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

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

REBUTTAL TESTIMONY
OF
CARL E. STEIDTMANN
ON BEHALF OF
THE UNITED STATES POSTAL SERVICE

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1 **AUTOBIOGRAPHICAL SKETCH**

2 My name is Carl Steidtmann. I am employed by Price Waterhouse LLP as
3 Director and Chief Economist in our retail consulting practice. My primary duties include
4 writing, speaking, and consulting on economic, consumer, technological, and
5 competitive trends as they relate to retailing and consumer goods distribution. I have
6 testified before the Postal Rate Commission once before in Docket No. MC96-3. My
7 testimony in that proceeding focused on the retail soundness of the Postal Service's
8 special services proposals.

9 During my career at Price Waterhouse, I have provided specialized consulting
10 services for many large retailers including Saks Fifth Avenue, Sears, Sara Lee and the
11 National Association of Convenience stores. I am a regular contributor to Price
12 Waterhouse's quarterly *Retail Outlook* and monthly *Retail Economist*. My research and
13 comments have appeared in major business publications such as *Advertising Age*, *the*
14 *Wall Street Journal*, *Business Week*, *Fortune*, *Forbes*, and *Time Magazine*. I have
15 testified in litigation cases as an expert witness in the areas of retail strategy, retail
16 market conditions, and consumer shopping motivation. On a number of occasions, I
17 have provided retail comment and analyses as a guest of major television news
18 programs including CNN, CNBC, ABC News, and the McNeil Lehrer News Hour.

19 I began my employment with Price Waterhouse LLP in the Management
20 Horizons division, in Columbus, Ohio, in 1985. I now work in New York for Price
21 Waterhouse's retail consulting practice. Prior to my employment with Price Waterhouse,
22 I was Vice President and International Economist for Nakagama and Wallace in New
23 York, New York, and Senior Economist for the American Productivity Center in Houston,
24 Texas. I have also worked for American Telephone and Telegraph, as an Internal

1 Consultant, and with IBM as a Systems Engineer. I received a Doctor of Philosophy
2 degree in Economics from the University of Colorado in 1982. I received a Master's of
3 Business Administration degree from the University of Colorado in 1975, and a Bachelor
4 of Arts degree in History from the University of Colorado in 1973.

5 **I. PURPOSE OF TESTIMONY**

6 The purpose of this rebuttal testimony is to respond to the Office of the
7 Consumer Advocate's (OCA) Courtesy Envelope Mail (CEM) proposal set forth in
8 witness Willette's testimony (OCA-T-400). This proposal would create two separate
9 retail prices. The OCA proposal provides a discounted price of postage for qualifying
10 CEM – a discount of three cents off the regular First-Class Mail rate. In this testimony, I
11 analyze witness Willette's failure to consider the impact on retail simplicity that will be
12 caused by the CEM proposal.

13 From a retailing perspective, this proposal will create a two-stamp, or two-tier,
14 pricing schedule, with two rates being charged for very similar products. There are a
15 number of reasons why a company would choose not to introduce different prices for
16 very similar products, even though there may be cost differences between the products.
17 First, multiple prices add complexity to the retail transaction and lengthen the time
18 required to complete a transaction. Second, retail pricing schedules with multiple 'tiers'
19 for similar products are burdensome to administer. Third, a simple pricing schedule
20 makes it much easier to communicate price and value of service to the customer.
21 Fourth, and most importantly, consumers prefer simple, easy-to-understand price
22 schedules, as evidenced by recent trends in retailing practices.¹

¹ Additional evidence of this point is provided in the market research conducted by Timothy Ellard and presented in his rebuttal testimony (USPS-RT-14) in this proceeding.

1 My testimony is organized into the following four sections, and in each of these
2 sections the four themes that I list above are supported. The first section contains a
3 general discussion of the importance of retail simplification, including maintaining a
4 simplified product line. In the second section, I address a key component of retail
5 simplification – simplifying the retail price schedule. In the third section, I argue that
6 retail simplification need not be a goal only for profit-maximizing companies, but should
7 be considered by any organization interested in promoting customer satisfaction and
8 repeat business. In the final section, I address the OCA's CEM proposal from a retailing
9 perspective. It is my opinion that the OCA's CEM proposal, which increases the
10 complexity of the retail price schedule,² is inconsistent with current retailing practices
11 and trends.

12 **II. THE IMPORTANCE OF RETAIL SIMPLICITY**

13 In my testimony in MC96-3, I emphasized the importance of simplifying a product
14 line in a retail environment. In general, retail simplification has the following four
15 benefits:

- 16 • Retail simplification leads to reduced transaction times for both the customer
17 and the retailer.
- 18 • A simplified product line is easier to manage and administer.
- 19 • A simplified product line makes it easier to communicate price and value of
20 service.
- 21 • Most consumers prefer a simplified product offering when the financial gains
22 from complexity are small.

² By analyzing the retail price schedule, I am differentiating this from the complex price schedule that more sophisticated, high volume mailers use.

1 Retail simplification is sound retail practice, and is consistent with recent trends in a
2 variety of companies and industries. This section contains three examples of retailers
3 moving towards retail simplicity and taking advantage of these four benefits.

4 The first example of the move towards simplification in retailing is the change
5 that has occurred in the automobile industry. Until several years ago, automobile
6 *manufacturers offered a wide variety of options on new cars. As a result of providing*
7 *consumers a variety of choices, virtually every car that was produced was unique. This*
8 *complexity increased production and inventory costs. The automobile manufacturers*
9 *responded to this by simplifying product offerings by creating a limited selection of the*
10 *most popular option packages. This change resulted in lower production and retail costs,*
11 *while satisfying the majority of customers with the options that were presented. In*
12 *addition to the benefits that the manufacturers and retailers realized, consumers*
13 *benefited from the reasonable number of option packages because they were better*
14 *able to make sense of product choices and compare price with their perceived value of*
15 *the product. A specific example of this is Saturn, a division of General Motors, which*
16 *was created with retail simplification as an objective. Only three automobile models are*
17 *offered under the brand and each model comes in only two or three option packages. As*
18 *a result, there is a simple product line – a total of seven automobiles – from which*
19 *customers have to choose. In addition to this, Saturn has created their own retail outlets*
20 *to simplify the experience of purchasing an automobile. Saturn offers only one price,*
21 *provides a relaxed sales environment, and includes routine maintenance at a fixed price.*
22 These initiatives have had the following benefits. First, it is very easy to communicate
23 price to consumers, because only one price per model is offered. Second, this pricing
24 schedule is very easy to administer compared to more complicated automobile pricing
25 schemes. And finally, customers are very satisfied as a result of the simplified retail

1 experience – they are able to purchase a car without being concerned that they could
2 have received a lower price.

3 The second example of the trend towards general retail simplicity is McDonald's
4 Corporation, which has taken steps to simplify the retail environment for their customers.
5 McDonald's has simplified their product offering in recent years by bundling the most
6 common items of a meal into a single "value meal." This allows a customer to choose
7 and order a meal in a very convenient manner. This simplified retail offering has had the
8 following benefits. For McDonald's, simplifying their product line has improved the
9 efficiency of the retail transaction – consumers can more quickly make a decision and
10 place their order, and clerks can more quickly process the order. In addition, consumers
11 are better able to compare their perceived value of the service to their willingness to pay
12 the price that is being charged for the product. For example, the pricing system that
13 McDonald's uses for value meals allows consumers to quickly compare and evaluate
14 the prices of entire meals that contain different product choices, rather than analyzing
15 the price of individual components.

16 An example of consumer preferences for simplified pricing schemes has recently
17 been demonstrated by a promotion that McDonald's attempted which complicated the
18 price schedule. The so-called "Campaign 55," launched in 1997, offered a Big Mac
19 sandwich or an Egg McMuffin breakfast sandwich for 55 cents when purchased with a
20 drink and french fries (or hashbrowns for the breakfast sandwich). Consumers, however,
21 were confused by this promotion which was more complex than McDonald's standard
22 method of pricing. McDonald's executives abandoned this price structure after only 41

1 days, actually citing the confusion associated with this pricing scheme.³

2 A third example is that of Apple Computer, which has recently embarked on a
3 product simplification strategy in an attempt to better compete with Wintel (Intel-based
4 Windows-operated) personal computers. In 1997, Apple Computer took steps to simplify
5 their products by offering a single Power Macintosh line of computers. This move
6 reduced the available models by nearly 50 percent. This streamlining is intended to
7 decrease the production price of the computers (by standardizing parts and
8 components), reduce the number of models that dealers have to stock, and simplify the
9 purchase decision by more clearly differentiating the available products.

10 III. THE IMPORTANCE OF SIMPLICITY IN RETAIL PRICING

11 Simplifying the retail product line has been a recent, successful trend in the
12 marketplace. One of the key components of this has been the simplification of the retail
13 price schedule. Retail price simplification is an important factor in realizing the four
14 benefits that I list in Sections I and II of my testimony. A complicated price schedule, in
15 contrast, adds costs to the retailer and may confuse the customer's purchase decision.
16 There has been a recent trend towards increased retail pricing simplicity, which is
17 demonstrated by the following examples. These examples also illustrate the benefits
18 that companies realize when they simplify their retail price schedule.

19 The first example of this trend is the retail gasoline industry, where retailers have
20 recently simplified their price schedule. Throughout the 1980s, gasoline retailers

³ McDonald's Chairman and Chief Executive Officer, Michael Quinlan acknowledges this, "The customers were telling us that they thought it [Campaign 55] was a bit confusing and what-have you, so we pulled it" on the November 11, 1997, CNN MONEYLINE.

1 maintained a two-tier pricing schedule where customers who paid with cash paid a lower
2 price than those who paid with a credit card. Cash transactions were discounted
3 because the cost of these transactions were less than credit card transactions, which
4 contained processing fees. However, many of the major gasoline retailers, including
5 Amoco, Chevron, Exxon and Mobil,⁴ began to move away from two-tier pricing when
6 they realized that customers were dissatisfied and confused by their price schedule.⁵
7 This is an example of two products with different costs – gasoline purchased with cash
8 and gasoline purchased with a credit card – yet the company chose to charge the same
9 price in the interest of retail price simplicity.

10 The long-distance telephone industry is a second example of the trend towards
11 retail simplicity. In recent years, as the industry has become more competitive, long-
12 distance telephone service providers have focused on a simplified price schedule.
13 Whereas rates once varied a great deal based upon where calls were placed, to whom
14 they were placed, and what time of day they were initiated, more recent rate schedules
15 have been dramatically simplified and provide a simple, one rate per minute schedule.
16 These simplified rate schedules have become a central theme of the marketing
17 initiatives of several major companies because it is very easy to communicate the price
18 of service to consumers. In addition, the recent popularity of these programs is evidence
19 of consumers' preferences for these simple, easy-to-understand pricing schedules.

20 A third example of the trend towards a simple pricing schedule is the adoption of
21 "everyday pricing" by a variety of companies. Wal-Mart is one of the best examples of

⁴ Shell Oil Co., Phillips Petroleum and Texaco either did not implement a two-tiered pricing scheme or quickly returned to a single price after briefly experimenting with separate prices.

1 establishing “everyday prices” in their retail stores. Their competitors often rely on a
2 system of periodic discounts and sale prices, while Wal-Mart has simplified their price
3 schedule by selling their products at a constant price. The benefit for Wal-Mart is that
4 this system is very easy to manage and administer. Consumers, on the other hand,
5 prefer this pricing policy because it allows them to shop with the confidence that each
6 and every time that they shop at Wal-Mart they will be getting Wal-Mart’s lowest price.
7 They need not be concerned about missing a coupon that could have saved them
8 money, or purchasing a product at full price the day before a sale begins.

9 There are exceptions to the trend towards pricing simplicity, but these exceptions
10 are driven by unique competitive circumstances. For instance, the price of airline tickets
11 is clearly an instance where there is a great deal of complexity in the price schedule. On
12 a given flight there are a number of different prices charged for the same seat and the
13 same level of service. While the pricing practices that airlines follow often confuse and
14 anger customers, airlines have a distinct advantage that most retailers do not have.
15 Airlines learn a great deal of information regarding their customers preferences and
16 demand when the customer states their travel plans. Based upon how far in advance a
17 ticket is purchased, the days on which the travel will occur, and whether the trip
18 incorporates a Saturday night stay, airlines can differentiate between different types of
19 travelers – leisure travelers who have a low willingness to pay and business travelers
20 who are willing to pay almost any rate – and can price accordingly. Through this
21 practice, they extract as much consumer surplus as possible to increase profitability.
22 This is an example that contradicts the current retail trend, but does so because of a

⁵ In fact, a credit card operations manager at Citgo Petroleum Corporation specifically said that, “It’s [two-tier pricing] very confusing to consumers,” from Credit Card News, April 1, 1995, page 6.

1 unique set of circumstances surrounding the airlines' sophisticated knowledge of the
2 customer's demand.

3 **IV. SIMPLICITY IN THE DELIVERY OF PUBLICLY-PROVIDED GOODS**

4 For a private business, product and retail simplification leads to customer
5 satisfaction, repeat business, and customer loyalty. These three factors, in turn, lead to
6 increased profitability for the private business. This is not to say, however, that because
7 the long-term financial goal of the Postal Service is to break-even that retail
8 simplification should not be a consideration. Regardless of whether profitability is a goal,
9 I would expect that the immediate effect of retail simplification – customer satisfaction,
10 repeat business, and customer loyalty – would be an objective in the delivery of publicly-
11 provided goods and services as well.

12 An example of simplicity in the delivery of publicly-provided goods is the tolls that
13 are charged to use many bridges and roadways. Instead of charging a small fee for
14 travelling both directions of a bridge or roadway, many operators have chosen to charge
15 a single toll for travel in only one direction. This single toll is often double what would
16 have been charged for one-way travel, as it averages the cost of two one-way tolls into
17 a single charge. This toll structure decreases the inconvenience to travelers, as they
18 only have to pay a single toll. It also benefits the roadway or bridge operator because
19 they only have to operate one toll booth. In this example, while profit-maximization is not
20 necessarily a goal of the road or bridge operator, simplifying the collection of fees is
21 beneficial to both the operator and the public.

1 **V. THE CEM PROPOSAL FROM A RETAIL PERSPECTIVE**

2 The OCA's CEM proposal set forth in witness Willette's testimony will create a
3 two-tier price schedule for the First-Class Mail letter. That is, CEM will create two prices
4 for two similar products. As a result, the CEM proposal will increase retail complexity,
5 which is inconsistent with the recent trends towards simplification that many successful
6 retailers have been following. Not only could Postal Service consumers become
7 confused and dissatisfied with a two-tier pricing system, but increasing the complexity of
8 the pricing schedule will require increased administration and management and retail
9 transactions will become more complicated.

10 The other aspect of the OCA's proposal that could have a negative impact on
11 customer satisfaction is the increased potential for "short-paid" mail. If CEM (discounted)
12 postage is mistakenly applied to a non-qualifying piece of mail and the piece is returned
13 to the sender, a delay in the ultimate delivery of the item may occur. To the extent that
14 this happens to a bill remittance that was not CEM-eligible, the customer could be
15 placed in a very frustrating and unfortunate position. This possibility adds to the potential
16 negative aspects of creating a two-tier pricing structure for First-Class Mail.

17 Witness Willette claims that customers will remain the same or will be made
18 better off under the two price system because the discount is voluntary. At Tr. 21/10740,
19 witness Willette explains that, "Note that CEM does not 'require' consumers to purchase
20 and maintain two sets of stamps; CEM is optional to the consumer."⁶ Therefore, if a
21 customer finds that the system is too complex to justify the small cost savings, the
22 consumer can simply ignore the discounted stamp and will not be made any worse off
23 by the two-tier system. This claim, however, fails to realize that the two-tier pricing

⁶ Witness Willette goes further to say that, "I would expect the convenience to be the same for both [a one-stamp system and a two-stamp system]."

1 system advocated by the OCA in their CEM proposal will add complexity to the
2 purchase decision facing both those who choose to use the discounted stamp and those
3 who do not. Even if customers choose not to use the discounted stamp, they may still
4 feel confused by it and may feel cheated when they cannot take advantage of the
5 discount.⁷

6 It is also interesting to note that witness Willette has argued that, “CEM
7 addresses the continuing erosion of bill payment mail to electronic means by providing
8 consumers a convenient, less expensive way to pay their bills.”⁸ That is, by adding
9 additional alternatives to the price schedule, the Postal Service can limit the movement
10 to alternatives to First-Class Mail. However, this argument seems to contradict the
11 examples and trends that I have described above. In each of the cases that I have
12 presented, the companies that have simplified their pricing schedule have done so in an
13 environment where consumers have the option of choosing between various service
14 providers. As one company has simplified their pricing scheme, consumers have
15 indicated their preference for simplicity by moving towards that company’s products. As
16 a result, in many cases, competitors in the same market have instituted similar retail
17 practices. In both the retail gasoline and the long distance telephone markets, for
18 example, one company led the move to simplification and others followed. The
19 implication of these examples is clear – simplified retail price schedules are preferred by
20 consumers and are in a company’s best interest. The OCA’s CEM proposal, on the
21 other hand, is not consistent with this trend towards retail simplification.

⁷ In the case of airline pricing, consumers dislike the complexity of the pricing scheme, but they do not protest this system because they realize the price savings for leisure travelers are substantial.

⁸ Tr. 21/10714, at lines 11-12.

1 **VI. CONCLUSION**

2 From a retail perspective, it is my opinion that the CEM proposal submitted by
3 the OCA is inconsistent with current retailing practices and trends. The creation of a
4 two-tier pricing scheme for First-Class Mail has a variety of potential consequences
5 which may cause dissatisfaction among customers. As demonstrated in the preceding
6 examples, a simplified price schedule is in the best interest of both the organization and
7 customers and is consistent with the current trends in retailing.