OFFICE OF
INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Package Price Simplification

Audit Report

Report Number
CP-AR-15-001

December 23, 2014

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Highlights

Opportunities exist for the Postal Service to offer new products and simplify package prices. Unnecessary prices create complexity and barriers to entry for new customers.

Background

Since fiscal year (FY) 2012, the number of U.S. Postal Service package prices has grown from 7,180 to 8,779, a 22 percent increase. Of the current total, 2,148 are retail prices and 6,631 are commercial prices.

In FY 2012, the U.S. Postal Service Office of Inspector General issued a report (*Postal Service Pricing Strategy*, Report Number CI-AR-12-002) that recommended the Postal Service develop a strategic plan to simplify pricing to eliminate unnecessary barriers to mail use. To address the recommendation, the Postal Service created Delivering Results, Innovation, Value, and Efficiency Initiative 15, Integrate Costing and Pricing for Profitable Revenue Growth. However, the initiative did not specifically address package price simplification and the Postal Service closed the initiative in April 2014.

Our objective was to identify and evaluate opportunities the Postal Service has to simplify package prices for the retail and commercial customer segments.

What the OIG Found

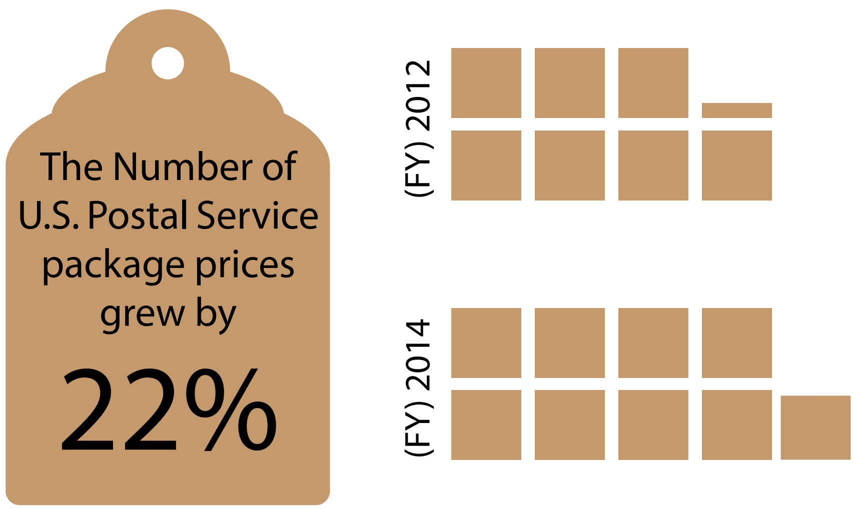
Opportunities exist for the Postal Service to offer new products and simplify package prices. The Postal Service has not expanded the number of Flat Rate Box dimensions offered since FY 2009. Although the Postal Service has conducted studies on Flat Rate Box market demand, it has not used the studies to introduce new dimensions to Flat Rate offerings. Offering new products would enable the Postal Service to meet changing customer needs, thereby helping it to be competitive and retain or gain customers. Furthermore, the Postal Service has 1,092 unused Parcel Select prices and 5,840 prices for packages weighing more than 20 pounds, which have low or no volume. Unnecessary prices create complexity and barriers to entry for new customers.

What the OIG Recommended

We recommended the vice president, Pricing, in coordination with the vice president, New Products and Innovation, periodically evaluate market demand for Flat Rate and other package products in the retail and commercial segments.

We also recommended they develop a strategic plan to simplify package prices by adjusting or eliminating low or no volume package prices to reduce complexity for customers.

Hover over the price tags to reveal more information



Transmittal Letter

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

December 23, 2014

MEMORANDUM FOR: CYNTHIA SANCHEZ-HERNANDEZ
VICE PRESIDENT, PRICING

GARY C. REBLIN
VICE PRESIDENT, NEW PRODUCTS AND INNOVATION

E-Signed by Kimberly Benoit
ERIFY authenticity with eSign Deskto

FROM: Kimberly Benoit
Deputy Assistant Inspector General
for Technology, Investment, and Cost

SUBJECT: Audit Report – Package Price Simplification
(Report Number CP-AR-15-001)

This report presents the results of our audit of the U.S. Postal Service's Package Price Simplification (Project Number 14WO021DP000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Kevin H. Ellenberger, director, Cost and Pricing, or me at 703-248-2100.

Attachment

cc: Corporate Audit and Response Management

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Findings

Of the 8,779 package prices in FY 2014, 2,148 were retail and 6,631 commercial, a 22% increase in package postage prices since FY 2012.

The Postal Service has unused Parcel Select prices and prices with low to no volume for packages weighing more than 20 pounds. The Postal Service could also consider expanding the number of Flat Rate Box dimensions.

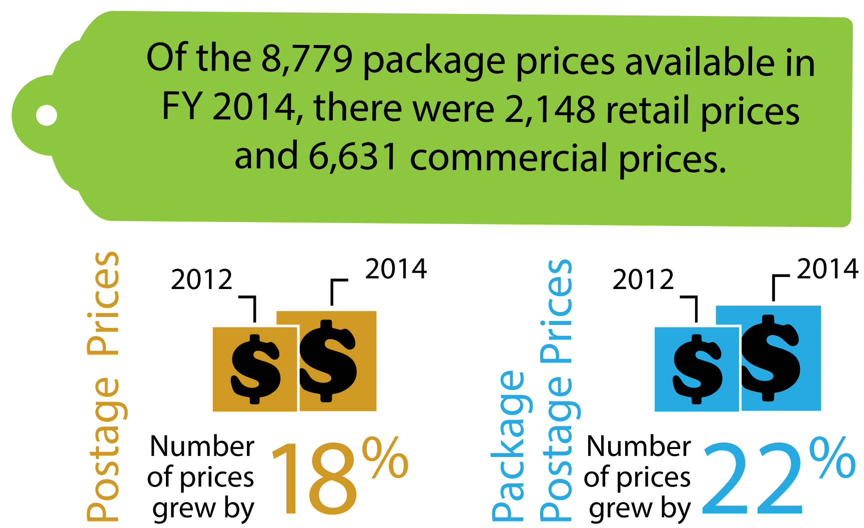
Introduction

This report presents the results of our audit of the U.S. Postal Service's Package Price Simplification (Project Number 14WO021DP000). The objective of this self-initiated audit was to identify and evaluate opportunities the Postal Service has to simplify package prices for the retail and commercial customer segments. See Appendix A for additional information about this audit.

The U.S. Postal Service Office of Inspector General (OIG) raised the issue of pricing simplification in a fiscal year (FY) 2012 report titled *Postal Service Pricing Strategy* (Report Number CI-AR-12-002, dated December 9, 2011). In that report we concluded that, due to declining mail volume, the Postal Service should reduce or eliminate any unnecessary barriers to entry to encourage mail use. Specifically, the OIG recommended the Postal Service develop a strategic plan to simplify pricing. The Postal Service agreed it could simplify price tables heavily used by consumers and should eliminate unnecessary complexity.

To close out the OIG recommendations, the Postal Service created Delivering Results, Innovation, Value, and Efficiency (DRIVE) Initiative 15, Integrate Costing and Pricing for Profitable Revenue Growth. However, the Postal Service closed DRIVE Initiative 15 in April 2014 and replaced it with DRIVE Initiative 47, Greenfield Costing. Although the DRIVE initiatives addressed pricing, neither specifically addressed package price simplification.

Of the 8,779 package prices available in FY 2014, there were 2,148 retail prices and 6,631 commercial prices. From FYs 2012 to 2014 the number of postage prices grew by 18 percent, while the number of package postage prices increased by 22 percent.



Conclusion

Opportunities exist for the Postal Service to offer new products and simplify package prices. The Postal Service has not expanded the number of Flat Rate box dimensions offered since FY 2009.[1] Although the Postal Service has conducted studies on Flat Rate box market demand, it has not used the studies to introduce new dimensions to Flat Rate offerings. Offering new products would enable the Postal Service to meet changing customer needs, thereby helping it to be competitive and retain or gain customers. Furthermore, the Postal Service has 1,092 unused Parcel Select prices and 5,840 prices for packages weighing more than 20 pounds, which have low or no volume. Unnecessary prices create complexity and barriers to entry for new customers.

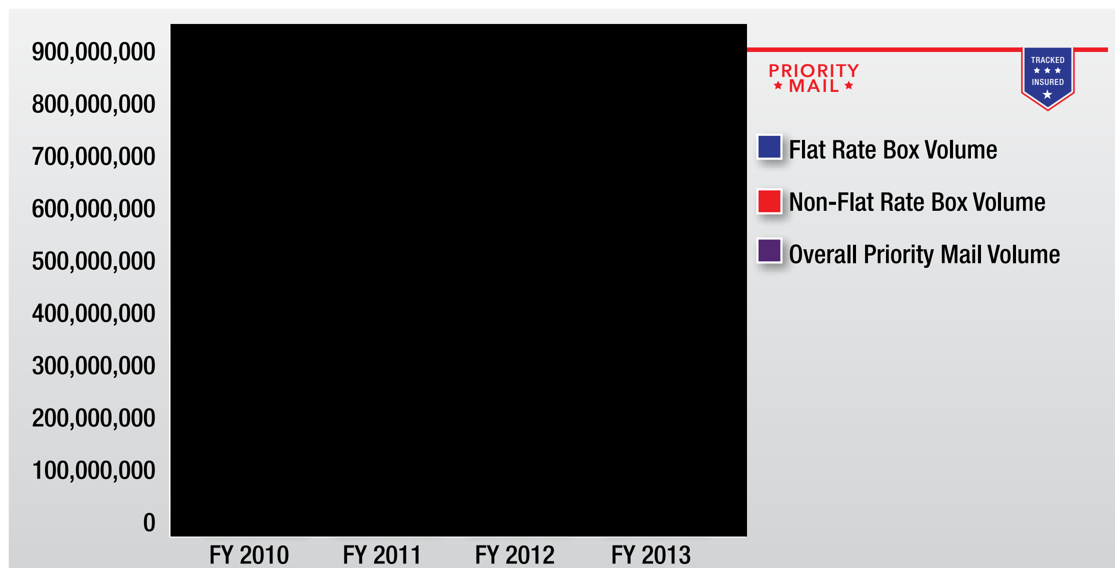
1 The Postal Service introduced two Priority Mail Express Flat Rate boxes in FY 2012. The dimensions of the boxes are the same as the two Priority Mail Medium Flat Rate boxes introduced in FY 2004.

New Flat Rate Box Offerings

The Postal Service has not expanded the number of Flat Rate box dimensions offered since FY 2009. Currently the Postal Service offers five Flat Rate package dimensions for Priority Mail and Priority Mail Express services, but does not offer Flat Rate pricing for any other package services. By comparison, domestic competitor FedEx introduced FedEx One Rate with nine different package dimensions and three different service standards.

Before introducing the medium-sized Flat Rate box in FY 2004, the Postal Service completed a customer study to determine the optimal box size. Additional studies on market demand for Flat Rate boxes were conducted in FYs 2006, 2012, and 2013; however, no changes have been made to the dimensions of Flat Rate box offerings. Although Flat Rate box revenue has increased, Priority Mail Flat Rate package volume has not grown as a percent of total Priority Mail since FY 2010.

Figure 1. Priority Mail Flat Rate Packages Compared to Total Priority Mail



Source: Postal Service billing determinant data from FYs 2010-2013.

Additionally, the Postal Service has recently begun to evaluate opportunities to simplify Flat Rate Box prices. Leveraging studies on market demand to develop new products and competitively price package services would help the Postal Service to retain customers and acquire new business.

Unused Parcel Select Prices

In FY 2013, the Postal Service had over 1,500 prices for non-drop shipment Parcel Select packages; 1,092 of those price categories had no volume. The price structure includes over 1,000 prices for two different presortation levels and over 500 prices for non-presorted packages. The Postal Service has begun to analyze its price structure but has not yet established a plan to simplify these prices.

Low usage or no usage prices create complexity that can confuse customers and create barriers to entry in the marketplace, causing the Postal Service to lose customers or fail to acquire new ones.

Low to no Volume for Packages Weighing More Than 20 Pounds

The Postal Service has 5,840 prices for packages weighing more than 20 pounds; however, these pricing categories have little or no volume. Specifically, 1,469 prices (about 25 percent) had no volume associated with them in FY 2013. In addition, 4,371 prices (about 75 percent) were used, but only accounted for 0.2 percent of the 3.7 billion packages mailed in FY 2013. These pricing categories include a different price for each pound up to 70 pounds and for each zone or distance traveled for eight zones.

Table 1. Number of Prices Over 20 Pounds With No Volume

Package Service	Number of Prices With No Volume
Parcel Select	1,016
Priority Mail	252
Priority Mail Express	121
Parcel Return Service	80
Total	**1,469**

Source: FY 2013 Postal Service billing determinant data.

A look at industry practices found that the Postal Service's leading package competitors, FedEx and UPS, announced that in the third quarter of FY 2014[2] they are moving from weight-based pricing to dimension-based pricing for their ground-transported packages. FedEx will make this change January 1, 2015, and UPS will do so December 29, 2014. The Postal Service recently evaluated its prices and implemented a change in commercial prices. The Postal Service believes price simplification is important and has identified it as an area to examine; however, a decision has not been made regarding the direction of this effort.

With almost 1,500 unused prices and over 4,000 underused prices, the Postal Service's pricing structure is unnecessarily complex, creates barriers to new customer entry, and does not reflect the marketplace, which can affect its ability to retain customers and acquire new ones.

2 *FedEx Announces Pricing Changes*, dated May 4, 2014; and *UPS Announces Dimensional Weight Changes*, dated June 17, 2014.

Recommendations

We recommend management periodically evaluate market demand for Flat Rate and other package products; and develop a strategic plan to simplify package prices for low or no volume.

We recommend the vice president, Pricing, in coordination with the vice president, New Products and Innovation:

1. Periodically evaluate market demand for Flat Rate and other package products in the retail and commercial marketplace.

2. Develop a strategic plan to simplify package prices by adjusting or eliminating low or no volume package prices to reduce complexity for customers.

Management's Comments

Management partially agreed with our findings and recommendations and their proposed corrective actions are responsive to the issues discussed in this report. Management stated they will work with the Market Research team, as needed, to periodically evaluate Flat Rate and other package products in the retail and commercial marketplace. Management also agrees that the 1,500 price cells for non-drop shipment parcel select are candidates for elimination and will renew efforts to reevaluate this action. Finally, management agrees they need to consider a strategic plan for simplifying prices but are not certain that eliminating low to no volume price cells would achieve this and need to carefully evaluate price cells before elimination. The target date for completing the reevaluation is September 2016.

Management provided the following comments to specific information in the report:

- Management believes comparing Postal Service Flat Rate boxes to FedEx One Rate boxes is misleading. Management stated that One Rate boxes are more analogous to the Postal Service's Regional Rate boxes because they are priced based on distance travelled. Management added that when the Postal Service adds Regional Rate boxes to Flat Rate boxes, it has more dimension offerings than FedEx One Rate boxes.

- Management also noted that the statement, "Priority Mail Flat Rate package volume has not grown as a percent of total Priority Mail since 2010," ignores the introduction of Regional Rate boxes. Management contends that if you combine the volume of both Flat Rate and Regional Rate boxes the Postal Service's share of total Priority Mail package volume grew from [redacted] to [redacted] percent from FYs 2010 to 2013.

- Management noted that the statement, "FedEx and UPS are moving from weight-based pricing to dimension-based pricing for their ground-transported packages," is somewhat misleading. Management added that FedEx and UPS will still price based on weight, but only when parcel density exceeds a certain density threshold, otherwise a dimensional weight will be assessed. Management added this could be confusing to shippers but they expect it to benefit the Postal Service with new volume, which intentionally maintains its weight-based only and simpler rate structure for ground shipments.

See Appendix B for management's comments, in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations in the report and the actions planned should resolve the issues discussed in the report.

Regarding management's comments to specific information in the report:

- Management believes comparing Postal Service Flat Rate boxes to FedEx One Rate boxes is misleading. Management stated that One Rate boxes are more analogous to Postal Service Regional Rate boxes because they have different prices based on distance travelled. The first finding discusses how the Postal Service has not expanded Flat Rate dimensional offerings since 2010; however, the OIG does not include Regional Rate boxes in this analysis. While FedEx One Rate boxes are similar to Regional Rate boxes in that pricing depends on how far the box travels, FedEx One Rate boxes only have three prices for distance travelled and Regional Rate Boxes have eight. There are also more weight restrictions on Regional Rate boxes than on One Rate boxes. In FY 2013, package volume for Flat Rate boxes dwarfed package volume for Regional Rate boxes, [redacted] compared to [redacted]. Additionally, the vast majority of Regional Rate package volume [redacted] percent) is from commercial plus high-volume commercial customers, whereas the majority of Flat Rate package volume is from retail customers. The Postal Service should consider this when analyzing customer demand for their products and determine whether it is meeting customer needs with the dimensions of their Flat Rate and Regional Rate packages.

- Management also noted that the statement, "Priority Mail Flat Rate package volume has not grown as a percent of total Priority Mail since 2010," ignores the introduction of Regional Rate boxes in FYs 2011 and 2012. Management contends that combining the volume of both Flat Rate and Regional Rate boxes will show that its share of total Priority Mail package volume grew from [redacted] to [redacted] percent between FY 2010 and 2013. The OIG did not include Regional Rate boxes in the analysis of Flat Rate because they are different products used by different customer bases. The volume of the two products combined represent [redacted] percent of Priority Mail package volume. However, this does not differentiate between customers who moved from Flat Rate to Regional Rate or how much of the volume increase is due to new customer growth. Even with the introduction of Regional Rate boxes, Priority Mail package volume fell by 3.5 percent from FYs 2010 to 2013.

The OIG considers all recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

Appendices

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

Appendix A: Additional Information

Background

The Postal Accountability and Enhancement Act of 2006 divided Postal Service products into two categories: market-dominant[3] and competitive.[4] The price increases for each market-dominant class are capped at the rate of inflation.[5] Each competitive product must cover its costs and competitive products as a whole are required to make a minimum contribution to institutional costs.[6] The Postal Service currently offers 10 different package products:[7] five market-dominant and five competitive. The Postal Service has 8,779 different prices for these package products, 2,148 of which are retail[8] and 6,631 of which are commercial.[9]

Table 2. Number of Postal Service Package Services and Prices

Product	Number of Retail Prices	Number of Commercial Prices
First-Class Mail Parcels	13	-
Priority Mail Express	568	1,137
Priority Mail	563	1,266
Standard Post	864	-
Media and Library Mail	140	280
First-Class Package Services	-	108
Parcel Select	-	2,660
Parcel Return Service	-	898
Standard Mail Parcels	-	102
Bound Printed Matter Parcels	-	180
Total	**2,148**	**6,631**
Grand Total		**8,779**

Source: Postal Service Price List Notice 123, effective January 26, 2014.

Generally, Postal Service package prices are driven by the weight and distance the package travels. The Postal Service's package pricing structure includes a different price point for each pound mailed and each zone[10] travelled. It has divided the U.S. into eight zones and will deliver packages weighing up to 70 pounds to each zone.

3 Products and services for which the Postal Service exercises sufficient market power that it can effectively set the prices with limited competition. This category includes First-Class Mail service, Standard Mail service, Periodicals, single-piece Standard Post service, Media Mail service, Bound Printed Matter, Library Mail, most Special Services, and certain international mail products.
4 A category of Postal Service products and services for which similar products and services are offered by private sector carriers. Competitive products include Priority Mail Express service, Priority Mail service, Parcel Select service, Parcel Return Service, Premium Forwarding service, and most international mail products except First-Class Mail International service, which is categorized as a market-dominant product.
5 The Postal Regulatory Commission calculates inflation as the percentage change in the Consumer Price Index.
6 Institutional costs are infrastructure and administrative costs.
7 The different delivery and pricing options customers can use to mail a package.
8 A published price that generally applies to transactions that take place in a Post Office or other retail location. A consumer price rather than a lower commercial price available to mailers.
9 A general term that distinguishes postage prices (such as presorted or automation prices available to mailers who meet various preparation requirements and minimum volumes) versus retail prices (such as single-piece prices) available to the public and not requiring special preparation or minimum volumes.
10 A number that expresses the distance that a zone-priced mailpiece must travel from point of entry to point of delivery.

Objective, Scope, and Methodology

Our objective was to identify and evaluate opportunities for the Postal Service to simplify package prices for the retail and commercial customer segments. The scope of this audit covers package prices in FY 2013 for the retail and commercial sectors. To accomplish our objective we:

- Obtained and analyzed package mail volume for FY 2013 to identify low to no volume package products.
- Obtained and analyzed Flat Rate package volume for FYs 2009-2013 to identify trends.
- Obtained and reviewed Price List Notice 123 to determine the number of package prices.
- Obtained price sheets/notices for domestic package services competitors and foreign post package services and completed comparative analysis to current Postal Service package products and the related price structure, contained in the *Domestic Mail Manual* and Price List Notice 123.
- Interviewed management to determine what actions the Postal Service has taken to simplify package prices and assess market demand.
- Reviewed the Postal Service's DRIVE initiatives to determine if they relate to our objective.

We conducted this performance audit from April through December 2014, in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management on October 21, 2014, and included their comments where appropriate.

We assessed the reliability of Postal Service Billing Determinant data by interviewing officials knowledgeable about the data and comparing the data to figures reported in the Postal Service's annual 10-K report. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact
Package Services: Get Ready, Set, Grow!	RARC-WP-14-012	7/21/2014	None

Report Results: The Postal Service needs a strategy that allows it to keep pace with developments in the evolving package market. The Postal Service should monitor and study consumer preferences to determine the best services to offer across the entire package delivery value chain. The Postal Service has an advantage in low-cost, last-mile package delivery, but many e-retailers want one-stop solutions that enable them to focus on their core business. The Postal Service can better serve these needs by expanding end-to-end and value-added services, as other package delivery companies have done. The Postal Service's networks are built largely on letters and flats whose volumes are decreasing; however, package volumes are increasing, so strategy and investment need to be shifted more towards packages.

Report Title	Report Number	Final Report Date	Monetary Impact
Postal Service Pricing Strategy	CI-AR-12-002	12/9/2011	None

Report Results: Based on declining mail volumes any unnecessary barriers to entry for the Postal Service should be reduced or removed to encourage mail use. There are over 7,600 domestic prices for the three primary product lines (letters, flats, and parcels) and almost 50 percent of these prices contain low to no mail volume. Major mailers use software packages to determine the postage for their mailings because of the complexity of Postal Service pricing. We believe customers should not have to use software to calculate their own postage. This complexity does not make it easy to do business with the Postal Service. The OIG recommended the Postal Service develop a strategic plan to simplify pricing. The Postal Service agreed there was room for simplification of price tables heavily used by consumers and it should eliminate unnecessary complexity.

Appendix B: Management's Comments

UNITED STATES POSTAL SERVICE

November 28, 2014

LORI LAU DILLARD

SUBJECT: Management Response Package Pricing Simplification
(Report Number DR-AR-15-DRAFT)

The U.S. Postal Service appreciates the effort made by the U.S. Postal Service Office of Inspector General's (OIG's) with "Package Price Simplification: Draft Audit Report"(November 13, 2014), as well as OIG's offer for us to submit a written response indicating our points of agreement and disagreement.

The Postal Service concurs that simplicity is a virtue. We are constantly weighing the benefits of adding rate categories (in order to satisfy identified market niches and thereby hopefully boost demand for our products) against the added complexity that may ensue.

We agree that we have periodically conducted studies of Flat Rate Box demand, yet have not introduced any new Flat Rate Box "dimensions" pursuant to those studies (Report, Pages 1 and 2). However, we did perceive the need for a "jumbo"-sized box, and accordingly in FY2012 introduced one to the suite of Regional Rate Boxes (Regional Rate Box C).

Page 2 of the Report offers a "comparison": nine different FedEx "One Rate" package dimensions as against only five Flat Rate Box dimensions for Priority Mail and Express Mail.

a. This is a misleading comparison. FedEx has billed/promoted their "One Rate" as a flat rate, but it is not. Instead it has three zones. Therefore it is more analogous to Priority Mail's Regional Rate Box.
b. When, appropriately, both the Flat Rate Box and the Regional Rate Box are considered, the Postal Service's box count increases to ten – surpassing FedEx's count.
c. We offer even more Flat Rate Box dimensions on a customized basis to certain NSA customers.
d. It should be borne in mind that the Postal Service was the innovator and FedEx the imitator in this field.

Page 2 of the Report also states: "Priority Mail Flat Rate package volume has not grown as a percent of total Priority Mail since FY2010." This ignores the introduction of the Regional Rate Box in FY2011. That box offers a key feature of the Flat Rate Box: a rate that does not vary with weight. Invariably, Regional Rate Box volume somewhat cut in to Flat Rate Box volume. If the two Boxes are considered – as appropriate – in combination, their share of total non-NSA Priority Mail volume grew from [redacted] percent in FY2010 to [redacted] percent in FY2013. We consider the growth of both boxes to be healthy.

At Page 3 of the Report it is stated that FedEx and UPS are "moving from weight based pricing to dimensional based pricing for their ground-transported packages." This is somewhat misleading. FedEx and UPS will still price on the basis of weight – but only when the parcel density exceeds a certain density threshold. Otherwise, a dim weight will be assessed. The new price will be an either/or: either weight-based or dimensionally based, depending on the density.

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This could be confusing to many shippers and is expected to benefit the Postal Service (with new volume) which is intentionally maintaining its weight-based-only, and simpler, rate structure for ground shipments.

Recommendation No. 1 Periodically evaluate market demand for Flat Rate and other package products in the retail and commercial marketplace.

Management response/Action Plan: Management agrees in part as discussed above. Management will work with the Market Research team as needed to periodically evaluate Flat Rate and other package products in the retail and commercial marketplace.

Target Completion Date: September 2016

Responsible Official: VP, New Products and Innovation and VP, Pricing

Recommendation No. 2: Develop a strategic plan to simplify package prices by adjusting or eliminating low or no volume package prices to reduce complexity for customers.

Management Response/Action Plan: Partially agree. We agree that the over 1,500 rate cells represented by Parcel Select "Nonpresort," "NDC Presort" and "ODC Presort" are potential candidates for elimination. However, elimination of price cells requires careful evaluation and strategic consideration. Such action has been considered in the past, only to be held back by concerns that a small number of shippers may be adversely affected. We will renew efforts to carefully reevaluate this action.

We agree that a strategic plan for simplifying our package prices needs to be considered. However, we are not so certain that "eliminating low or no volume package prices" would serve the cause of simplicity. "No volume" rate cells are not the same from period to period. If a rate cell has no volume in a particular period, that doesn't mean it won't have volume in the future, particularly now that we are looking at growing our package business. Careful evaluation of price cells is needed before elimination.

Target Completion Date: September 2016

Responsible Official: VP, Pricing and VP, New Products and Innovation

Cynthia Sanchez-Hernandez
Vice President, Pricing

Gary C. Reblin
Vice President, New Products and Innovation

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