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Royal Mail – Beyond the Hooper Report – Part 2 (REVISED)

The four prior articles ([Privatising Royal Mail – Part I](#), [Part II](#), [Part III](#), and [Beyond the Hooper Report – Part I](#)) in the series identified obvious errors in the modernisation efforts for Royal Mail, but they have had no impact. Therefore, this article shall briefly cover the latest proposals/events, as well as major participants not already discussed, mainly for completeness. Then, two past (and very applicable) examples are provided as the foundation for a prediction on the outcome of modernisation efforts at Royal Mail given the current direction taken.

The latest events include a proposed price increase, postal union strikes and the proposal to add banking services. The [Hooper Report](#) proposed increasing prices to offset declining volumes, and [Postcomm](#), along with Royal Mail, are now finalising the processes to impose a price increase. A single sentence in my second article addressed the pricing error: "*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.*" Clearly, it was not sufficient to say, even though the statement is a well-established principle (fact) of basic economics, and absolutely not theoretical in any sense. In short, if supply remains unchanged (and it does in this case), while demand continues to decline (which it does) due to a shift to the left in the demand function (what is occurring), then the result is (must be) equilibrium at a lower price with smaller quantities sold. This is absolute. Thus, any further price increase means the quantity sold will decrease even further, resulting in even less revenue (and thereby, less contribution towards profit than if prices were not lowered). Again, the concept provided here, and their resulting outcomes, are absolute.

In advanced economics, marginal value or marginal analysis establishes absolutes relative to maximising revenues and profit. It is essential to both understand and properly apply these principles to avoid unnecessary "*failure*". Some have already argued the declining airline industry's ability to raise prices represents a valid argument countering the claim. That would be a correct statement if the underlying economic principles were the same, which they are not. The airline industry has greatly reduced supply (eliminated flights and seats), thus shifting the supply function forcing a higher market equilibrium price for the given demand. Raising prices in a declining demand market with no supply change is a (well-established) weak strategy (failure), unless of course, the objective is to accelerate further demand declines, while generating even less revenue (side effects). For anyone needing a more applicable example, as petrol (gas) prices reached their maximum last year, did anyone consider purchasing the same or more petrol when the price increased, or was your reaction the norm...purchase less petrol, while finding alternatives to avoid paying the higher price

(i.e., even less quantities as prices increased)?

As for the postal union strikes, there are two issues, namely, their strategy for employing strikes (objectives) and implementation (strikes). The Communications Workers Union (CWU) demands appear to include, in part, the disclosure by Royal Mail of its business plan, a pledge modernisation will be agreed upon rather than imposed, and benefits packages to reward postal workers for delivering success. (Unfortunately, I had no access to the actual letter stating CWU demands; therefore, I relied on published reports). The demand for a business plan is logical, but one everybody should demand before any major changes occur. As for a pledge to agreeing on modernisation, the request does little towards solving the problems, except to introduce potential future arguments that "*so-and-so*" broke their pledge. And, the benefits package is too vague to comment on either way, for it sounds reasonable, but in the end, the benefits demanded may be unrealistic.

Are the union's reasons for striking merely distractions to gain public support, or are their claims valid? Modernisation will include retooling, automation and efficiency changes, all of which are likely to reduce jobs. The unions represent labor, so there is an inherent bias for the unions to preserve jobs and gain benefits for its members. Therefore, the best approach to analyse the union's objective is an inverse indirect proof. That is, consider Royal Mail was about to expand operations that would result in more jobs, with no published business plan, no pledge with the union and no established benefits packages for successfully operating the new service. Furthermore, a strike would be damaging and would likely result in a smaller expansion (fewer new jobs). Would the union still strike, or even threaten to strike, under these circumstances, or would the union consider non-strike actions the more applicable strategy? In this case, the public must decide if they support the strike or not, for they are the ones impacted (i.e., inconvenience and additional taxes imposed to compensate for lost revenues). Support means they will return to Royal Mail after the strike ends, and no support means they will vow to continue to use alternatives whenever possible.

On the issue of strategy implementation, clearly strikes can be a tool for addressing labor related issues. However, modernisation will entail workforce reductions, so labor reduction is a crucial element in the modernisation efforts. The initial strikes by the union made most everyone aware of the issues, but any further strikes, and especially a shutdown or full strike, will only inflict additional damage on Royal Mail. First, lost business during a full strike is not stored or recoverable, so the result is a total loss of revenue for the duration of the strike. Second, history shows similar strikes lead some to permanently find alternatives; therefore, some effects are long term. Third, a strike will force Royal Mail customers to seek alternatives, which means competitors will gain knowledge of which are the best customers to target after the strike ends. It is equivalent to showing your cards in a card game (others players may have had an idea what was in your hand, but now they definitely know, and it is to their advantage). Fourth, expect a competitor to offer "*relief services*" during the strike if the majority of UK residents oppose the strike, which will do nothing less than tarnish Royal Mail (including the unions), and result in "*reward business*" for the firm(s) offering the relief services. No strike is going to truly bring a resolution to the problem of preserving jobs, while reforms lead to the elimination of jobs. The outcome is a lose-lose situation.

There is a proposal to add banking to Royal Mail's portfolio of services. It may be a good idea, but the approach also has the potential for disaster. First, the concept is a copycat idea taken from Le Poste (France) rather than due to a formulated strategy, so just because it works in one culture does not mean it will work in the UK. Second, decisions on closing post offices have already occurred, and if banking is added, are the post offices going to be reopened? Each of the prior articles emphasised strategy formulation is a pre-requisite to implementation, rather than a "*wing-it-as-you-go*" process, unless of course, wasted money, effort and potential failure are all highly desirable outcomes.

The other major player in the modernisation effort is Royal Mail management and its leadership. The section on union strikes may have left some thinking the unions are to blame, but unfortunately, blame is not with just one group. First is the issue of EU open postal rule changes. When the rule changes were first proposed, that was the time for Royal Mail to recognise the need for a long-term directional change, developing a strategy that would keep Royal Mail competitive and potentially a leader in the EU market overall. Second, when letter volumes were first impacted, that again was the time to assess the market impact and develop a strategy to handle the threat. Third, management and its leadership should have remained diligent in the pursuit for efficiencies, but in their defense, most businesses generally focus on the efficiencies only during challenging business cycles (a common error). Royal Mail management and its leadership can argue certain limitations or rules prohibited actions, but the argument is invalid unless of course management and its leadership articulated each of the deficiencies, consistently presented the threats along with proposed changes, and remained active in the pursuit for change. Finally, management and the unions seem to be at odds, so much so that confrontation is likely to continue.

Errors demonstrate the proposed remedies (Postal Services Bill/Royal Mail changes) are likely not to have the results advertised, but there is no change in direction. Therefore, continued proofs and attempts to assist are illogical, so the best strategy at this point is to state or predict the outcome for Royal Mail going forward, presenting two past and very similar predictions.

In the mid 1980's, I was hired in the turnaround effort of a logistics operation involving overnight (expedited) shipping. The business was devastated by the prior shipping provider, Airborne Express, so much so that the company had no sales, to include no takers of free trial services offers, during the prior 3+ years. In fact, with some former clients were openly hostile towards the firm. An all out sales strategy was already created, and the company did not believe my assessment of the situation, nor my approach, would have any chance of success. Six month later and the company's plan produced no sales results (but did manage to increase hostility towards the company), so the company concluded the effort was futile. Then I applied my approach, although the company still believed their approach had the only chance of success. In less than one quarter, clients returned, and before one year had expired, all former clients (100%) had returned. Clearly, the firm knew the problems they faced, but the example demonstrates that knowing the problems is not sufficient in itself to solving the problems. Note, if their initial effort resulted in say 2%, 20%, even 50% of the clients returning, then the company's management would have falsely conclude that their approach was the solution, along with a false claim of having incurred the best possible outcome. It is next to impossible to argue what "*could have been*", so management almost always easily escapes accountability if the result is not a loss or if growth exceeds 0%, which clearly can be a mistake.

In 2003, DHL announced the acquisition of Airborne Express to quickly gain entry in the US express and package delivery logistics markets. My firm advised DHL against the acquisition, stating the risks exceeded the proposed benefits, and that more viable alternatives existed. I further advised DHL key success factors had to be properly addressed in order to achieve their goal of becoming number one or two in the market. They disagreed. In early to mid-2008, after losing roughly \$1 billion per year, DHL announced their next dramatic change. Under different management, I advised DHL Express against the plan ("*...it does not address the problems that hinder DHL's growth in the US market*"), stating that they could compete for number one, but their proposed plan will only have unattractive results. They disagreed, again. Then unattractive results lead Deutsche Post, parent of DHL Express, to announce full withdrawal from the domestic US express and package delivery markets. I decided to advise DHL one last time by contacting their parent company Deutsche Post (now Deutsche Post DHL). It included an assessment of their withdrawal plan and counterarguments to their [DHL Express] various erred arguments that attempted to explain away their failure, as well as a short-term and long-term outlook (prediction) for their express business overall.

First, FedEx and UPS will spend at least the first half of 2009 fighting each other, trying to get as many former DHL domestic US clients as possible (which was not the best strategy, but predictable). Likewise, FedEx and UPS will spend time attempting to convert DHL's largest international customers (a wasteful effort considering DHL surely anticipated the move and placed considerable resources and effort to ensure no major clients defected in the short-term). Once the *"land grab"* period ends, then global market strategies will once again take over. Second, DHL will post gains in emerging markets and markets with little or no competition (anybody can do that), but in competitive markets, DHL will see continued market share declines. In short, the full withdraw from the US market will be significant relative to the US market, with little market share impact in most all other markets in the short-term. Long-term, DHL will experience market share declines, except in emerging markets or non-competitive new markets. Note, revenues are important, but market share distributions will show the impact predicted. Deutsche Post again opted not respond, just like in 2003, and that error cost them close to \$10 billion in losses due to failure. What will the cost of ignoring facts be this time around? Finally, on 22 September, DHL provided an update on the impact of the US domestic withdrawal saying, *"...but the changes in the US did not involve a significant shift of business internationally"*, meaning FedEx and UPS were not able to gain the numbers of international clients they each predicted or anticipated. The statement confirms my first stage prediction (that is, my short-term DHL prediction), which contradicts the expectations of FedEx, UPS, analysts and probably others too. It is not that logistics firms do not know their businesses, but turnarounds and overtaking a competitor are not simple, basic feats.

Now for the predictions for Royal Mail, which cannot be too specific because many decisions have yet to be made or finalised. However, this and the prior articles define most all of the major errors, along with their resulting consequences in general terms, if not specific. On part-privatisation, the main objective appears to be cash generation, with decision makers ignoring viable alternatives; therefore, a minimum 49% sell-off of Royal Mail will be approved, with a large portion of the percentage allotted in the initial sale. A competitor is the least attractive partner, but the likely winner after giving them concessions. Digital declines (and basic pricing/profit strategies) are clearly still misunderstood, so efforts will be employed to *"chase after"* these digital markets, with virtually all results ending in costly *"experiments"* (with one digital service exception, but I have not seen nor heard anyone mention it). The Hooper Report's recommendations on regulatory changes will all be adopted. Political involvement will increase, not decrease, making future changes even more difficult. Automation and efficiency changes will likely result in continued excess capacity. Royal Mail management and leadership will continue to clash with labor and the unions, with no real personnel changes. Nothing significant will result in the area of new, innovative, higher-margin services that generate consistent competitive services with attractive profits. Long-term growth plans will focus on expansion. Losses will force the discussion of a further selloff (maybe two years after the completion of automation).

The first article covered several major errors in the Hooper Report (as well as the Postal Services Bill) and closed with a statement that additional errors existed. Nobody inquired about the additional errors. Likewise, the challenge that was provided in the first article offered a significant financial solution if the errors presented could be proven not to exist. It was not possible to win the challenge (errors exist), but nobody bothered to inquire about the financial solution anyway. The second article, a week later, presented several more errors in the Hooper Report, and closed with a statement that additional errors existed. Two and a half weeks were allowed to pass, but still no inquiries were made by officials regarding the errors. The third article covered two more major errors in the Hooper Report, and ended with a statement that more errors existed. Again, no inquiry was made about any additional errors or even solutions. Last week, the fourth article did not generate any inquiries either.

Many errors and problems exist, and it is impossible to achieve a successful outcome if the errors, as well as proposed solutions, are ignored, with rhetoric and ridiculous, unsubstantiated threats of absurd outcomes creating further divide and unnecessary animosity. Errors, like facts, do not care, and will not change, simply because of your title, or position, or income, or level of influence. The only way to achieve a successful outcome is to properly understand the facts, as well as the entire problem set, devise or engineer solutions that address the actual problems, taking into consideration all internal and external factors, and implementing the solution in a logical or appropriate ordering. Unanimous agreement is not likely, but agreement nonetheless is required. If decision makers presume their approach is the best approach, without proper consideration of alternatives, then the problem will likely persist, and future attempts to solve the problem (resulting in even higher costs) shall be required.

There is a phrase, *"You can lead a horse to water, but you cannot make it drink."* Having worked with horses since I was seven, I can say if a horse needs to drink and you lead it to drinkable water, it will drink. A donkey, on the other hand, near death from dehydration can be led to pristine waters, and it will stubbornly refuse to drink to its own detriment (death). If the debate is led by personalities mimicking donkeys, then no argument will be sufficient to change a negative position. On the other hand, if the personalities mimic that of a horse, then logic will surely prevail, resulting in above average solutions rather than mere remedies.

The issue of preserving universal service is one all national postal services face, so it is imperative the right solutions are undertaken, and there is no reason it cannot be done correctly the first time. A discussion has to take place, rather than the approach seen to date, and until that time comes, modernisation will remain in limbo or fall well short of an average solution.

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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