Postal Regulatory Commission
Submitted 7/16/2010 1:25:40 PM
Filing ID: 69111
Accepted 7/16/2010

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Estimating Volume Changes from Pricing Incentive Programs	:	**Docket No. RM2010-9**

COMMENTS OF THE SATURATION MAILERS COALITION AND VALASSIS DIRECT MAIL, INC.

(July 16, 2010)

In its Notice of Proposed Rulemaking in this proceeding, the Commission requests comments on methodologies for estimating volume changes caused by broad-access and relatively short-term pricing (volume) incentive programs. It is keenly interested in estimating the amount of new volume and contribution generated by such programs. However, the issues on which the Commission requests comments affect not only those broader pricing incentive programs but also longer-term initiatives such as individual Negotiated Service Agreements (NSAs). Our comments are principally directed at the short-term broad programs but extend also to NSAs and other longer-term initiatives.

So far, the Commission has authorized the Postal Service to conduct four short-term broad programs: the 2009 Saturation Volume Incentive Program (VIP), the 2009 Summer Sale for Standard Mail, the Fall 2009 First Class Presort Incentive Program, and the 2010 Summer Sale for Standard Mail. It has examined the results of one of those programs – the 2009 Summer Sale.

These programs can be both a way to generate additional short term revenue, especially during a seasonal or cyclical drop in demand, and an important part of the Postal Service's long-term strategy to retain customers and remain viable. As the

Commission has noted previously, a discount will always generate more volume than otherwise, all else equal, and if the revenue from the additional volume is greater than the additional cost, such discount can lead to greater contribution to institutional costs.[1] Any time the additional revenue exceeds the additional cost, there is an economic efficiency gain. That gain is even greater if the additional volume takes advantage of "excess capacity" in the system that would go unused without the discounts.

Likewise, NSAs and other longer-term postal rate initiatives are designed to generate greater contribution to institutional cost by promoting new volume as well as retaining existing volume. Stemming further volume erosion is even more critical to the Postal Service's viability than short-term gains – preventing existing mail from becoming "where'd it go" volume.

The objective in either case, of course, is that the contribution from the additional volume generated by the discount be greater than the contribution lost from providing the discount to volume that would be in the system even without the discounts. Or, alternatively, that the contribution from retained volume that might otherwise have been lost is greater than the retention discount. How can one tell the difference between new pieces and "anyhow" pieces, or identify mail that is at risk of becoming "where'd it go" volume? The Commission recognizes that estimating "anyhow volume," "where'd it go volume," and new volume and contribution stimulated by those programs is not an easy matter.

---

1 See, e.g., Opinion and Further Recommended Decision, MC2004-3, April 21, 2006.

Effectively, there is no way to accurately estimate the amount of volume that would have been generated by a mailer or group of mailers in the absence of an incentive price, or the amount retained that might have otherwise been lost. Aggregate mailer trends, individual mailer trends, or a calculation using a presumed price elasticity may be used to "mathematically estimate" that amount. Though it may be reassuring to have such a quantitative analysis, the numerical "precision" of that result should not be construed as being either reliable or accurate. Despite having a quantitative result to point to, it will likely be misleading. Dependence upon such results could lead to the wrong conclusions.

For example, we have concerns about the use of price elasticities taken from the current subclass demand models to estimate "anyhow" volume for either the short-term, broader programs or for NSAs. Those elasticities are derived from historic changes in volume and price that may not reflect current or future market conditions. Moreover, the demand models are designed to estimate volume changes rather than true price elasticity. They do not include all control variables necessary to estimate true price elasticity and they assume constant elasticity. They are also based on aggregated volumes from diverse mailers although individual mailers within a demand model's aggregation will likely have different elasticities (and different seasonal and cyclical patterns). And, as noted by Mitchell, the elasticities are from models that assume the same price is paid for *all* the quantity purchased.[2] Finally, using price elasticity alone to estimate "anyhow" volume cannot account for volume changes caused by shifts in the

---

[2] Comments of Robert W. Mitchell on Proposed Summer Sale 2010, Docket No 2010-3, March 22, 2010.

demand curve or impacts caused by prevention of a downward shift in the demand curve (e.g., improved competitive alternatives, decreased mailer profitability due to postal cost shifting, reductions in service quality, etc.).

There are also numerous flaws in the alternative estimating approach the Postal Service used for its 2009 Summer Sale, as documented by both Mitchell and the Public Representative.[3] In reality, there are flaws with any approach that does not recognize and take into consideration the individual characteristics of each mailer and its market. In many cases, even a mailer may not be able to estimate, prior to the implementation of an incentive program, what it may be able to do with either short-term or longer-term incentive pricing. Market dynamics and opportunities change quickly. Enrepreneurial innovations cannot always be predicted.

Further, no one can estimate in advance the longer-term (demand-shifting) effects that could be generated from both types of programs – e.g., increased mailer confidence in the Postal Service and willingness to stay in the mailstream; mailer ability to introduce a permanent new program, product, or customer; improvements in USPS understanding of mailers and their markets, etc. But these effects, even if they cannot be precisely quantified, should not be ignored. The shorter-term incentive programs likely produce more than just short-term increases in volume. Moreover, initiatives that couple volume retention with longer-term growth incentives could permanently shift the curve in favor of postal distribution and away from the many competing communication

---

[3] Mitchell, ibid.; Comments of the Public Representatives, Docket 2010-3, March 22, 2010.

channels. Both types of programs should also be considered Postal Service marketing investment that will produce better efforts and results in the future.

The Commission and Postal Service cannot know all mailer and market characteristics and cannot predict these longer-term demand-shifting or demand-preserving effects from either type of incentive program. Instead, they should be focusing on ways to create an environment that makes use of the mail attractive and affordable for businesses to prosper in the competitive marketplace. Hopefully, the Postal Service is in the process of learning how to create this environment – in part by continuing to offer incentive programs and thoroughly reviewing their results.[4]

The Postal Service clearly needs to improve its marketing skills, techniques and infrastructure as well as acquire a better understanding of the diverse sets of mailers and markets that are served within Standard Mail (and within other mail classes as well) and then serve each of them with different postal products priced on the basis of those mailers' specific market conditions.[5] The broader short-term incentive programs the Postal Service now offers are one way to obtain knowledge that will move it closer to that point. Yes, in that process, there may be some "anyhow" volume that will be discounted, but that contribution loss should be considered both in terms of the regulatory and administrative constraints binding the Postal Service as well as in terms

[4] For example, the USPS survey of the 2009 Summer Sale participants is evidence of its attempt to obtain a deeper understanding of the program results. As the programs continue, the Postal Service will be able to study and report estimates of the longer-term effects of the programs.

[5] For example, in our comments in RM 2009-3, we explained the reasons why Saturation and High-Density Standard "program" mail should be considered separate products with differing market and postal demand characteristics.

of postal investment in better market understanding. By comparison to the minimal regulatory attention focused on contribution maximization or total contribution generated when the Postal Service changes its general schedule rates, the emphasis on “anyhow” volume from relatively small-scale, short-term programs seems excessive. While oversight can serve a useful and even necessary stimulus in encouraging disciplined business decisions by the Postal Service, micro-management of these efforts through the regulatory process is penny-wise and pound-foolish.

The preoccupation with “anyhow” volume ignores an even bigger threat to the Postal Service: the “where’d it go” volume that has left the mailstream. Initiatives to retain existing volume – the current base – are at least as important as those to generate new volume. Twenty years ago, “where’d it go” volume was not an issue. Then, the Postal Service had a true monopoly and did not have to be concerned about marketing to its customers’ needs. That “monopoly” is now a shambles. Mailers now have multiple new channels to reach their audiences, many that are lower cost and/or more immediate.

The problem in identifying “where’d it go” volume is even more acute than “anyhow” volume: you can’t be sure what mail it is until it’s gone, and then it may be too late to get it back. But the Postal Service must make the effort to identify “at risk” volumes and mailers, and to develop programs to retain that mail using its knowledge of the mailers and the marketplace and its best business judgment. This is not a “science” that is susceptible to easy mathematical modeling and measurement. It is instead good old business judgment like that practiced daily in the private sector – knowing your customers and your market, being aware that you don’t really have a monopoly hold and must respond to the needs of your customers or risk losing them. Regulatory barriers predicated on the difficulty or subjectivity of identifying potential "where'd it go" volumes in advance of an initiative will handcuff the Postal Service's ability to respond to the market and retain critical volumes.

This calls for a hybrid approach to regulation and oversight of the Postal Service. In the old days, the Postal Service enjoyed both a *de jure* and *de facto* monopoly. It was the only game in town for most mailers. The revolution in technology and alternate communication channels has changed that forever. Today, there is hardly a category of mail that does not have affordable legal alternatives to the mail. The old form of rigid regulation, predicated on the monopoly, has been made obsolete. Yes, the monopoly law still exists, with important exceptions. But its force in the marketplace is greatly eroded. The necessary hybrid approach to oversight would still take into account the monopoly law, but must recognize the reality that its scope in the real-world marketplace is greatly diminished. The multi-channel marketplace is where the Postal Service faces its greatest challenges, and we would urge the Commission to facilitate the Postal Service's ability to meet those challenges with innovative initiatives to retain and grow its business more like companies in the private sector.

Importantly, it is in the Postal Service's own interest to ensure that its incentive programs generate positive contribution. It bears the full risk of contribution losses, since those program and NSA discounts are ignored for purposes of the rate cap. Thus, the Commission should continue to allow the Postal Service design and implement these programs as the Service believes appropriate. Regardless of how the Commission decides to estimate "anyhow" and incentivized volumes, the "mathematical results" it obtains must be recognized as imprecise generalized estimates and should not stand in the way of the Postal Service's attempts to become more market-oriented and move up its learning curve.

In summary, we recognize that the Commission is compelled to quantitatively estimate the volume and contribution gained in each of the Postal Service's pricing/volume incentive plans. Unfortunately we can offer no mechanism by which that can be accomplished accurately and reliably at this time. But we urge that, regardless of the approach settled upon, the Commission not use its results to reject or repudiate further Postal Service efforts to retain existing volumes and incentivize volume growth and contribution that it needs to be a viable marketplace service provider.

Respectfully submitted,

Thomas W. McLaughlin
Burzio McLaughlin & Keegan
1054 31st Street, N.W., Suite 540
Washington, DC 20007
(202) 965-4555, bmklaw@verizon.net

*Counsel for Valassis Direct Mail, Inc.
and the Saturation Mailers Coalition*