be promoted to engage in the normal operational decisions of a company, whether government operated or otherwise. Oversight yes, but operational involvement, no.

Second is *Access to Capital*, which is one of the most challenging aspects of Royal Mail's modernisation efforts. Here, the Report offered a single, all or nothing approach of part-privatisation, thus allowing proponents of the plan, including the major political parties, to incorrectly state no other options exist, or more notably, no better options exist. Instead of exploring and documenting potential methods for raising capital, the Report's authors missed the opportunity to take full advantage of the many constituents and sources available to it during the information-gathering portion of the project. Clearly, options exist. In fact, for virtually every problem, there is a set of probable solutions, with most ranked below average (remedies) and a few ranked above average (solutions), with the goal in problem solving to always aspire for the highest above average solution possible, recognising limits (i.e., constraints) do not always allow selection of the best solution. If only one option is seriously considered, it is impossible to claim it is the "best obtainable" solution unless you know the alternatives (i.e., what was eliminated and why).

Next is *Access to Corporate Experience*, which has two claims. First, the Report makes the claim that a "*strategic partner will provide Royal Mail with a deep and wide range of experience at all levels of management, offering superior value over hiring a limited number of people regardless of the extent of their knowledge*". To start, why is Royal Mail limited in the number of qualified people it can hire? Presumably, Royal Mail would be able to hire, or contract, all those required. In addition, if Royal Mail was properly structured, it could easily attract some of the best and brightest people. As to the claim of deep and wide, the assumption is that a partnership means full or near full access to all the expertise at the partnered company. This is absolutely not true. If the partner is an equity investor, the norm is for one partner to oversee the investment and assist Royal Mail in hiring the needed expertise to develop and implement the modernisation efforts. If an equity investor can assist in hiring corporate experience (which is the industry practice), then Royal Mail can perform the same task. On the other hand, if the investor partner is a competitor, there is no competitive advantage for the investor-competitor to provide Royal Mail with deep and wide access to expertise at its firm. Instead, the partner will establish parameters and set deliverables. It is illogical to assume or expect an investor-competitor partner to strengthen Royal Mail to its own detriment (beyond the essentials), which is exactly what deep and wide access would provide. In business, this is a form of cannibalism, and not a practice any competent or successful business is willing to engage in or perform. The Report and politicians may consider it, but reality will prevail.

The second *Corporate Experience* claim is a "*benefit from a long-term or permanent transfer of expertise from the partner company to Royal Mail*". In the case of an equity investor, it was already established that expertise would be hired, and therefore, not originate from the

partner firm, so the claim does not apply. As for an investor-competitor, no such transfer will occur unless the personnel are of no strategic advantage to the investor-competitor firm, in which case, one can logically question if expertise is ever actually transferred. Regardless, the transfer of expertise, long-term or permanent, equates to deliberate intellectual dilution at the partner firm, which is illogical, and therefore, not likely. The desire for deep and wide and long-term/permanent is understood, but the Report's stated approach will not deliver that which is desired—as the phrase goes, "*good idea, but bad plan*".

Continuing with the concept of a partner for Royal Mail, the arguments relating to the competitive advantages Royal Mail will suffer have all but been ignored. Using Royal Mail as an example, a competitor will have access to data relative to letters and package volumes, specific regional data, existing customers, et cetera. The list is endless, but the data itself can be used to assist a competitor in devising strategies of their own, and at the demise of Royal Mail. Partnering is not a one-way street and can result in more risk than reward. Considering the partner will likely be a competitor, the risks are under appreciated by those proposing part-privatisation.

Finally, *Diversify*, which is what the Report identified as its second phase, includes finding new sources of revenue or expanding operations. Obviously, Royal Mail must be competitive in order to be a self-sustaining entity; however, future plans must be realistic and achievable. The Report states one area of consideration is "*...expanding to cover a wider geographical area*", further stating how competitors TNT and DHL have succeeded as postal providers expanding beyond their national borders. Although expansion is a common proposal to combat a declining industry, in context, the remedy is unrealistic for Royal Mail given its current situation.

First, Royal Mail is in financial distress, a situation not shared by most, if any, of its competitors (or likely competitors given a geographical expansion). Royal Mail must first secure the funds necessary for modernisation, to include satisfying past pension obligations, which will cost anywhere from £9.0 to £17.0 billion. If part-privatisation is pursued, then profit sharing will also occur. Where exactly would the billions of pounds for expansion come from considering the difficulty in raising the roughly meager £1.2 billion for automation and efficiency efforts? Also, it is likely investors would want to see success in modernising Royal Mail's UK operations before investing, and the time required makes expansion a distant future endeavor at best.

Second, a comparison to TNT or DHL expansion is wholly inappropriate unless Royal Mail can nearly duplicate market conditions and cost structures, which it cannot. For example, Deutsche Post expanded by purchasing DHL, a global delivery services firm with little overlap in services. TNT expanded in a market with fewer competitors and a lower cost structure. That is not to say expansion is not possible, but to claim, "*so-and-so did it*" is an insufficient claim in itself. In addition, geographical expansion is only part of the equation, meaning an expansion of services is also required. [*A competitor partner helping to devise an expansion strategy that directly competes against their own business...not recommended and likely a disaster*]. The issues of geographical expansion are more pronounced if extrapolation is introduced. For example, other EU postal operators are considering expansion plans, so presume one enters the market in addition to Royal Mail. The result (simplified) is a dramatic increase in supply, with no comparable demand increase, placing downward pressure on prices for all competitors, and further eroding profits and lowering revenues. All, or at least most, will sustain losses, while the market enjoys artificially low prices. The winners will be those best able to sustain losses, although true market winners will not exist until supply and demand, or price stabilisation is achieved (e.g., the disk drive industry is an example of price wars impacts, while the US airline/air travel industry shows supply/demand imbalance impacts). The least financially sound, that is Royal Mail, is likely to fail first, and a competent competitor should definitely exploit Royal Mail's deficiencies. For geographical expansion to

be successful, the expanding entity must not have burdensome financial constraints, and must have a proper formulated strategy for success for each respective market. The weakest competitor will succumb to liquidation or consolidation, and losers will jeopardise their universal service by increasing the costs associated with performing the service.

Less risky and more profitable strategies involve building on existing strengths, delivering higher margin services and becoming more competitive in Royal Mail's own domestic market. Building on existing strengths is the key to success against the larger, global providers, so if Royal Mail and other national postal providers can properly identify their strengths, costly geographical expansion is not necessary. Although expansion is usually the first proposal for addressing a declining market, the only true approach is to review the market and properly identify strategic strengths. The latter is generally not performed well because it requires a broad understanding of new markets, their respective customers and related needs versus wants.

In summary, Royal Mail is in financial distress, so geographical expansion is simply not an option, while expanding services is risky in its own right if not properly developed and managed. A rather large number of errors exist in the Report's modernisation proposals, and those errors are propagated to the PSB, current modernisation efforts underway and most likely future planning as well. The requirement of political separation in the Commercial Confidence section does not provide a solution, but does increased political involvement with one of its proposals. One of Royal Mail's most pressing problems, Access to Capital, is inadequately addressed in the Report. Furthermore, the part-privatisation plan was presented as a single, all or nothing proposal, incorrectly claiming status as the best and only option by sheer virtue of pursuing no alternatives. As for Corporate Experience, the concept is good, but the proposed plan is unrealistic and contrary to standard industry practices. Finally, Diversify, which was incorrectly placed in a subordinate role to implementing changes without first devising a strategy for moving forward (that is, turning around Royal Mail operations and securing self-sustainability). Geographical expansion was suggested without full appreciation of the risks and challenges, while only providing a cursory mention of generating "*new sources of revenue*", which is a challenging task in its own right.

Since the modernisation efforts for Royal Mail are mostly driven by the content in the Report, any errors in the Report must be resolved or eliminated to avoid propagation of the errors throughout the modernisation process. The errors will not eliminate themselves, and ignoring the errors will not eliminate them either. The phrase, "*Hindsight is twenty-twenty*" is a true statement, but also a crutch used to explain away errors or mistakes that the speaker either wishes or incorrectly perceives as not being known or existing at the time of the originating event. Accidents differ from mistakes in that mistakes are errors that could certainly have been avoided, while accidents are less obvious, and thus, harder to avoid. Even many accidents are avoidable.

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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