Office of Inspector General | United States Postal Service

RISC Report

How Institutions Change

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Executive Summary

Over the past 20 years, digital diversion of communication, growth in ecommerce, changing customer needs and expectations, and new sources of competition have transformed the mail and parcel industry. A decrease in mail volume led to a drop in revenue for the Postal Service. Increased package volume created new revenue opportunities for the agency, but the package business alone is not enough to fully offset the losses related to mail volume. Additional challenges stem from the fact that the parcel market is more competitive and harder to predict. The agency must also determine how to maximize the value of an extensive, but costly national retail network.

Delivering for America: Our Vision and Ten-Year Plan to Achieve Financial Sustainability and Service Excellence, which the Postal Service released in March 2021, shows the path the agency intends to follow to address these and other challenges. With this white paper, the U.S. Postal Service Office of Inspector General (OIG) identifies takeaways from public and private organizations that, like the Postal Service, have managed to adapt and succeed in other disrupted industries. While no other industry is a perfect parallel to the postal industry, we selected specific insights that can be informative for the Postal Service.

First, we studied the passenger rail industry, which, like the postal industry, has experienced large changes in customer demand and expectations. Amtrak, the national provider of intercity passenger rail service, is similar to the Postal Service in its quasi-public status and the competing expectations it faces to cover its operating costs while providing a minimum level of service across the country. Our case study examines the experience of Amtrak in trying to build a sustainable business model after a sharp decline in demand for rail travel. A takeaway for the Postal Service is the importance of committing to a clear strategic vision for the future. A clear vision was useful not only in affecting change within Amtrak, but in promoting its agenda to stakeholders, including Congress. A transparent approach to communication and the use of evidence-backed business cases are key to pushing for change and increasing public support for management's strategic goals.

Second, we examined the home video rental industry, which experienced a dramatic disruption due to advances in technology, the rise of the Internet, and evolving customer expectations. Our case study on this industry explored the rise of Netflix and the decline of Blockbuster. The experiences of the two companies suggested the importance for the Postal Service to not only adapt, but to anticipate and prepare for change through more nimble and agile innovation processes. Another takeaway is that an organization should strengthen its ability

Highlights

As the Postal Service experiences disruption in its industry, it can learn from the experiences of organizations that navigated change in their markets.

The Amtrak case study illustrates the importance of developing a clear strategy that can both guide internal decision-making and help the Postal Service pursue stakeholder support for legislative reforms and other strategic goals.

The experiences of Netflix and Blockbuster reinforce the importance for the Postal Service of anticipating and quickly preparing for change in its industry, as well as addressing consumer discontent before it becomes a larger strategic problem.

The strategies of brick-and-mortar retailers suggest that enhancing the in-store experience, finding ways to use physical proximity to customers as an asset, and omnichannel approaches to commerce have allowed retailers to meet changing customer expectations.

The Postal Service's ability to plan for the future is constrained by several key issues that require cooperation between the agency and key stakeholders to resolve.

to distinguish when consumer discontent may be a symptom of a larger strategic problem and address that discontent before it threatens the viability of a business.

Finally, we looked at how brick-and-mortar retailers adapted to the rapid rise in ecommerce through strategies aimed at maximizing the value of their physical retail locations. The retail industry is highly relevant to the Postal Service due to the agency's extensive physical retail network, which has experienced a sharp decline in customer transactions. The case study showed that enhancing the in-store experience and embracing omnichannel retail are key to boosting customer satisfaction and retention. Retailers also found ways to use their physical proximity to customers as an asset, for instance by providing new ecommerce-related services such as the option to pick up products purchased online in stores or at curbside.

The Postal Service recently released a plan intended to place it on a path toward future financial stability and continued market relevance. Longstanding policy and regulatory issues, however, have constrained how far the Postal Service can go in implementing change and planning for the future. Several key issues require cooperation between the agency and key stakeholders – including Congress, the Postal Regulatory Commission, and mailers – to resolve. These issues include clearly defining the Universal Service Obligation, finding consensus on how the Postal Service should balance the expectation to solely support itself with the revenue from its operations against the need to provide quality service to all Americans, and alleviating financial burdens related to the requirement that the Postal Service pre-fund decades' worth of future retirement benefits. Reaching a broad agreement among stakeholders about these issues will be essential for building a sustainable business model that meets the needs of the American people.

Observations

Introduction

Over the past 20 years, the shift to digital communications and transactions, changing consumer needs and expectations, and new sources of competition dramatically transformed the mail and parcel industry. Postal Service leadership faces the difficult task of charting a strategic path that will allow the agency to survive financially and best serve the changing needs of the American people. In this report, we examine select industries that have experienced significant disruption to highlight strategic insights as the Postal Service adapts and plans for the future.

Disruption in the Postal Industry

There are two primary disruptive trends that are driving change in the mailing industry: the decline in letter volume and the growth of ecommerce. A consistent decrease in mail volume and increases in processing and delivery costs have resulted in significant financial losses for the Postal Service. In fiscal year (FY) 2020, the Postal Service delivered 52.6 billion pieces of First-Class Mail, a 49 percent decrease from its peak in 2001 (Figure 1). The downward trend is a serious threat to the Postal Service because First-Class Mail is its most profitable product. Further, while mail volume declined, the number of delivery points and processing costs have grown annually, increasing the cost per delivery for each piece of mail.[1] The decline in mail volume contributed to financial losses for the Postal Service in every fiscal year since FY 2007.[2]

While letter mail volume decreased in recent years, ecommerce growth during the same period resulted in an overall increase in package volume. The rise in package volume has not been enough to offset the loss of profit from declines in letter mail because packages are expensive to process and have a smaller profit margin. The Postal Service's package volume flattened in 2019, due primarily to greater competition from private carriers and more insourcing (delivery of their own packages) by shippers that previously had used the Postal Service. In 2020, the agency experienced a pandemic-related rise in package volume, but this was below the overall parcel market growth rate.[3] Also, evolving market dynamics make it difficult to predict how much of the future package volume growth the Postal Service will be able to capture.[4]

Planning for Change

The Postal Service's strategic plans from 2020 and 2021 highlight its efforts to adapt to recent changes.[5] The Postal Service expects current letter and package volume trends to continue, and its 10-year plan reflects these expectations. For example, the Postal Service aims to invest in package sorting equipment, redesign processing and distribution facilities, and purchase delivery vehicles with larger cargo capacity. The goal of these initiatives is to successfully handle increasing package volume in the coming years. The plan also describes efforts to adapt to the continuing decline of mail volume through the easing of service standards and the rightsizing of mail and flat processing capacities, all while maintaining six-day-a-week delivery.

This paper highlights lessons learned from outside organizations trying to adapt and succeed in other disrupted industries. We examined how organizations in three industries — passenger rail, home video rental, and brick-and-mortar retail — adapted to disruption in their markets. While each of these industries are different from the postal industry in significant ways, we present specific aspects of these organizations' experiences that are informative for the Postal Service.

1 U.S. Postal Service, "First-Class Mail volume since 1926," https://about.usps.com/who-we-are/postal-history/first-class-mail-since-1926.htm and U.S. Postal Service, "A Decade of Facts & Figures," https://facts.usps.com/table-facts/.
2 See: U.S. Postal Service Annual Reports, FY 2007 to FY 2020, available at https://about.usps.com/what/financials/.
3 U.S. parcel market trends projections prepared for the Postal Service by Colography.
4 U.S. Postal Service Office of Inspector General, *Same Day Delivery: Implications for the U.S. Postal Service*, Report No. RISC-WP-20-002, https://www.uspsoig.gov/sites/default/files/document-library-files/2020/RISC-WP-20-002.pdf, p. 1 and Mark Solomon, "FedEx completes shift of former Postal Service business, rebrands service," FreightWaves, March 10, 2021, https://www.freightwaves.com/news/fedex-completes-shift-of-former-postal-service-business-rebrands-service.
5 U.S. Postal Service, *Ready-Now ➔ Future-Ready: The U.S. Postal Service Five-Year Strategic Plan FY2020-FY2024*, 2020, https://about.usps.com/strategic-planning/five-year-strategic-plan-2020-2024.pdf and U.S. Postal Service, *Delivering for America: Our Vision and Ten-Year Plan to Achieve Financial Sustainability and Service Excellence*, pp. 28-29, 32-33.

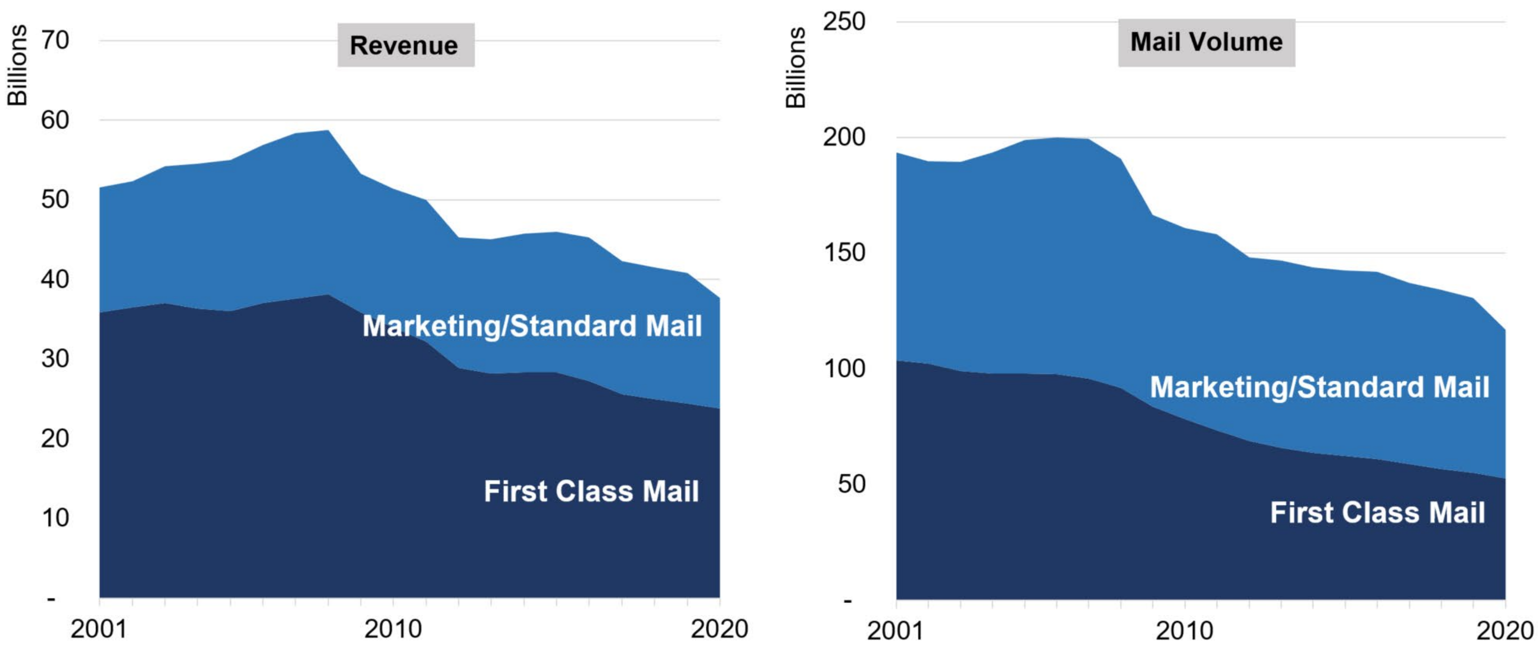
We selected the passenger rail industry — specifically, Amtrak — because, like the Postal Service, Amtrak is expected to cover its costs, while federal legislation and regulation limit its ability to make significant changes to its operations. Home video rental companies — specifically Blockbuster and Netflix — are a benchmark due to the disruptive effect of digital communication on both industries. Finally, the experience of brick-and-mortar retailers is highly relevant because that industry shares the challenge of declining retail foot traffic and must find new ways to extract value from existing physical retail infrastructure.

It is important to keep in mind that, compared to the private sector, the Postal Service is somewhat limited in its ability to unilaterally make business decisions. Many of the Postal Service's strategic decisions call for input, collaboration, or action from multiple stakeholders, including Congress, labor unions, the Postal Regulatory Commission, and mailers. Coordination with these

Figure 1: Mail Revenue and Volume, 2001 to 2020

REVENUE AND VOLUME DECLINES IN MAIL

First Class Mail and Marketing Mail make up the majority of the Postal Service's total revenue and volume. Both revenue and volume for these products declined over the past 20 years. Increases in package volume and revenue have not been enough to offset financial losses from mail declines.



Source: USPS Annual Reports and 10-Ks.

stakeholders is essential for the Postal Service to achieve consensus on critical postal issues and realize its strategic vision.

Amtrak in the Passenger Rail Industry

After peaking during World War II, demand for passenger rail service in the U.S. greatly decreased through the 1950s and 1960s as other transportation options – chief among them cars and air travel – became widely available. Inter-city passenger rail service had been the responsibility of private freight rail companies, which were losing money operating passenger trains and seeking to exit the market. In 1971, the U.S. government created Amtrak to take over passenger rail service from the freight rail companies. Amtrak, a quasi-public organization, is legally structured as a private company, but the U.S. Department of Transportation holds virtually all its shares.[6]

Figure 2: Amtrak Train

Source: Phillip Capper, licensed under CC BY 2.0.

Since its inception, Amtrak has lost money every year. In recent years, the Northeast Corridor, which runs between Boston and Washington, D.C., has been the only stretch of track in the Amtrak network that generates an operating profit. Like other sectors of the transportation network, such as the interstate highway system, airports, and air traffic control, Amtrak's passenger rail network has relied on government subsidies to survive. These subsidies are subject to the annual appropriations process, which makes the company's funding unpredictable from year to year and creates significant challenges in planning for the future.[7]

Similarities to the Postal Industry

Amtrak and the Postal Service are similar in a several ways, including challenges in being a self-funding organization while meeting legal obligations to provide service across the country, constraints in implementing operational changes, and changing expectations of their customers.

Caught Between Acting as a Public Service and a Private Company

Amtrak is legally obligated to provide efficient and effective inter-city passenger service across a nationwide rail network, while also facing continuous pressure from the federal government to reduce its operating losses. Similarly, the Postal Service is mandated to provide reliable, affordable, and universal service nationwide, including in regions that are more expensive to serve, while generating enough revenue to cover the cost of operations.[8]

Limited Scope to Change the Business Model

Any significant changes to Amtrak's national network, such as cutting service on money-losing, long-distance routes, require Congressional approval. Members of Congress, however, have historically resisted any service cuts in their districts.[9] The Postal Service also requires the cooperation and approval of stakeholders such as customers, unions, Congress, and the Postal Regulatory Commission

6 Jeff Davis, "Amtrak at 50: The Rail Passenger Service Act of 1970," Eno Center for Transportation, October 30, 2020, https://www.enotrans.org/article/amtrak-at-50-the-rail-passenger-service-act-of-1970/ and Ben Goldman, U.S. Congressional Research Service, *Improving Intercity Passenger Rail Service in the United States*, Report No. R45783, February 8, 2021, accessed at https://crsreports.congress.gov/product/pdf/R/R45783/4.

7 Ted Mann, "Amtrak Plan to Expand Ridership Could Sidetrack Storied Trains," *Wall Street Journal*, February 20, 2019, https://www.wsj.com/articles/amtrak-plan-to-expand-ridership-could-sidetrack-storied-trains-11550664000 and U.S. Congressional Research Service, *Improving Intercity Passenger Rail Service in the United States*.

8 39 U.S.C. § 101(a).

9 Scott Mall, "Amtrak seeks to switch tracks to new long-term strategy," *FreightWaves*, February 22, 2019, https://www.freightwaves.com/news/railroads/amtrak-seeks-to-travel-new-rails.

to make significant changes to the service it provides. For both Amtrak and the Postal Service, forging consensus on major changes to its network and operations can be difficult to achieve.

Changing Consumer Expectations

Since the company's inception, it has been difficult for Amtrak to adapt its network and service to meet Americans' transportation demands. The evolution of other means of transportation changed what consumers want from the passenger rail industry. Similarly, the Postal Service has seen the increasing preference for digital communication affect how business and residential customers use the mail. The Postal Service also shares with Amtrak the challenge of meeting Americans' expectations for performance and convenience.

How Amtrak Adapted to Change

Beginning in 2017, new Amtrak leadership set new goals, emphasized cost cutting and more strategic investment decisions, and presented a new vision to Congress.

Setting New Goals

According to the Amtrak Office of Inspector General (Amtrak OIG), the company had historically struggled to set and adhere to clear strategic goals that drove spending priorities and business decisions.[10] In July 2017, a new CEO with experience in the airline industry focused on implementing a clearer strategy. He set a goal of eliminating the company's net operating loss by the end of the FY2021. Amtrak announced that it would focus on six strategic pillars: defining the company's strategy, improving safety and operations, securing the company's financial future, investing in assets, taking care of customers, and building the Amtrak workforce.

The Amtrak OIG also identified a lack of emphasis on controlling and cutting costs in previous Amtrak administrations. Under the new CEO, the company introduced a more business-minded focus on cost control. The Amtrak OIG noted a shift in managers' mindsets and saw more effort put into negotiating better deals with partners. A new policy stipulated that Amtrak would only fund internal budget requests that directly aligned with one of the six strategic pillars. To cut costs, the company negotiated new collective bargaining agreements, reduced its reliance on contracted services, decreased its management headcount, closed a call center, ended its membership in multiple trade organizations, and curtailed less essential investments.[11]

Focusing Investment and Cutting Costs

Instead of trying to improve less profitable parts of the network, Amtrak chose to channel investment toward the only part of its network that generated net operating earnings. The company used some of the limited funding it had available to invest in the Northeast Corridor, with the intention of making train service there quicker and more reliable. The new CEO said this was investing "in the core product," according to a media report.[12]

Additionally, Amtrak sought to improve customer service and marketing. Executives monitored trends in customer satisfaction scores and gave funding priority to initiatives that addressed customers' needs and preferences. The company made efforts to drive up ridership, in part, by overhauling its marketing, including the use of more targeted ads.[13]

Communicating with Stakeholders

While these efforts to cut costs and increase revenue helped Amtrak get a stronger financial footing, the company also pursued bigger structural changes to its network and service provision that required the cooperation of stakeholders.

10 Amtrak Office of Inspector General, *Amtrak: Top Management and Performance Challenges— Fiscal Years 2017 and 2018,* OIG-SP-2017-009, March 29, 2017, https://amtrakoig.gov/sites/default/files/reports/OIG-SP-2017-009_0.pdf.
11 Amtrak Office of Inspector General, *Amtrak: Top Management and Performance Challenges—Fiscal Years 2019 and 2020*, OIG-SP-2018-011, Amtrak Office of Inspector General, September 28, 2018, https://amtrakoig.gov/sites/default/files/reports/OIG-SP-2018-011%20Management%20Challenges%20FY2019%20and%202020_0.pdf and Kevin Smith, "Rethinking Amtrak," *International Railway Journal*, September 23, 2019, https://www.railjournal.com/in_depth/rethinking-amtrak.
12 Ted Mann, "Amtrak Has Lost Money for Decades. A Former Airline CEO Thinks He Can Fix It," *Wall Street Journal*, July 6, 2019, https://www.wsj.com/articles/amtrak-has-lost-money-for-decades-a-former-airline-ceo-thinks-he-can-fix-it-11562385660.
13 Amtrak Office of Inspector General, *Amtrak: Top Management and Performance Challenges—Fiscal Years 2019 and 2020* and Ted Mann, "Amtrak Has Lost Money for Decades. A Former Airline CEO Thinks He Can Fix It."

For example, Amtrak aims to invest in building new corridors connecting population centers poorly served by existing transportation networks and mapped out where new stations and routes could be created to expand service. The company is also looking to tailor long-distance train service to better meet demand. While Congress has not yet appropriated funds to implement these changes, the company has been clear about what it wants to accomplish.

Amtrak executives used several strategies to make the case to Congress for these big changes. Improving the company's financial picture helped demonstrate to Congress that the company can be sustainable in the future and less of a burden to the taxpayer.[14] Demonstrating to Congress that Amtrak was a good steward of the funds allocated bolstered the case for a more stable and predictable source of federal funding and Congressional backing for larger investments to improve and expand the network.

Amtrak leadership emphasized their statutory position, with the CEO distributing to members of Congress laminated copies of the law that defined Amtrak's mission. He cited the law's mandate "to provide efficient and effective inter-city passenger rail mobility" that is "trip-time competitive with other inter-city travel options" to support his proposal to invest in new inter-city corridor service.[15]

Getting Results

Since implementation of these changes began in the 2017 calendar year, Amtrak made significant progress in reducing its operating losses and creating a path toward operational profitability. It appeared on track to meet the company's goal of breaking even in FY 2021 until the COVID-19 pandemic hit the country in early 2020, severely decreasing ridership and revenues. In response, the company reduced service and offered employees buyouts that were expected to reduce the workforce by up to 20 percent.[16]

While the financial improvement prior to the pandemic was noteworthy, representatives of the Amtrak OIG, who studied the company's strategic and management challenges, warned that deep cuts, especially to its workforce, could have negative effects on the company going forward. For example, the company's reduced staff capacity could hinder its ability to effectively oversee its growing portfolio of planned capital projects.

Takeaways for the Postal Service

The Amtrak case study highlights how committing to a clear strategic vision, promoting that vision to stakeholders, and emphasizing transparency and evidence-based business cases in its communications have helped the organization drive change successfully.

Commit to a Clear Strategic Vision

An Amtrak OIG report stated that the company's inconsistent use of strategic goals to drive spending priorities and business decisions had been a challenge in the past.[17] Recent efforts by the agency addressed this challenge by articulating a set of clear goals and making spending decisions based on these priorities.

With its 2021 *Delivering for America* 10-year plan, the Postal Service took a step toward developing its own strategic vision and aligning the organization behind it. The Amtrak case study suggests that a sustained internal commitment to strategy, such as ensuring spending aligns with the plan's priorities, will be important for the success of the Postal Service's plan going forward.

In an interview with the OIG, a Postal Service representative stated that the agency has tried to more closely involve individual business units in the implementation of the 10-year plan. This effort includes having business units set specific targets and milestones that are directly in line with the organization's plan.

Promote this Vision to Stakeholders

Forming a clear strategy not only proved important for achieving goals internally, but also helped Amtrak communicate a consistent message to Congress and other stakeholders. Amtrak benefited from setting out in detail how it would

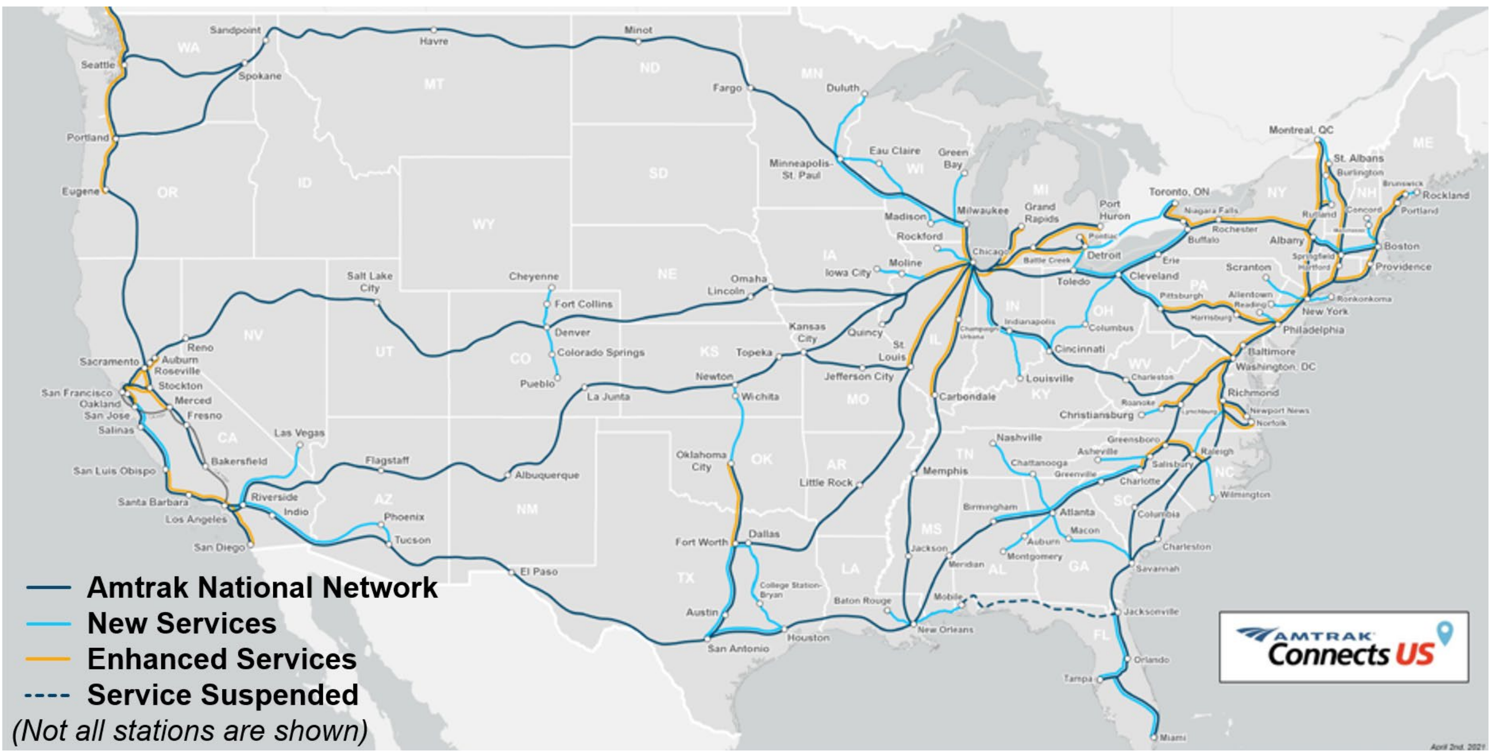
14 Kevin Smith, "Rethinking Amtrak."
15 Ted Mann, "Amtrak Has Lost Money for Decades. A Former Airline CEO Thinks He Can Fix It" and Kevin Smith, "Rethinking Amtrak."
16 Kanishka Singh, "Amtrak reducing service, offering buyout packages to employees," Reuters, June 16, 2020, https://www.reuters.com/article/us-health-coronavirus-amtrak/amtrak-reducing-service-offering-buyout-packages-to-employees-idUSKBN23O04X.
17 Amtrak Office of Inspector General, *Amtrak: Top Management and Performance Challenges— Fiscal Years 2017 and 2018*.

adapt its network to meet the needs of the future, given necessary support from Congress and other stakeholders, which prepared the company to take advantage of shifting political priorities. When the Biden Administration took office in 2021 and announced an intention to increase infrastructure spending, Amtrak immediately responded by publishing a map of its "2035 Vision," an expanded passenger rail network that included more than 30 proposed new routes (Figure 3). Amtrak publicly appealed for Congress to provide the funding called for in the president's plan and released a statement asserting that doing so would "create jobs, improve the quality of life, reduce carbon emissions and generate economic growth."[18]

Figure 3: Amtrak's Proposed Future Rail Network

AMTRAK'S EXPANDED PASSENGER RAIL NETWORK

In 2021, Amtrak unveiled its "2035 Vision" which included a proposed map of Amtrak's future rail network. Presenting a clear vision of how the network could evolve benefited Amtrak when a new administration announced its intent to increase infrastructure spending.



Source: Amtrak (legend enhanced by OIG)

18 Amtrak, "Amtrak Connects US: A Vision to Grow Rail Service Across America," April 2021, http://media.amtrak.com/wp-content/uploads/2021/04/Amtrak-Connects-US-Fact-Sheet-2021-04-16-1.pdf and Amtrak, "Statement from Amtrak CEO on President Biden's American Jobs Plan," March 31, 2021, https://media.amtrak.com/2021/03/statement-from-amtrak-ceo-on-president-bidens-american-jobs-plan/.

Congress has not passed significant reform legislation since the 2006 Postal Accountability and Enhancement Act. The 10-year plan calls, among other things, for specific legislative action to alleviate burdensome obligations related to retiree health benefits and pension funding. The Amtrak case study suggests that promoting a clear vision for the future can help the Postal Service push for changes and potentially increase support for management's strategic goals.

The Postal Service's previous strategic plans have generally been incremental and focused on addressing existing challenges rather than trying to proactively tackle big changes anticipated in the industry. The Amtrak case study suggests that a more ambitious plan for the future can be more effective at driving change.

Present the Vision with Transparency and Evidence

The Amtrak OIG report stressed the need for transparency in presenting a strategy to Congress. Some members of Congress have opposed Amtrak leadership's strategic priorities, such as their desire to cut back on long-distance routes; however, it was important for Amtrak executives to be transparent about where their plan conflicted with the goals and interests of those in opposition, and about how the scope and timing of their plan would affect stakeholders. Also important was the need to provide compelling, evidence-based business cases supporting their decisions.[19]

For the Postal Service, prioritizing transparency and strong evidence is key to building consensus around its strategic objectives and addressing stakeholders' potential concerns. There is value in publicly engaging in difficult conversations, with the goal of finding room for cooperation and compromise. One way in which the Postal Service shares information and engages with stakeholders is through public meetings it holds before submitting desired service changes to the Postal Regulatory Commission (PRC) for an advisory opinion. Additionally, once the Postal Service presents a change to the PRC, there is a 90-day period during which the public can submit comments and ask questions.

Netflix, Blockbuster, and the Home Video Industry

Beginning in the mid-1990s, technological trends disrupted the home video rental industry and reshaped the way consumers access video entertainment at home. At the time, the industry focused on providing people physical copies of videocassettes available to rent at retail locations. Blockbuster, founded in 1985, became the largest video rental chain in the U.S., with more than 9,000 stores internationally at its peak in 2004. By 2010, however, retail video rental was in steep decline, and Blockbuster went bankrupt and was delisted from the New York Stock Exchange as it surpassed $900 million in debt. Netflix, which provided customers with new, Internet-based options for accessing video entertainment, had become the number one renter of prerecorded media.[20]

Figure 4: Netflix Envelope and DVD

Source: BlueMint, licensed under CC BY 2.5.

19 Amtrak Office of Inspector General, *Amtrak: Top Management and Performance Challenges for Fiscal Year 2021*, OIG-SP-2021-002, October 23, 2020, https://amtrakoig.gov/sites/default/files/reports/OIG-SP-2021-002%20Management%20Challenges.pdf.

20 Andy Ash, "The rise and fall of Blockbuster and how it's surviving with just one store left," *Insider*, August 12, 2020. https://www.businessinsider.com/the-rise-and-fall-of-blockbuster-video-streaming-2020-1?r=US&IR=T and Thomas K. Arnold, "Netflix and Redbox gained in 2010 as DVD sales slid," *Reuters*, December 27, 2010, https://www.reuters.com/article/industry-us-dvd/netflix-and-redbox-gained-in-2010-as-dvd-sales-slid-idINTRE6BM0E120101227.

The disruption in the home video rental industry centered on technological advances and related changes in consumer expectations. As Internet access proliferated in American households through the 1990s and 2000s, consumers gradually became comfortable purchasing goods and services online. In the 1990s, DVD technology started chipping away at the market for videocassettes, which had been the dominant home video technology since the early 1980s. The new technology opened the way for Netflix, an online movie rental service that sent consumers DVDs through the mail, to become a dominant player in the market. Netflix could maintain a large catalog of titles and offer customers the convenience of home delivery without bearing the costs of retail storefronts.

The next step in technological disruption was on-demand video streaming. By the mid-2000s, broadband service was becoming more prevalent in American homes. Faster Internet speed allowed consumers to access movies instantly through the Internet. Netflix adapted its business model to provide customers with streaming video, which soon replaced physical DVD rental as the primary way Americans access video entertainment on demand.

Similarities to the Postal Industry

In both the home video rental and postal industries, customers rapidly developed new expectations and behaviors that threatened existing business models.

Changing Customer Expectations and Behavior

As technology rapidly advanced and renting DVDs online became widespread, consumers began became less tolerant of the late fees charged by traditional video rental stores. These shifting expectations parallel how access to digital communication and online transactions created new consumer expectations for speed, service, and convenience in the postal industry.

Technological innovations shifted the mode of accessing entertainment – first to online rental, and then to streaming content online. In the postal industry, technological advances have had a similarly disruptive effect by reducing people's use of mail for communication and transactions but increasing their demand for packages.

Large Physical Retail Footprint

Like the Postal Service, Blockbuster had thousands of physical locations across the country and faced the challenge of determining how to maximize the value of its brick-and-mortar retail assets.

How Netflix and Blockbuster Adapted to Change

Netflix achieved success through continuous adaptation, while Blockbuster waited too long to respond to disruption and remained tied to an unsustainable business model.

Netflix: Continuously Adapting its Business Model

From its beginning in 1997, Netflix anticipated and prepared for change in the movie rental industry by continuously evolving its business model accordingly. Initially, customers paid a fee for each rental and could also purchase DVDs through its website. The company regularly tested different promotions with consumers and found great success in offering a subscription-based rental service that allowed customers to rent a certain number of DVDs at a time and keep each DVD at home as long as they wanted, with no late fees. After a successful pilot, this became the company's primary business model. Netflix continuously tested new services that improved the customer experience, including personalized movie recommendations.

Even as Netflix adapted and optimized its business model for online DVD rentals, its leaders were aware that technology would soon make that model obsolete. From the earliest meetings with potential investors, Netflix anticipated that home Internet would become fast enough to handle digital transmission of video entertainment directly to people's homes.[21] In 2007, the company began offering customers the option to stream some of its content.[22] Netflix bought the streaming rights to some shows and movies through affordable deals with content owners who did not anticipate the rapid rise in streaming.

21 Marc Randolph, *That Will Never Work: The Birth of Netflix and the Amazing Life of an Idea*, (New York: Little, Brown and Company, 2019).
22 Cynthia Littleton and Janko Roettgers, "Ted Sarandos on How Netflix Predicted the Future of TV," *Variety*, August 21, 2018, https://variety.com/2018/digital/news/netflix-streaming-dvds-original-programming-1202910483/.

As Netflix grew its market share of the video rental industry through its DVD rental and streaming services, it continued to look for new opportunities to adapt and transform. In 2012, it began offering exclusive content that could only be viewed on its streaming platform.[23] Exclusive content brought in new users and helped prepare the company for the rise of content producers' own streaming services. Netflix also began releasing entire new seasons of episodic series on its streaming service at the same time instead of releasing episodes weekly, a new approach that appealed to customers and has become common in the industry.

Netflix: Making the Most of Limited Physical Infrastructure

Netflix had only one warehouse in California, but it used data to maximize the effectiveness of this limited physical infrastructure. It determined that most of the DVDs people wanted to rent were already in circulation somewhere in their region. Netflix built 60 small facilities around the U.S. that had a limited storage capacity but were designed to quickly route a DVD returned by one user to a nearby user waiting for the same title. This innovation allowed the company to provide 95 percent of the continental U.S. with next-day DVD delivery without building additional warehouses around the country.[24]

Blockbuster: Committing to an Unsustainable Business Model

Blockbuster entered the 2000s still focused on its traditional model of rentals at physical stores. It continued to pursue a model that included built-in consumer discontent. Late fees were unpopular but were estimated to account for more than 20 percent of the company's pretax profits. For example, a Blockbuster consultant once proposed increasing customer satisfaction by emailing reminders to customers about when their rentals were due, but the company rejected this idea because reminding customers would reduce late fee revenue.[25]

Blockbuster was dismissive of Netflix and did not demonstrate a willingness to adapt to or anticipate the effect of changing technology. In 2000, Blockbuster and Netflix executives met, and Netflix offered to sell itself to Blockbuster for $50 million, in essence becoming Blockbuster's online presence. Blockbuster did not accept the offer.[26] Also in 2000, Blockbuster partnered with another company to develop an online video platform, but despite developing a working pilot, Blockbuster abandoned this project in 2001.[27] After that, Blockbuster never offered a streaming service to consumers.[28]

As it lost market share to Netflix and other competitors, Blockbuster belatedly tried to match its competitor's innovations.[29] In 2004, Blockbuster announced its own DVD-by-mail rental service and, in 2005, stopped charging late fees at its stores.[30] In 2006, Blockbuster tried to use its physical stores as an asset, allowing customers to return a DVD rented online to those locations and exchange it for an in-store rental. The new model helped Blockbuster grow its share of the DVD-by-mail rental market, but Blockbuster lost money on each exchange transaction and the company's debt, among other factors, made it difficult to sustain this model. Soon, Blockbuster changed the terms of that service, reinstated late fees, and scaled back investment in its online offerings.[31]

Takeaways for the Postal Service

The home video rental case study suggests that the Postal Service should focus on building its capacity for rapid innovation and address consumer discontent before it becomes a strategic problem.

23 Joe Nocera, "Can Netflix Survive in the New World It Created?" *The New York Times*, June 15, 2016, https://www.nytimes.com/2016/06/19/magazine/can-netflix-survive-in-the-new-world-it-created.html.
24 Marc Randolph, *That Will Never Work*.
25 Michael Schrage, "Blockbusted: A Case Study in Experimental Frustration and Failure," in *The Innovator's Hypothesis: How Cheap Experiments Are Worth More than Good Ideas*, (Cambridge: MIT Press, 2014).
26 Marc Randolph, *That Will Never Work*.
27 Anne Marie Squeo and Bruce Orwall, "Enron and Blockbuster Terminate Partnership for Video-on-Demand," *Wall Street Journal*, March 12, 2001, https://www.wsj.com/articles/SB984181374790463655 and Nathan Gregory, "Blockbuster VOD Demo (2001)," YouTube video, 20:23, December 17, 2016, https://www.youtube.com/watch?v=xml4usZJsUQ.
28 After Blockbuster went bankrupt in 2010, Dish Network offered a streaming service under the Blockbuster brand.
29 In addition to Netflix, Blockbuster faced competition from Redbox, another innovative company that allowed people to rent DVDs from physical kiosks set up in convenient locations, such as grocery stores.
30 Eve Tahmincioglu, "More Companies Say, 'The DVD Is in the Mail,'" *New York Times*, December 26, 2004, https://www.nytimes.com/2004/12/26/business/yourmoney/more-companies-say-the-dvd-is-in-the-mail.html.
31 John Antioco, "How I Did It: Blockbuster's Former CEO on Sparring with an Activist Shareholder," *Harvard Business Review*, April 2011, https://hbr.org/2011/04/how-i-did-it-blockbusters-former-ceo-on-sparring-with-an-activist-shareholder and Greg Satell, "A Look Back At Why Blockbuster Really Failed And Why It Didn't Have To," *Forbes*, September 5, 2014, https://www.forbes.com/sites/gregsatell/2014/09/05/a-look-back-at-why-blockbuster-really-failed-and-why-it-didnt-have-to/?sh=26641bef1d64.

Develop the Capacity for Rapid Innovation

From the time of its founding, Netflix focused on anticipating and preparing for possible changes in its market. The company began renting out DVDs when the technology to watch them was barely available to consumers. It foresaw the importance of video-on-demand technology and offered that service to customers when home Internet connections became fast enough to support it. It evolved its streaming service and became a content owner and producer, drawing in more customers with exclusive content. Blockbuster, by contrast, resisted change, continuing to focus on its retail rental service, which relied on unpopular late fees for revenue. Instead of looking for ways to take advantage of cutting-edge technology and stay ahead of the curve, the company waited until it had to attempt a drastic reworking of its business model to adapt to disruptions in the industry.

For the Postal Service, this case study suggests a need to stay on the cutting edge of shipping and delivery technology and to anticipate changes in customer needs and behavior. Potential future changes in the market could include new delivery modes, increased expectations for same-day or even speedier delivery, and alternative delivery locations.

A process and culture of fast innovation is essential for organizations to stay ahead of the curve. Piloting innovative ideas and testing new products can yield new sources of revenue and allow an agency or company to better meet changing customer demands and behaviors. Currently, the rules regarding the market testing of new postal products or initiatives can slow down the process of implementing change. Working with customers to explore what solutions might or might not work can help the Postal Service identify promising innovations before going into a formal pilot. A greater focus on incorporating customer feedback from the outset when conceiving new solutions can speed up the innovation process, increase the chances that new initiatives succeed, and develop a stronger culture of experimentation.

Address Consumer Discontent Before It Becomes a Bigger Problem

Netflix prospered by offering a service that addressed the key sources of consumer discontent, while Blockbuster failed to adequately respond to changing expectations. Netflix offered a service that avoided late fees and eliminated the problem of limited in-store selection, two major sources of dissatisfaction among Blockbuster customers. Blockbuster remained tied to late fees as a pillar of its financial model until 2005, by which time Netflix had attracted more than four million customers.[32]

For the Postal Service, this example demonstrates the importance of identifying where customers consistently feel frustration and addressing those problems before they become a strategic issue. This highlights the importance of the Postal Service's internal process for identifying and evaluating which customer complaints at the local level might indicate a larger systemic problem and elevating these to higher levels of management. However, as the Netflix case demonstrated, it is the ability to anticipate customer needs and wants that is most important for reducing the risk that major customer discontent arises in the future. For example, the agency's Brand Health Tracker, an ongoing survey of consumers and commercial postal customers, collects valuable data on current perceptions of postal products and services. Investing in efforts to project future trends in customer expectations can help the Postal Service understand both the current needs of customers and likely future trends.

Addressing customer dissatisfaction requires the Postal Service to respond to the needs of different sets of customers. A challenge for the agency is balancing potential conflicts between the interests of various customer groups and offering a channel that they all value. For example, residential customers may not want large quantities of marketing mail that they do not find relevant, while mailers are trying to reach the largest number of potential customers. The agency has made strides in this area by working with mailers to ensure their mail is as targeted as possible, and it has also tried to ensure that residential customers will actively engage with mail that they find relevant to their lives. Informed Delivery is one example of a program that has allowed mailers to better target marketing mail

32 Mansoor Iqbal, "Netflix Revenue and Usage Statistics (2021)," *Business of Apps*, March 9, 2021, https://www.businessofapps.com/data/netflix-statistics/.

and offer more interactive features for consumer engagement. For residential postal customers, Informed Delivery has allowed them to quickly see when a relevant piece of marketing mail is on the way and learn more about that message even before they open the mailbox. These efforts demonstrate that the needs of senders and recipients are closely interrelated. Catering to both groups is essential for preserving the relevance and value of the postal channel going forward.

Multiple Disruptions Transformed Brick-and-Mortar Retail

Over the past 25 years, several interconnected disruptions impacted the retail industry. Ecommerce emerged in the late 1990s and grew rapidly; by 2018, U.S. ecommerce sales totaled $520 billion.[33] The Great Recession of 2007 to 2009 negatively impacted consumer spending and some retailers struggled to recover, leading to a ‘retail apocalypse’ in the 2010s. Numerous stores filed for bankruptcy, closed store locations, or went out of business entirely. Today, the retail landscape continues to evolve, with in-store and online shopping becoming less distinct. The COVID-19 pandemic has further hastened the integration of these two shopping channels.

Similarities to the Postal Industry

The retail industry, like the Postal Service, relies on an extensive physical footprint but must respond to the changing way in which consumers expect to use these retail spaces.

Extensive Physical Retail Footprint Coupled with Changing Use

Digital sales account for an increasing proportion of retail sales in the U.S. Between 2012 and 2019, digital sales in the U.S. grew from five to 11 percent of all retail sales.[34] The COVID-19 pandemic accelerated this trend; 14 percent of 2020 retail sales were made through digital channels. As customer behavior changed, brick-and-mortar retailers strategized how to best adapt their existing physical retail networks. Similarly, the Postal Service maintains a nationwide network of 31,000 retail post offices that are experiencing declining customer use. Post office transactions decreased by one-third between 2004 and 2020, and 42 percent of post offices do not generate enough revenue to cover their costs.[35] The Postal Service must provide services and products to all areas of the U.S., and post offices that operate at a deficit are explicitly protected from closure.[36] The Postal Service is continuously exploring ways to expand the services provided at post offices, generate retail revenue, and make post offices a more convenient and inviting destination for customers.

> The Postal Service maintains a large retail network that is experiencing changing customer use, much like the brick-and-mortar retail industry.

How Brick-and-Mortar Retailers Adapted to Change

Successful brick-and-mortar retailers adapted to the growth of ecommerce by embracing technology-driven innovations that leveraged stores’ proximity to customers and bridged online and in-person retail.

One example of this strategy is ‘buy online pickup in store’ or BOPIS. With BOPIS, a customer can buy a product online and pick it up at a retail store, typically within two hours. BOPIS was growing in popularity even before the pandemic; sales from this channel more than doubled between 2017 and 2019.[37] COVID-19 further drove adoption of BOPIS, and BOPIS sales in 2020 again more than doubled from the previous year.[38] Allowing order pickup at a local store leverages stores’ proximity to customers to provide goods quickly. Compared to Amazon’s standard next-day delivery, offering merchandise within a few

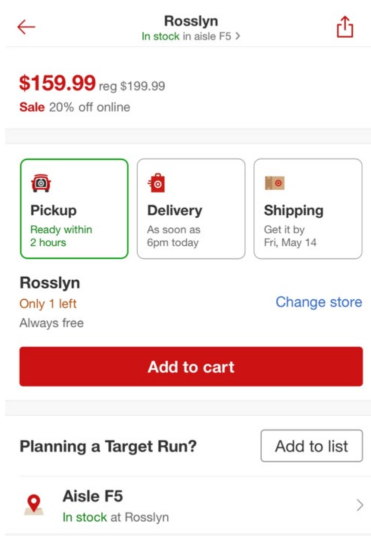
33 U.S. Census Bureau, *E-Stats 2018: Measuring the Electronic Economy*, Report No. E18-ESTATS, May 21, 2020, https://www.census.gov/content/dam/Census/library/publications/2018/econ/e18-estats.pdf.
34 U.S. Census Bureau, “Quarterly retail e-commerce sales, 4th quarter 2020”, Report No. CB21-23, February 19, 2021, https://www2.census.gov/retail/releases/historical/ecomm/20q4.pdf.
35 U.S. Postal Service Office of Inspector General, *Revenue and Costs in the Retail Network*, Report No. RISC-WP-21-003, April 12, 2021, https://www.uspsoig.gov/sites/default/files/document-library-files/2021/RISC-WP-21-003.pdf, p. 1.
36 39 U.S.C. § 101(b).
37 BOPIS is also known as ‘click and collect’. “Click and Collect Sales 2017-2023”, eMarketer, December 2019, and Holly Briedis, Anne Kronschnabl, Alex Rodriguez, and Kelly Ungerman, *Adapting to the next normal in retail: The customer experience imperative*, McKinsey & Company, May 2020, https://www.mckinsey.com/~/media/mckinsey/industries/retail/our%20insights/adapting%20to%20the%20next%20normal%20in%20retail%20the%20customer%20experience%20imperative/adapting-to-the-next-normal-in-retail-the-customer-experience-imperative-v3.pdf?shouldIndex=false, p. 2.
38 “Click and collect, an already popular option, finds a new gear”, eMarketer, March 29, 2021, https://content-na1.emarketer.com/click-collect-already-popular-option-finds-new-gear.

hours can be a competitive advantage. For example, Target offers both in-store and curbside pickup of online orders. In 2020, Walmart introduced its Express Delivery service, which uses contracted delivery drivers to deliver goods directly from 2,000 Walmart stores within two hours of purchase.[39]

Figure 5: Omnichannel Retail Experiences

INTEGRATING SHOPPING CHANNELS

Retailers use technology – including phone apps – to bridge digital and in-person retail. For example, the Target app shows the in-store availability of products and the location of the item. The app also allows the customer to opt for in-store pickup or same-day delivery. Brick-and-mortar retailers can use their retail networks to get customers their items more quickly.



Brick-and-mortar retailers also used their physical stores to support delivery directly from the store. Stores can also be used as mini fulfillment centers or even ‘dark stores.’ Dark stores are retail locations (generally found in more densely populated areas) that do not offer traditional in-person shopping. Rather, these locations only fulfill delivery or pickup orders.[40] Whole Foods Market opened a dark store in Brooklyn, NY that only processes delivery orders.

In addition to using technology to bridge online and in-person shopping, retailers improved the in-store experience for shoppers. These changes included offering different product assortments, improving stores’ look and feel, and introducing new store formats catering to specific communities. For example, Target is rolling out smaller stores in urban areas and near college campuses, two new locations for the retailer. Discount retailer Dollar General, prevalent in rural areas, is also introducing a small-format store called DGX for urban shoppers.

Partnerships and ‘store within a store’ models can be mutually beneficial for the retailers involved. With these models, one retailer agrees to sell another product inside its stores, while the other retailer has a degree of control over the look and feel of the space. Retail partnerships and ‘store within a store’ models can drive foot traffic, improve the customer experience, and increase profitability. Examples include Sephora Inside JCPenney, the Etsy Shop at Macy’s, and West Elm’s collaboration with Casper mattresses. Target leverages partnerships in several ways, such as through CVS branding and operation of all in-store pharmacies and a recent partnership with beauty retailer Ulta to design a store-within-a-store at 100 Target locations. In another type of partnership model, retailers may sell their products at small kiosks located within a larger retailer’s facility.

Takeaways for the Postal Service

The Postal Service’s extensive retail network is often seen as a primary strength of the agency, enabling accessibility to every American. However, maximizing the value of this network, especially given retail purchase declines over the past 15 years, will be critical to the Postal Service’s continued success.

Enhance In-Store Experiences to Boost Customer Satisfaction and Retention

Retailers worked to improve multiple aspects of customers’ in-store experience through innovations such as new store formats or curated product assortments. The Postal Service has a similar opportunity to improve customers’ retail experiences. A 2018 OIG audit estimated that customers have negative

39 Walmart, “Walmart introduces Express Delivery,” April 30, 2020, https://corporate.walmart.com/newsroom/2020/04/30/walmart-introduces-express-delivery.
40 Blake Morgan, “Dark stores are the future of post-pandemic retail,” *Forbes*, April 25, 2020, https://www.forbes.com/sites/blakemorgan/2020/04/25/dark-stores-are-the-future-of-post-pandemic-retail/?sh=674acb8f7826.

experiences at about 25 percent of post offices.[41] The brick-and-mortar retailer case study suggests potential approaches to enhancing the post office experience, such as improving the look and feel of the retail space and developing new store formats catering to certain consumers.

There are multiple opportunities for the Postal Service to improve the in-store experience at post offices. First, the Postal Service has an opportunity to enhance the services it already provides. For example, windows that cater to certain customer needs, such as business customers or customers shipping pre-labeled packages during the holidays, can offer a more customized in-store experience. Interactive post office displays that explain different postal products and their pricing can offer customers additional information about their options.

Second, there are opportunities for the Postal Service to make additional services available at post offices. Although there are legal constraints on offering non-postal services, previous OIG research identified potential post office offerings such as notary or printing services, which would currently be allowable under the law. The same report suggested developing technology that would allow mailing and payment via a customer's electronic fingerprint.[42]

Use Omnichannel to Meet Customer Expectations

Using omnichannel, the blending of digital and physical retail, can also improve the customer experience at post offices. Online and in-person retail are no longer separate shopping channels; the line between them is blurred. It is increasingly common to purchase an item online and have the order fulfilled by a physical store, or to return an item to a physical store or even to a local post office.

Successful brick-and-mortar retailers embraced the blending of digital and physical retail. The experiences of these retailers suggest that there is room for the Postal Service to create an improved omnichannel experience for customers. In one potential example, a customer would order stamps or boxes on USPS.com and pick them up at a nearby post office. This would also save the Postal Service money, as it does not charge money for shipping Priority Mail packaging supplies to customers' homes. The Postal Service currently offers Click-N-Ship, a service to print postage at home; however, the service requires supplies like packaging, a scale, and a printer. There are potential opportunities for the Postal Service to develop an omnichannel Click-N-Ship experience with fewer barriers to entry. For example, instead of printing a shipping label at home, the customer could receive a QR code on their phone and scan the code at the post office to print a label. Another potential omnichannel enhancement is to allow customers to complete mailing and shipping forms digitally. A window clerk could retrieve the digital form, speeding up the customer's transaction.

Leverage Proximity to Customers to Keep the Retail Network Viable

Retailers use their presence in communities as a competitive advantage against online-only competitors like Amazon. The Postal Service maintains a retail presence in just about every community in the U.S., something not shared by any parcel carrier, retailer, or other government agency (Figure 6 shows the Postal Service's vast network of post offices).[43] Proximity to customers is an asset the Postal Service can continue promoting to ensure that customers value its retail network.

One way to take advantage of the proximity of post offices to American communities is to provide additional non-postal services at these retail locations. These services can make post offices a more essential part of every community. The Postal Service already partners with other government agencies to process passport applications or provide identity management services. Past OIG research highlighted some additional partnership opportunities for post offices, such as installing health kiosks or offering additional government services.[44] These offerings would be especially valuable to customers in rural areas who

41 U.S. Postal Service Office of Inspector General, *Customer Retail Experience*, Report No. SAT-AR-18-001, September 28, 2018, https://www.uspsoig.gov/sites/default/files/document-library-files/2018/SAT-AR-18-001.pdf, p. 1.
42 U.S. Postal Service Office of Inspector General, *Retail Opportunities for the U.S. Postal Service*, Report No. MS-WP-15-004, September 4, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/ms-wp-15-004_0.pdf, pp. 7, 10-11.
43 U.S. Postal Service Office of Inspector General, *Revenue and Costs in the Retail Network*, p. 3.
44 Health kiosks use videoconferencing and medical equipment to facilitate individual health exams. U.S. Postal Service Office of Inspector General, *Partnering for Health: Potential Postal Service Roles in Health and Wellness*, Report No. RISC-WP-21-001, March 11, 2021, https://www.uspsoig.gov/sites/default/files/document-library-files/2021/RISC-WP-21-001.pdf, p. 13.

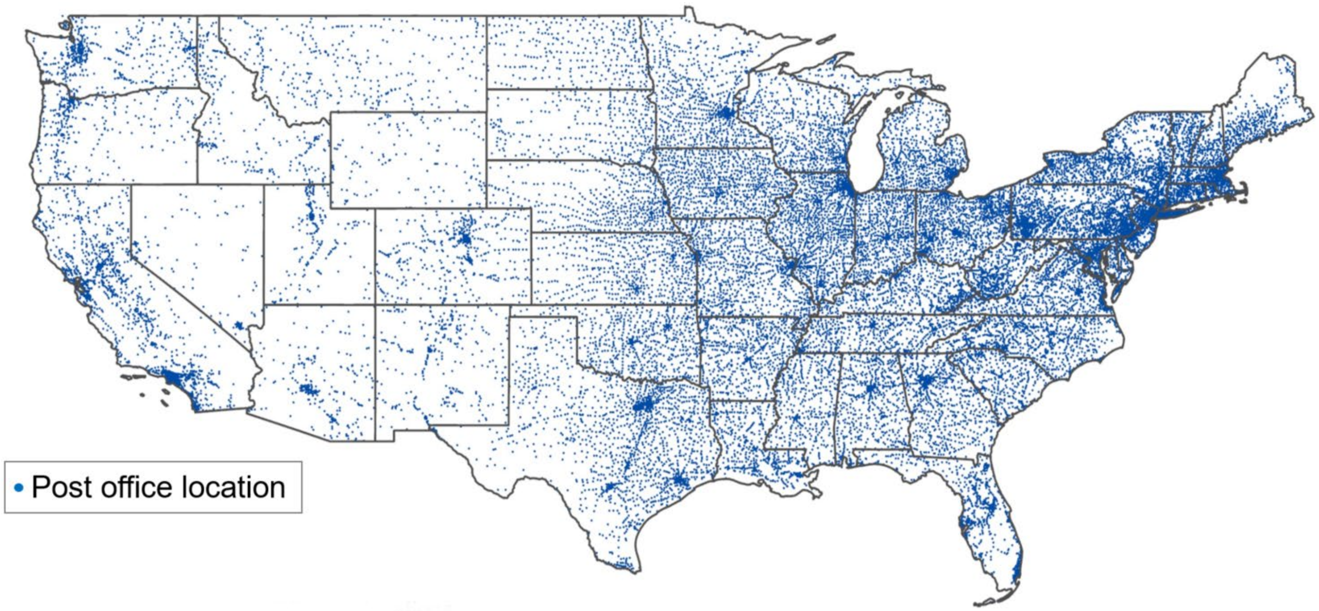
otherwise have to travel long distances to access these services. Previous OIG research also found that the Postal Service has an opportunity to expand its program to lease space for broadband antennae on post office properties.[45] Finally, the Postal Service can designate some post offices as drop-off points for package-less ecommerce returns. However, some partnerships may require changes to the laws and regulations governing the Postal Service.

The Postal Service is considering initiatives aimed at improving the postal retail experience, including a $4 billion investment in retail units. Planned retail strategic changes include refreshed lobbies, employee training, as well as expanded government services for the public, such as notary services.[46] In addition, the agency is examining the potential for post offices to become hubs of local

Figure 6: Post Office Locations

MOST AMERICANS LIVE NEAR A POST OFFICE

The Postal Service maintains more than 31,000 post offices nationwide, providing access to most American communities. The map below depicts post office locations in the 48 contiguous states. There are opportunities to extract more value from the retail network and enhance the customer experience at post offices.



Source: OIG analysis of USPS retail locations.

45 U.S. Postal Service Office of Inspector General, *Next Generation Connectivity: Postal Service Roles in 5G and Broadband Deployment*, Report No. RISC-WP-20-009, September 14, 2020, https://www.uspsoig.gov/sites/default/files/document-library-files/2020/RISC-WP-20-007.pdf.

46 U.S. Postal Service, *Delivering for America: Our Vision and Ten-Year Plan to Achieve Financial Sustainability and Service Excellence*, p. 34.

economic activity by supporting small businesses and enhancing package return services.

Significant Changes Require Stakeholder Support

While the Postal Service navigates disruption in its industry, there are several broader policy issues that affect how far the agency can go in setting strategies and implementing change to stay viable and relevant in the future. The Postal Service cannot make decisions about these issues on its own, but can work with stakeholders and policymakers – including Congress, the Postal Regulatory Commission, and mailers – toward building a consensus on a sustainable path forward.

Defining the Universal Service Obligation

The Universal Service Obligation (USO) is a collection of requirements that ensures all users receive a minimum level of service at a reasonable price. Currently, U.S. law does not contain a comprehensive and clear definition of the USO, leaving many of its aspects open to interpretation. For example, there are no rules about the number of access points – such as collection boxes or post offices – that the Postal Service must provide. A more specific USO would give the agency guidance on what changes it can implement to improve its financial stability while fulfilling its public service mission. Changes to the USO are under the purview of Congress.

Conflicting Mandates

The Postal Service would benefit from a political consensus about how it should balance the expectation to solely support itself with the revenue from its operations against the need to provide effective, reliable service to everyone, including delivering mail and parcels in unprofitable areas. If the Postal Service is required to continue to cover the cost of the USO with postal revenue, this will require changes to its operational model, pricing policy, and network structure. Declining mail volume, increasing operational costs, and the price cap on market dominant products have eroded the ability of the Postal Service to financially sustain its USO mandate without either changes to its scope or new sources of funding in addition to its own revenue. Reaching political consensus on whether the Postal Service should act more like a business or a public service would provide the Postal Service strategic direction as it plans for the future.

Financially Unsustainable Liabilities Related to Retirement Benefits

A 2006 law mandated the Postal Service to pay up to $5.8 billion into the Retiree Health Benefits Fund each year for 10 years, in effect prepaying the cost of health benefits decades into the future. The advent of the Great Recession in 2008 and the consistent decline in mail revenue significantly impacted the Postal Service's finances. Beginning in FY 2012, the agency defaulted on the required payments, leading to more than $74 billion in unfunded liabilities as of September 2020.[47] This issue has contributed to the Postal Service's financial losses and reduced its ability to invest in modernization of its networks and operations. On this issue, there are recent signs of cooperation. The Postal Service has pushed for reform to lessen the cost of its benefit obligations, and as of mid-2021 there appeared to be bipartisan support in Congress for legislation that would remove the prefunding mandate and integrate the Postal Service's health care with Medicare.[48]

Conclusion

The Postal Service is experiencing volume declines in its core mail products. Package volume has been increasing, though future volume is uncertain and difficult to predict. The agency is also challenged by questions about its role in American society, how it should balance service and cost coverage, and the significant financial burdens it faces.

The analysis of organizations responding to industry disruption yielded several takeaways to inform the Postal Service as it adapts to a changing postal industry. The Amtrak case study highlights the commitment to a clear strategic vision, promote that vision to stakeholders, and emphasize transparency and evidence-based business cases to build consensus around its strategy. The success of Netflix in overtaking Blockbuster as the dominant player in the home video rental and streaming industry demonstrates the importance of adapting quickly

47 U. S. Postal Service, *2020 Report on Form 10-K*, 2020, https://about.usps.com/what/financials/10k-reports/fy2020.pdf, p. 40.
48 Halley Fuchs, "Senators Introduce Bipartisan Bill to Overhaul Postal Service," *New York Times*, May 19, 2021, https://www.nytimes.com/2021/05/19/us/politics/postal-service-reform-legislation.html.

to change and addressing customer discontent before it becomes a major strategic problem. Finally, the strategies of brick-and-mortar retailers in the age of ecommerce offer lessons about enhancing the in-store experience, embracing omnichannel, and leveraging stores' proximity to customers.

The Postal Service faces difficult strategic decisions about how to best ensure its relevance and viability in the future. A broad agreement among stakeholders about the role of the Postal Service in American society will bring the clarity and support needed to increase the chances of the Postal Service to succeed in this endeavor.

Appendices

Click on the appendix title below to navigate to the section content.

Appendix A: Additional Information

Objectives, Scope, and Methodology

The objective of this white paper was to examine how large organizations have navigated major changes in their industries and consider whether their approaches might be applicable to the Postal Service as it adapts to a changing market. Sub-objectives included: 1) Identifying industries undergoing transformative changes that may allow for comparison with the mail and parcel industry, 2) Selecting notable examples of organizations that have succeeded in these changing industries, or that failed to adapt, 3) Analyzing the strategic decisions made by these organizations that contributed to their success or failure, and 4) Deriving lessons that the Postal Service could potentially learn from these examples.

The scope of this white paper differed for each of the industries discussed. For the passenger rail industry, the scope is 1971 (Amtrak's founding) to present. For the home video industry, the scope is 1997 (Netflix's founding) to present. For the retail industry, the scope is 2000 (roughly when ecommerce began) to present.

To meet our objectives, the OIG conducted research of prior OIG reports, media reports, academic studies, company reports, published books, and other relevant sources.

The OIG conducted a total of six interviews with experts in the passenger rail, video rental and streaming, and retail industries. The OIG also conducted two interviews with Postal Service representatives. The full list of interviews follows:

1. Robert Gallamore, Principal at the Gallamore Group (04/06/21),
2. Michael Pachter, Analyst at Wedbush Securities (04/12/21),
3. Amtrak OIG Office of Audits (04/12/21)
4. Tarun Kushwaha, Professor of Marketing at George Mason University (04/13/21),
5. Katherine Cullen, Senior Director of Industry & Consumer Insights at the National Retail Federation (04/26/21),
6. Surcharita Kodali, VP and Principal Analyst at Forrester (05/05/21), and
7. Postal Service executives focused on strategic planning and future products.

We conducted this work in accordance with the Council of the Inspectors General on Integrity and Efficiency, Quality Standards for Inspection and Evaluation. We discussed our observations and conclusions with management on July 9, 2021, and included their comments where appropriate.

Prior Coverage

Report Title	Objective	Report Number	Final Report Date
Revenue and Costs in the Retail Network	1) Examine the revenue generated by each postal retail unit and the costs associated with operating each facility, 2) analyze differences in the revenue/costs ratios for retail units across the country, and 3) provide insights for optimizing the retail network.	RISC-WP-21-003	April 12, 2021

Report Title	Objective	Report Number	Final Report Date
Package Delivery in Rural and Dense Urban Areas	To explore the unique issues related to package delivery in remote rural and dense urban areas, and to identify opportunities to remedy the challenges. Further, this paper examines the Postal Service's position in the package delivery market in rural and dense urban areas.	RISC-WP-20-008	September 16, 2020
Reevaluating the Universal Service Obligation	1) Provide an overview of the Postal Service's current universal service obligation and the challenges faces in continuing to provide services that meet its USO; 2) identify recent changes in foreign posts' USOs that may provide valuable insight for the U.S. Postal Service, 3) assess the importance of gathering information on stakeholder needs prior to redefining the USO.	RISC-WP-20-004	May 6, 2020
Same-Day Delivery: Implications for the U.S. Postal Service	To assess current customer interest in same-day delivery products and draw conclusions regarding the potential value of same-day delivery to USPS and its customers.	RISC-WP-20-002	January 8, 2020
A Closer Look at Postal Labor Costs	To get a better understanding of the sources of the Postal Service's labor costs and how it has changed over the last 10 years.	RISC-WP-20-001	December 2, 2019

Appendix B: Management's Comments

UNITED STATES POSTAL SERVICE

August 2, 2021

JENNIFER MYKIJEWYCZ
DIRECTOR, OPERATIONS CENTRAL
RESEARCH AND INSIGHTS SOLUTION CENTER

SUBJECT: How Institutions Change – Final Review Draft (Project Number 2021RISC006)

The Postal Service has reviewed the OIG draft report on How Institutions Change, and generally agrees with the overall findings. The conclusions of the report are:

1. The U.S. Postal Service needs a clear strategic vision with supporting business case
2. The U.S. Postal Service must adapt to quickly changing mailing and shipping industries
3. The U.S. Postal Service should embrace omnichannel and leverage locations in close proximity to customers

All three conclusions have already been realized and addressed in the March 23, 2021 release of the U.S. Postal Service Delivering for America, Our Ten-Year Plan to Achieve Financial Sustainability and Service Excellence. The Delivering for America plan clearly defines the strategic vision for the Postal Service as well as the organizational structure and investment strategies to drive successful execution of the plan.

As the OIG is aware, there has been an extensive communications and education effort to all stakeholder groups. Incorporated within the Delivering for America Plan are initiatives to invest and restructure to meet current and future customer needs – and to adapt quickly as market and customer demands evolve in both the mailing and shipping industries. As is also articulated in the plan, we have initiatives already underway for both mail and shipping which will continue to leverage our assets – digital and physical to serve our customers.

As defined in Delivering for America plan, we have clearly defined our role to bind the nation together – delivering reliable service at affordable prices while returning the U.S. Postal Service to financial stability.

Steven W. Monteith
Chief Customer & Marketing Officer
and Executive Vice President

Jacqueline Krage Strako
Chief Commerce & Business Solutions
Officer and Executive Vice President

cc: Thomas J. Foti, Vice President, Product Solutions
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We conducted work for this white paper in accordance with the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluation (January 2012).