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Part-Privatising Royal Mail *(REVISED)*

The push for part-privatisation of Royal Mail Group (RMG) continues, with Prime Minister Gordon Brown and Business Secretary Lord Mandelson using the Hooper Report (officially known as *"Modernise or decline, Policies to maintain the universal postal services in the United Kingdom"*, 16 December 2008) as substantive evidence that the Postal Services Bill (the "PSB") is the correct approach to resolving the many problems at RMG. Even the opposition party believes part-privatisation and the PSB will solve RMG's problems. What if a number of the assumptions and conclusions in the Hooper Report are erred? Two such errors are presented.

The Hooper Report states, *"...postal services increasingly compete directly with broadcasters, internet, and telephone companies in the communications market."* There are known declines in letter volumes due to increased usage of email, text messaging, IM and other forms of electronic communications. A long established example of the grocery store vs. restaurant markets will aid in demonstrating the first of two Hooper Report errors, along with an example of the impact of a disruptive technology on non-competitor markets.

In economic prosperous times, people generally go out to dinner more frequently, resulting in a decline in grocery store sales. This is an established relationship, which is logical, and therefore, in economic depressed times, restaurant patronage declines and grocery store sales increase. Notice, price is not the determining factor directly, but rather the perceived economic situation. Furthermore, the direct relationship, although known and established, does not mean the two are in the same industry, or that they are competitors. The Standard Industrial Classification (SIC) has all retail trade classified as industries #52 through #59, with grocery stores in the Food Stores industry (#54) and restaurants in Eating/Dining Places industry (#58). They are not in the same industry even though both deal with food/beverages; and they are not competitors although grocery stores can offer a form of meals (i.e., salad/hot food bars and eating areas). The claims are best proved via an example.

Pick a 5-star hotel with one or more restaurants. It does not matter which grocery store you select, the two establishments are not competitors in any economic environment. At the lower end of the restaurant scale, one could occasionally stretch the argument that there exists a possible substitute relationship under certain conditions; however, those irregular occurrences under extenuating circumstances should not be relied upon in development of a business model or strategic long-term plan if success is the desired outcome. In any respect, until one can enter a restaurant, select individual items similar to those offered at a grocery store (e.g., celery, bleach, raw lamb, rosemary, dishwasher detergent, et cetera) and purchase them, the two businesses are not in the same industry, nor are they competitors. As for grocery stores, until they are a desired destination for dining, entertaining and atmosphere, the establishments are not competitors. To clarify, Royal Mail is the restaurant and telephone/internet companies are grocery stores.

Turning attention back to RMG, telephone companies offer electronic communications, and internet companies offer a host of online services, to include various electronic communications. Neither offers physical delivery services as their primary business. RMG offers physical delivery of letters, postcards and small packages, and to my knowledge, offers absolutely nothing in the area of electronic communications services such as email, IM, text messages, cell/landline phones, et cetera. In fact, RMG is not in the communications industry at all, with the sole exception of postcards (a miniscule market in itself). Undoubtedly, many vehemently disagree, but ignoring for a moment what is contained in most letters, persons purchase the right to have a small package or letter physically taken from one location and delivered at another in some set time period. If a small package contains a food item or a letter contains a radon gas sample, neither are communications. In fact, universal postal service is daily physical delivery/pick-up at every physical address, and not daily communications.

To those that would argue the difference is subtle and does not matter, the difference may seem subtle, but it definitely matters. An understanding, and correct classification, of one’s primary market is essential to success. In marketing, understanding your market is second only to location, location, location, and thus, definitely matters. Physical delivery services represent an accurate, and much broader, span of potential market opportunities, whereas a communications provider is focused only on communications services. Since RMG does not offer communications services (aside from postcards), focusing on such area of least competitive strength is a recipe for disaster.

Some will argue letter volume declines are due to email, IM and other communications services (no argument with that), so the firms must be competitors, or at least in the same industry (not necessarily). A discussion of disruptive technologies will address the issue. Disruptive technologies by definition disrupt markets due to technological advancement, and the disruption is not limited to just markets or industries with traditional or direct competitor relationships, which is one reason the phenomenon is known as disruptive. Put another way, disruptive technology displaces a competing product/service or an entire market, with disruptions extending along the displaced supplier’s and buyer’s "chains", directly impacting otherwise unrelated markets and industries, although the impact is not always negative. In other words, letter volume declines are actually due to the advent of a disruptive technology, that is the internet, but the same disruptive technology has led to a demand increase in small package delivery services. The relationship between increase internet communications (i.e., email) and letter volume declines, although on the surface appears to be direct and a result of a competitor relationship, is actually not.

An example will assist in understanding the concept. The advent of the automobile was a disruptive technology at the time, much like the internet is for this century. The automobile displaced the horse and carriage as the primary mode of transportation, and obviously the two were competitors in the transportation market. Furthermore, it is well documented the buggy whip industry (accessories market) was decimated by the popular growth of automobiles. Buggy whips were accessories for horse carriage owners, used much like an accelerator pedal is used for an automobile (i.e., to accelerate the horse). Still, buggy whips and automobiles are not in the same market, nor are they competitors. However, to most buggy whip producers of the time, it truly seemed plausible to state the two were competitors due to the direct impact automobiles had on the buggy whip industry. Buggy whip producers that understood the relationship (i.e., not competitors) were able to adapt and remain competitive in their markets.

RMG is the buggy whip producer and the internet is the automobile. To make the association that RMG represents the horse/carriage market would, in fact be incorrect, and exactly what most buggy whip producers of the time did, which led to their demise. Again, there undoubtedly are those that still disagree and contend RMG is in the communications market, or that postal services increasingly compete against broadcast, internet and telephone companies. This continued disagreement must be dispelled if a solution is to be reached, rather than mere remedies that compound the problem over time, so a proof using marketing itself is needed.

According to Prof. Philip Kotler, the recognized global leading authority on marketing, an industry is a group of firms offering a product or class of products that are close substitutes. Close substitutes are defined such that a price increase in one substitute product results in a market demand increase in the associated substitute product, or inversely, a price reduction in one substitute product results in a market demand decrease in the associated substitute product. Competitors obviously have substitute products. Grocery stores and restaurants are not competitors because product price itself is not the factor that changes demand.

RMG's letter volume demand declines are the result of expanded usage of email, IM, text messaging and other forms of communication, but demand changes are not the result of a price increase/decrease of a resulting associated substitute product; therefore, the two businesses are not in the same industry and are not competitors. Instead, the letter demand reductions are due to the advent of the disruptive technology—the internet, much like the buggy whip's demand reduction was due to a disruptive technology. Again, some examples help explain the concept.

Beginning with telephone companies, a decrease in postal rates must result in a decrease in demand for telephone services (cell phone, landlines and text messaging) if the two are in the same industry or are competitors. Reasonable persons will conclude even free postage (i.e., postal rate reduced to zero) would not reduce demand for cell phone, landline or text messaging. On the other hand, any price change in telephone rates would result in a proportional change in telephone demand itself, and no change in demand for postal services. Therefore, the two are not in the same industry, nor are they competitors. This is absolute, remembering that the demand change is change for the entire market.

Regarding the internet (and broadcasters), a change in price must result in a change in market demand for RMG if they are in the same industry or are competitors. Internet services involve much more than just email, IM, tweets and other forms of electronic communications, for example, school work, research, entertainment, portfolio management, banking, telecommuter work, et cetera. Therefore, a price change for internet service is unlikely to be directly associated with any single service, so a demand change at RMG is also unlikely. Taking the inverse, if RMG lowered its price, a resulting decline in market demand for internet services is not likely. Therefore, the two are not in the same industry, nor are they competitors. Postal services have long been a market for sales and marketing, so any change in price would result in a demand change with or without the internet, so it can be ignored or excluded. Finally, internet-based communications offers businesses paperless billing, statements, catalogs, et cetera, so even with an unrealistic postal rate of zero (free, no fees), businesses (excluding sales and marketing activities, which were already addressed) would continue to opt for paperless internet-based communications to eliminate or reduce paper, envelope, ink, printing and other costs, so there is no real demand change. Conceding one could plausibly argue some kind of demand change may occur, reasonable persons should conclude any realistic price change by RMG, internet providers or broadcasters is unlikely to change the overall market demand (excluding sales and marketing activity, which existed beforehand), so therefore, the two are not in the same industry, nor are they competitors.

At the market level, the arguments become a little less clear, so I offer a challenge to show the lack of comparable products and dispel any final disagreement or doubt that RMG is not in the communications market and RMG does not compete with telephone, internet and broadcasters. Either (1) enter any RMG post office and purchase directly from RMG any online (internet-based) email or IM service offered at the time of submission of this article, or (2) enter any legitimate and properly registered telephone company in the UK with a physical letter or package and purchase any physical delivery service offered directly, and provided in full, by the telephone company at the time of submission of this article. If either or both can be successfully executed without special consideration, or use or purchase of another business' services, I will concede (a) RMG is indeed in the communications market, and (b) in competition with telephone, broadcasters and internet companies, while providing in return for wasting everyone's time (c) a solution for potentially reducing the UK government's overall debt obligations for RMG's modernisation efforts and past deficit pension obligations, thus potentially eliminating the need to part-privatise RMG.

Given the proofs, as well as the inability to successfully execute the challenge, RMG must now be unequivocally recognised as not in the communications market and not in competition with telephone, internet and broadcasting companies, which leads to the second error in the Hooper Report. The report made the recommendation for an RMG regulatory change from PostComm, the postal regulator, to Ofcom, the communications regulator. Clearly, the recommendation is in error. There are additional errors, serious errors, in the Hooper report, and as a result, errors in the PSB.

The problems RMG faces (as well as other national postal services offering universal service in the EU's expanding competitive postal market) are serious, and the issues are serious too, for as long as the problems are misunderstood, a solution is unlikely. Without a solution, there is a risk of potential loss of universal service in the future or a significantly higher cost to execute another attempted solution. The issue is not who is right or who is wrong, or even what political party makes the changes, but rather, what are the actual issues/problems so mere remedies can be avoided and actual solutions developed and implemented.

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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