



POSTAL OPERATORS: THE NEED FOR TRANSFORMATION AND CORRESPONDING STRATEGIC MOVES

From cash cows to key assets for future development

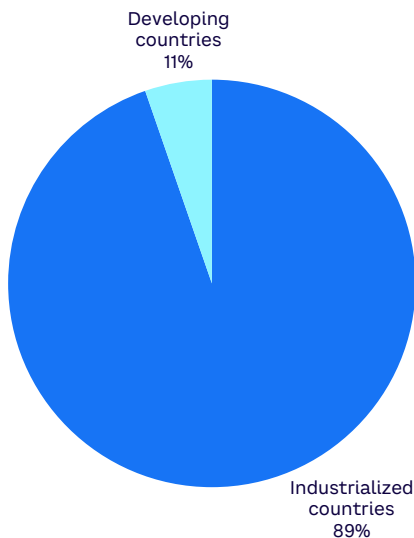
From the first horse-drawn couriers to drone delivery via creating the “penny black” stamp, the automation of sorting, and so on, postal operators (“posts”) have always adapted. Moreover, given their public service spirit, they have shown great resilience to unforeseen obstacles. This explains their longevity. But digitalization of the economy is changing the context of posts — in a positive way as e-commerce increases but negatively as mail and retail networks use declines. Their resilience is being tested and will require major transformations; posts need to utilize their tools and assets to face up to this and continue their development.

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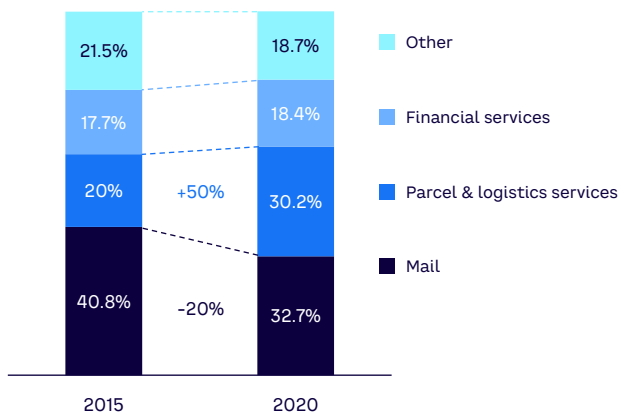
Historically, in order to fulfill their public service missions, posts have deployed large networks for the transport and distribution of physical mail and for direct contact with the public at large for various operations at the retail counter (e.g., delivery of undelivered documents or parcels, postage, payments, banking activities). The relative importance of these activities depends strongly on the country. In particular, mail is a predominant activity in industrialized countries, which account for nearly 90% of total volume processed worldwide (see Figure 1).

Figure 1. Total volume of mail processed worldwide



Source: Arthur D. Little

Figure 2. Average posts revenue breakdown



Source: Universal Postal Union (UPU)

TRANSFORM TO STAY ALIVE

Whatever the breakdown of their business portfolio, all posts are experiencing a rapid transformation of their traditional activities, marked by an accelerated decline in mail volumes; a decreasing utility of their retail networks for historical purposes, which are largely being digitized (e.g., bill payment, government services, banking activities); and the rapid development of logistics and transport of parcel activities driven by the growth of e-commerce (see Figure 2). These underlying trends have been further amplified by the disruptions of the COVID-19 pandemic. However, despite the dynamics of demand that have been at work for more than a decade, mail (including personal/business mail, advertising, and magazines/newspapers) still accounts for a major share of the activity of posts — and is still higher than parcel and logistics activities in many countries.

We might think that changes in historical activities could have little effect on the profitability of posts as they counterbalance each other, but this is hardly the case. On the contrary, there is strong pressure on posts' operating results due to the following challenges:

- Mail, where it has been a developed means of communication, was formerly a very profitable activity, thanks to nominal competition (with the exception of a few countries) and significant economies of scale in the context of high fixed costs. Today's sharp drop in volumes has gradually reduced these economies of scale, and tariff increases are generally no longer sufficient to stabilize results, forcing posts to reconsider their service model and to request adjustments to the Universal Service Obligations (USOs).
- The decline in the number of people using general public networks for traditional operations is also having a very strong impact on the profitability of posts, given the high fixed costs (staff, real estate) of these networks.

- The parcel business is historically much less profitable than mail (see Figure 3) due to intense competition (its dynamics attract the interest of both traditional players and startups with varied positioning) and, moreover, requires significant investment to meet growth in demand. Generally, economies of scale are much less than in its mail business counterpart and the seasonality of demand is very strong. Both factors limit improvement in results, despite the growth in volume processed.

In these circumstances, posts must manage the decline of their main activities over the long term, while at the same time organize development of growth areas and of e-commerce activities in particular. Therefore, transformation of the business model is no longer optional; it's mandatory to stay valid.

There are three main strategic priorities for posts:

- 1. Defend/maintain the profitability** of their mail business for as long as possible, particularly by transforming their business model, which has not adapted to the significant changing personal/business communications needs.
- 2. Capture the growth of e-commerce** in the field of logistics and parcels and develop the competitiveness and profitability of this activity by relying on mail assets.
- 3. Diversify the business portfolio** by leveraging mail and retail assets and entering into attractive markets. These diversifications are also useful when it comes to completing the load of mail carriers and office networks in order to better employ them and contribute to the overall profitability of the company.

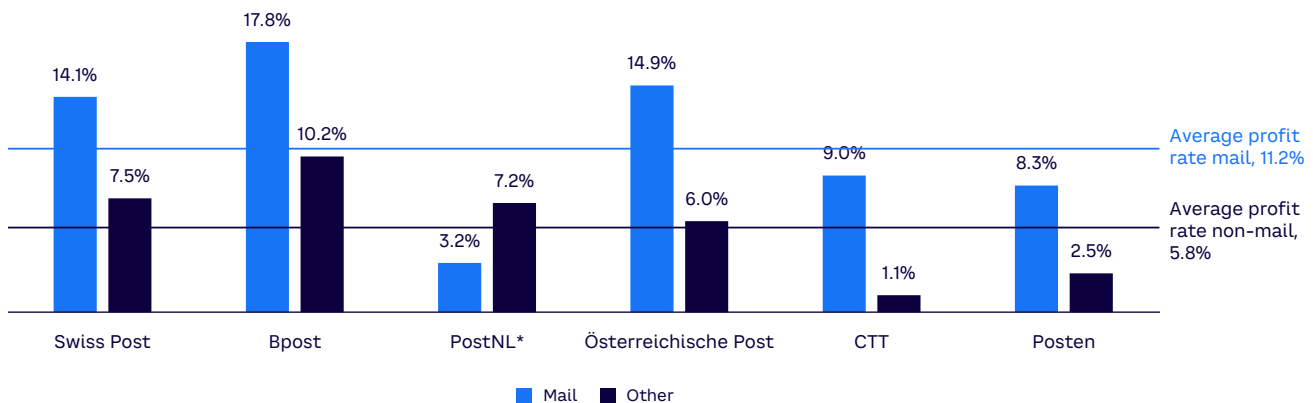
DEFEND PROFITABILITY OF MAIL IN ALL DIRECTIONS

Posts have long been adjusting to the decline in activity in mail and retail networks. Certainly, there is no “magic formula,” to overcome this challenge, but a combination of actions, when implemented simultaneously, make it possible to defend profitability when the decreases are not too severe.

In addition to promoting mail as an efficient means of communication to alleviate or slow the decline in demand, posts are taking several actions to mitigate costs:

- Offsetting most of the volume decline with targeted price increases.
- Reducing overheads and indirect costs, particularly in the IT and digital areas, by adapting systems.
- Adjusting work rhythms and reducing nonproductive time to achieve a competitive hourly labor cost.

Figure 3. EBIT/sales ratio for selected posts, 2019



*There was fierce competition in the Dutch mail market until 2019, when approval of the merger between PostNL and Sandd took place, which explains PostNL's lower level of profit in mail.
Source: Arthur D. Little, postal operators' annual reports

- Adapting the logistics network (sorting and transport) downward, focusing on a smaller number of platforms.
- Optimizing automation and delivery routes.
- Increasing the mutualization of activities in the operational processes.

THE MOST EFFECTIVE LEVERS FOR ACTION ARE THOSE THAT FOCUS ON REDUCING COSTS AND MAKING THEM MORE VARIABLE

But this recipe for action has its limits and cannot be renewed indefinitely. Moreover, in the context of mostly fixed costs, decreases in activity end up being prejudicial. The most effective levers for action are therefore those that focus on reducing costs and making them more variable, as well as recreating economies of scale.

USOs, which have changed little in the past despite the transformation of communications media that may have made them partly obsolete, are responsible for a significant proportion of the fixed costs of posts. However, their adaptation or renegotiation are complex, require changes in directives and postal laws by countries, and can be subject to obstacles due to the symbols they represent. Consequently, in order to recreate the economies of scale that in the past have enabled mail to achieve very high levels of profitability, actions may include:

- Outsourcing part of the retail network to third parties.
- Creating and promoting nonurgent products with sufficiently attractive prices for these products to progressively concentrate most of the demand.
- Implementing new organizations at the delivery level (more than 60% of operational costs) with mail carriers working only every other day or every day but alternately distributing across two different rounds.

Observations & convictions – Traditional recipe to maintain profit

- The **price elasticity** of mail demand is quite low (with the exception of advertising mail), and the price effect on volumes is negligible compared to the effects of digitalization and changes in communication habits.
- With **heavily labor-intensive activities**, despite automation efforts, controlling hourly costs and improving productivity are keys to success. In this context, processes must favor all pooling between mail and parcels (this contributes to the productivity of mail carriers and the cost competitiveness of parcels) as well as a mixed use of counter staff (who can become carriers during low attendance periods in the retail network). This last point serves as justification for not dissociating the organizations of the different networks (industrial and retail).
- **Change management**, particularly with the implementation of diversification projects, is facilitated by postal workers' strong awareness of the need to change, as they observe on a daily basis the drop in volumes in sorting and distribution centers as well as the decline in traffic in the retail network.

Observations & convictions – Rebuilding economies of scale

- Changing the **offer and pricing** to drive demand toward more profitable products is safer and more effective than relying on changes in USOs.
- In terms of the **retail network**, it is important to find the right balance between complete outsourcing, which allows for cost variability, and diversification, which generates value.
- **Alternate delivery systems** are very effective and, per ADL analysis, can reduce the unit cost of delivery by nearly 30%, particularly in low-density and horizontal housing areas. Delivery every three days, and eventually every week, can replace delivery every other day when a decrease in volumes becomes more important.

CAPTURE GROWTH OF E-COMMERCE

The growth of e-commerce is leading to a boom in the volume of business-to-consumer (B2C) parcels, which doubles every four to six years depending on the country, according to ADL analysis.

The four main purchase criteria of e-commerce customers (e-retailers) are:

1. **Price**, because logistics and transport costs are high for merchants, retail margins are low and declining, and also because free delivery for the consumer is a key to success.
2. **Speed**, because there is an elasticity in demand for fast delivery of purchases (impact on the conversion rate proven and impact on demand observed, for example, at Target in the US, where 50% of digital growth is linked to the "same day" delivery offer). This speed reduces the structural handicap of e-commerce compared to physical commerce and explains why "next day" delivery has become the market standard in many countries.
3. **Convenience/simplicity for the consumer**, which is essential for removing barriers to online purchase and building lasting loyalty. Indeed, the delivery experience is a "moment of truth" for the consumer, as all surveys on the subject demonstrate. Depending on the product, this convenience can result from a dense network of parcel pickups/drop-offs (PUDOs) or lockers, as well as the options of delivery to a mailbox, to a neighbor, in the evening, during a chosen time slot (less than two hours), or on demand.
4. **ESG practices of the logistics providers**, particularly with regard to the reduction of polluting emissions. This demand is still emerging among consumers but is becoming increasingly important among e-retailers as logistics and transport providers are investing heavily in this area, with many major players targeting net-zero carbon emissions by 2030.

THANKS TO THEIR HISTORICAL MAIL AND RETAIL ASSETS, POSTS CAN COMPETE ON ALL FRONTS

There are three main positioning options for competitors in this market:

1. **The low-cost operator** seeking to capture the maximum volume of traffic and all types of product categories to cover its fixed costs.
2. **The operator differentiating** through service (e.g., same day, delivery slot) and targeting fewer product categories (e.g., food, wine, household appliances).
3. **The niche operator** for complex products requiring, for example, installation or delivery by two people, which limits the number of product categories targeted.

Thanks to their historical mail and retail assets, posts can compete on all fronts by simultaneously offering low cost and high value-added offerings, all of which can be very competitive. Thus, they can combine the following three positioning aspects:

1. A dense network of PUDO points, potentially complemented by lockers.
2. A delivery system to mailboxes of small parcels, whose delivery can be mutualized with that of mail and thus be very competitive.
3. The use of mail distribution centers as microhubs in cities, enabling delivery by soft modes (cargo bikes, in particular) for more ecological and economical delivery and to develop delivery services (evening or time slot delivery), thanks to the proximity of these urban distribution centers.

This need to develop competitive and differentiated offers for parcel delivery is particularly important for some posts that are additionally challenged by players like Amazon on logistics and last-mile delivery.

Observations & convictions – Building both low-cost and high-value offerings in parcels

Based on our experiences, projects, and observations, we have developed several strong beliefs on how to develop the competitiveness and profitability of the parcel-logistics activities of posts:

- Within their **end-to-end mail organizations**, posts can process a portion of small parcels at a much lower cost than their competitors. The development of format-based pricing can give them a significant competitive advantage, as 20%-50% of parcels (depending on the country) can be handled in formats in which posts have no real competitors, according to ADL analysis.
- The **density of postal networks**, particularly in cities, gives posts a strong competitive advantage in parcel delivery, especially during times when access and traffic constraints in cities are increasing. It is also possible to improve the hand-delivered parcel service by carrying it out in the evening (after having deployed an adapted organization).
- Achieving a **critical size** on these evening parcel delivery services allows the expansion of value-added services, thanks to the density of the network: same-day delivery, delivery on selected time slots, delivery on demand, and so forth.

LEVERAGE NETWORK ASSETS TO DIVERSIFY REVENUES

For a long time, posts have been diversifying away from the business of communications and transport of small domestic goods. They have been building leaders in financial services and banking/insurance, such as Japan Post, Poste Italiane, and La Poste, with activities that initially benefited from the mutualization of the retail network, but also by going outside their own countries to extend their networks and cover transnational express and parcel exchanges as the globalization of the economy progressed (e.g., Deutsche Post DHL, Royal Mail/GLS, La Poste/DPD, Japan Post/Toll). (Note: here, we do not address these diversifications at the international level or in the field of banking/insurance.)

Diversifications are necessary for postal companies because the sharp decline (or even the potential disappearance) of their historical activities in mail and retail completely challenges their domestic business models. Diversifications may take the form of positions in new businesses that have no particular connection with traditional activities or, conversely, of developing in coherence and synergy with them. In this case, their purpose is twofold:

1. Enhance the value of commercial or productive assets (the networks) in attractive new markets, where these assets can contribute to the creation of a competitive advantage.
2. Bring additional workload to the different networks by contributing to cover part of their fixed costs, which are important.

For posts, these diversifications can be done in three main domains close to their historical activities: (1) physical distribution (valorization of the retail network), (2) communications (by extension of the usages of the mail), and (3) logistics and transport (valorization of the mail-parcel network). Lessons to be learned from such diversifications include:

- The diversification of the retail networks of posts has most often been a failure, which explains the very high level of outsourcing of these networks by posts that do not offer banking or insurance services. The main significant exception is the development of mobile virtual network operators (MVNOs), whose offer is marketed in post offices (e.g., in Italy and France).
- The diversification of posts into digital communications has most often been a failure, consuming a lot of cash for disappointing results. However, there are exceptions, especially when they have been initiated in collaboration with governments to support paperless policies.
- It is in the field of logistics (and reverse logistics, or the circular economy) that diversifications are both the most natural (in line with the assets and know-how of the posts) and the most attractive, with developments in terms of service (same-day delivery, time-slot delivery), format (from letter to pallet), and products (e.g., fresh food, healthcare, sensitive products).

Observations & convictions – Lessons learned from diversifications

The lessons we have learned from posts over the past 20 years, based on the benchmarks we have conducted and the projects we have assisted, include the following:

- A **call for partners** is an effective way of diversifying the use of retail networks, making the most of their density and the commercial power they allow in B2C business. This has been the case for MVNO developments.
- In addition, these calls for partners can be implemented effectively for **diversification in logistics or last-mile activities** other than postal services. They have the benefit of being much less risky than acquisitions and quickly reveal potential synergies.
- Despite the status of a trusted third party of the post, it is **very complex and risky** to try to diversify the networks into B2C service activities, which are not necessarily compatible with the business model and require skills that are difficult to standardize across very large networks.
- With **urban postal organizations** of mail delivery traditionally very close to the urban logistics models that are becoming the norm, posts can diversify the use of their mail transport and distribution networks and become leaders in carbon-free urban logistics.

CONCLUSION

TRANSFORM ON THREE PILLARS AND PREPARE FOR NEXT TRANSFORMATIONS

SALVATION WILL COME FROM IN-DEPTH TRANSFORMATION

For posts, in the context of a severe decline, or even disappearance, of their historical activities, and with the simultaneous very strong growth in e-commerce, doing nothing is not an option. In fact, their salvation will come from in-depth transformation. In the short term, three major reorientations are necessary:

- 1 Transformation of the historical business model.
- 2 Development of a strong competitive position on the e-commerce parcel, thanks to the historical assets.
- 3 Diversifications in new businesses.

All this must be carried out simultaneously with a dual ecological and digital revolution. Moreover, posts must follow an in-depth transformation, one that will continue to evolve and always anticipate the next move, because a vast array of new technologies — net-zero carbonization, robotic process automation, autonomous vehicles, or blockchain — will demand continuous transformation in an increasingly digital environment. More than ever, CEOs and their teams need to work with an ambidextrous mindset that balances creativity and rigor in solving today's most pressing challenges and seizing tomorrow's most promising opportunities.

NOTES



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Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. ADL is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

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