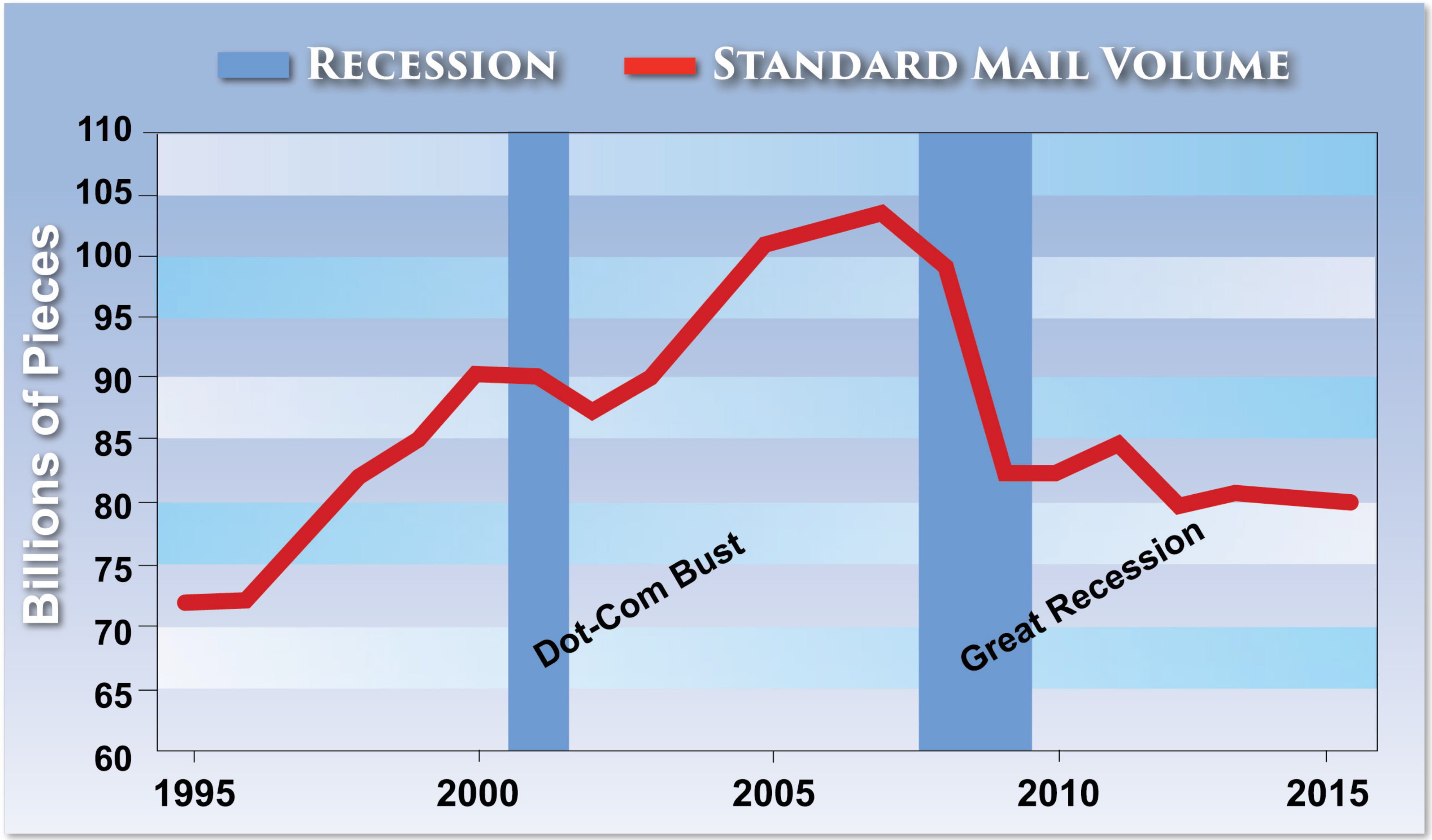
OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Advertising Mail: Past and Present



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OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Executive Summary

Since the end of the Great Recession, advertising mail volume growth has stalled. Advertising mail is one of the U.S. Postal Service's most important products. In fiscal year (FY) 2015, total advertising mail volume, composed primarily of Standard Mail, was close to 85 billion pieces, generating $19.4 billion in revenue and $7.8 billion in contribution. Beyond the benefit to the bottom line of the Postal Service, advertising mail is also an important tool for businesses and nonprofits to increase their sales and customer bases.

In order to understand the stagnation in advertising mail growth, the U.S. Postal Service Office of Inspector General (OIG) asked RCF Economics and Financial Consultants, a firm with deep expertise monitoring postal volumes and trends, to examine recent historical trends and provide insights into the overall advertising market. This paper summarizes that research.

Working with RCF, the OIG examined trends in the size of the advertising market as well as the size of its respective market shares. Despite the ubiquity of advertising in today's world, spending on advertising has declined as a share of Gross Domestic Product (GDP). At the same time, the Internet has gone from a virtually nonexistent share of the market to a 30 percent share in just 20 years.

In an ironic twist, for many years, the primary loser of market share to Internet advertising has been newspapers, which have long been close competitors of direct mail advertising. Now that newspapers' market share is in the single-digit range, Internet advertising may begin to take market share from other media, including television and advertising mail.

Highlights

The OIG asked RCF, an economic firm with longstanding postal expertise, to look at recent trends and possible future scenarios for advertising mail.

Advertising mail generated 19.4 billion in revenue and $7.8 billion in contribution in FY 2015 (85 billion pieces).

Most ad mail is sent as Standard Mail. Standard Mail volumes declined 20 percent during the Great Recession and have not rebounded.

Budgets for overall advertising spending have been declining, in part due to digital deflation (pressure for lower prices driven by low-cost digital technologies).

Future risks include continuing cannibalization by digital alternatives and macroeconomic trends such as declining median household income and structural changes in industries like financial services.

However, by pursuing a digital-physical integration strategy, the Postal Service may be able to turn the looming competitive threat from the Internet into an opportunity for future growth.

The pattern of historical growth suggests that advertising mail is a mature product, one not likely to repeat the exceptional growth of the 1980s. Nevertheless, advertising mail has many inherent strengths that make it still relevant in the digital age. Moreover, with the rise in mobile communications, the Postal Service could find an opportunity for advertising mail to experience synergistic growth.

To succeed in the smaller, Internet-dominated advertising market, several strategies are suggested:

- Simplification of mail make-up requirements and acceptance would improve direct mail's competitiveness.
- Advertising mail needs to innovate mail piece functionality and take advantage of exploding growth in mobile-based advertising. The Postal Service should promote multichannel marketing that integrates direct mail with other advertising media.
- Repurposing advertising mail offers opportunities for direct mail to feed and benefit from the fast-growing ecommerce market.
- Service levels must be maintained and improved. Predictability and consistency in delivery is especially important when competing in a world of instant electronic communication.

By combining these strategies, the Postal Service may be able to turn the looming competitive threat from the Internet into an opportunity for future growth.

The historical trends examined in this paper have implications for the future of advertising mail. A forthcoming OIG paper develops 10-year projections of Standard Mail volume, based on various scenarios about the advertising market and Internet advertising growth.

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Observations

Unlike many parts of the economy, advertising mail has not recovered from the Great Recession.

Introduction

Like Facebook, Google, and network television, the U.S. Postal Service relies significantly on revenue from advertising. Without advertising, many of these familiar businesses and institutions — including the Postal Service — might not even exist in their current forms.

The Postal Service derives over a quarter of its revenue and volume from advertising. Advertising makes a significant contribution to the funding of the Postal Service's vast network. Yet there is a serious challenge facing the Postal Service: unlike many other parts of the economy, direct mail advertising has not recovered from the Great Recession. After decades of growth, advertising mail volume growth has stalled. This paper looks at possible reasons why this is the case. A forthcoming second paper will examine what this might mean for the future of advertising and the Postal Service. The U.S. Postal Service Office of Inspector General (OIG) worked with RCF Economics and Financial Consultants to examine advertising mail. RCF has over 3 decades of experience monitoring trends in Postal Service mail volumes and their underlying causes. Its report is contained in Appendix A.

The Importance of Advertising Mail

Advertising mail is not a formal postal product. It does not appear explicitly in official reports such as the Revenue, Pieces, and Weight Report (RPW) or the Cost and Revenue Analysis Report (CRA). Nevertheless, the vast majority of Standard Mail is advertising mail.[1] This is also true of a significant portion of First-Class Mail.[2] In fact, more than half of all mail volume is advertising mail.[3]

Advertising mail's revenue per piece and cost per piece are relatively low. As a result, despite composing more than half of all mail volume, advertising mail accounts for 28 percent of revenue, 29 percent of attributable cost, and 27 percent of contribution to institutional cost. Put succinctly, without advertising mail, $7.8 billion of contribution would have to be borne by other postal products. Obviously, this would put tremendous stress on the entire the Postal Service, its employees, and its customers (See Table 1).

Table 1: Advertising Mail by the Numbers in Fiscal Year 2015 (in Billions)

	Volume	Revenue	Attributable Cost	Contribution
Standard Mail Advertising	80.1	$17.7	$11.1	$6.6
First-Class Advertising	4.4	$1.7	$0.5	$1.2
Total Advertising	84.5	$19.4	$11.6	$7.8
All Mail	154.2	$69	$40.2	$28.8
Percent of Total	55%	28%	29%	27%

Source: OIG – Calculation based on data from the fiscal year (FY) 2015 U.S. Postal Service RPW; 2015 Cost and Revenue Analysis; and 2014 Household Diary Study Reports.

Beyond its immediate financial importance to the Postal Service, advertising mail serves important roles in American life. Businesses use advertising mail to maintain relationships with current customers. Consumers become aware of new products and services through advertising media such as direct mail. Advertising mail is also used extensively for prospecting, which is finding new customers for businesses. Finally, advertising mail is critical to nonprofit organizations that use direct mail to generate donations and increase membership.

1 RCF Economic and Financial Consulting, Inc., http://www.rcfecon.com.
2 Of course, advertising is included in Periodicals and even in parcel shipments. This paper focuses on mail for which advertising is the primary purpose.
3 Another 5.7 billion pieces of First-Class Mail (mostly bills and statements) include advertising material. Although this advertising does not generate revenue on its own accord, it does improve the value proposition for mailers of certain types of First Class Mail such as bills and statements. OIG calculation based on US Postal Service RPW and Household Diary Study (HDS) Reports.

Of course, other advertising media can fulfill some or all of these roles, but businesses and other institutions have found that advertising mail is an efficient and effective way to achieve their purposes.

Four Eras of Advertising Mail

Until recently, advertising mail has had a long history of robust growth. As RCF discusses in the Appendix, Standard Mail, which accounts for the vast majority of advertising mail, has seen four distinct eras in the last 36 years.[4]

From 1980 to 1988, Standard Mail volume was growing rapidly at a compound rate of 9.8 percent per year. This growth was fueled by two main factors. First, the use of computers to manipulate mailing lists enhanced the capabilities of marketers to more efficiently target their advertising mail campaigns and reduce mailing costs. Second, workshare discounts made advertising mail more affordable for mailers. During this period, Standard Mail volume grew almost three times faster than the economy.

In the next era, from 1989 to 2007, advertising mail continued to grow, but at a slower annual rate of 2.7 percent as the direct mail product matured. It weathered two economic recessions and several price increases with only short-term disruptions to its growth. During the 1990s, the baby boom generation became increasingly familiar with direct mail advertising. Perhaps more importantly, baby boomers reached their peak earning (and spending) years. For most of the 2000s, Standard Mail benefited from a boom in the financial sector and from an increase in advertising mail sent by merchants. During this period, Standard Mail volume and the economy grew at nearly the same pace.

Table 2: Four Eras of Standard Mail Volume

THE FOUR ERAS OF ADVERTISING MAIL	Period	Growth Pattern	Real GDP Growth	Direct Mail Volume Growth	End-of-Period Volume (in Billions)
There are four distinct eras of Standard Mail. In the 1980s, there was rapid growth followed by steady growth until the Great Recession. Volumes collapsed during the Great Recession and have stagnated ever since. Volume growth has decoupled from economic growth.	1980 – 1988	Mail Grows Faster than Economy	3.3%	9.8%	82.2
	1989 – 2007	Economy and Mail Grow at Similar Rates	3.0%	2.7%	103.6
	2008 – 2009	Recession Mail Volume and Economy Crash	-2.5%	-20.4%	82.4
	2010 – 2015	Economy Recovers. Mail Volume Stagnates	1.7%	-0.5%	80.1

Source: OIG – Analysis of RCF Economics and Financial Consulting.

During 2008 and 2009, the financial sector imploded, and with it, the global economy. The Great Recession caused Standard Mail volume to plummet from its peak of nearly 104 billion pieces in 2007 to about 83 billion pieces in 2009, a 20 percent decline in just 2 years.[5] This massive decline was in large part attributable to the financial sector reducing its advertising mail volume by nearly

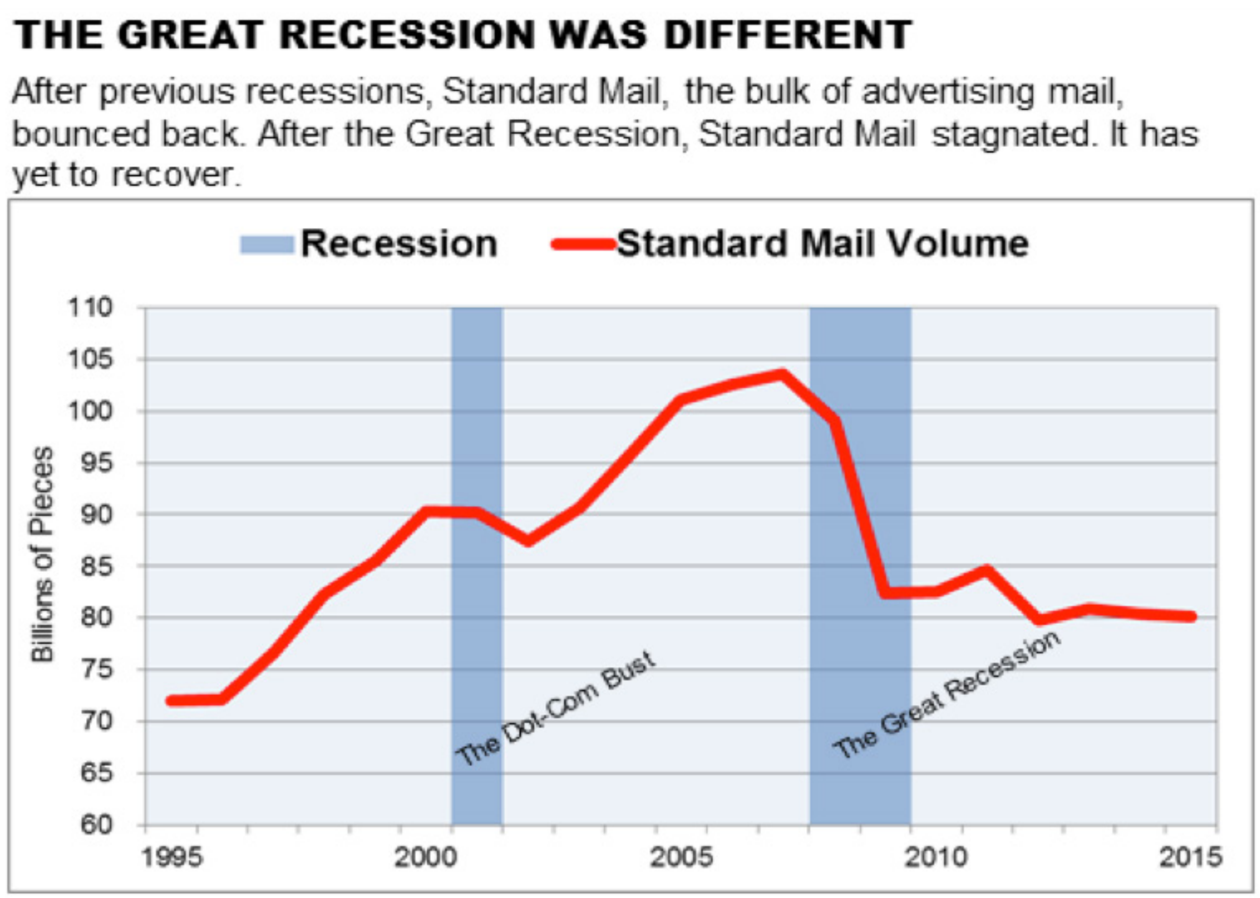
4 RCF also discusses First-Class advertising mail. Trends in First-Class are similar to those in Standard Mail.
5 Comparable RPW data on total First-Class advertising mail is not available. However, according to the Household Diary Study, First-Class advertising mail delivered to households declined 50 percent.

30 percent. The Great Recession saw only a small 2.5 percent decline in annual Gross Domestic Product (GDP), but the economy lost 8.8 million jobs.[6]

The final period of note is from 2010 to 2015. As Figure 1 demonstrates, this recovery is different. Previous recessions, such as the 2001 recession, interrupted Standard Mail growth, but only mildly and only for a year or 2. While the economy has recovered from the most recent recession, advertising mail volume has not. Standard Mail volume in 2015 was only 80 billion pieces. To place this in historical perspective, this is approximately the same level of volume as in 1998.

Figure 1 shows the volume history of Standard Mail. Superimposed on this history are two economic recessions.

Figure 1: Standard Mail Volume and Economic Recessions 1995 to 2015

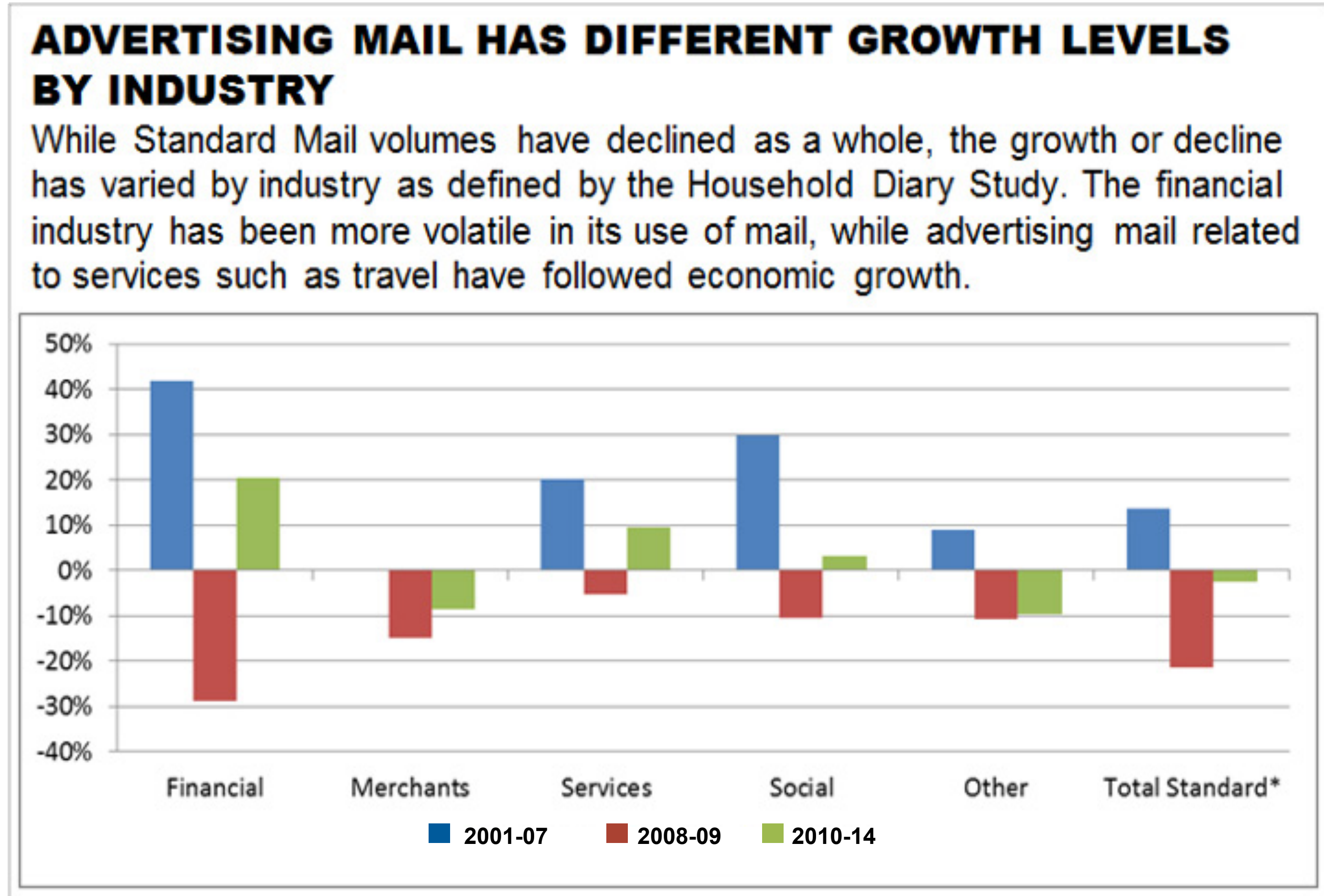


Source: OIG – Analysis of U.S. Postal Service RPW Reports and Recession Data from the National Bureau of Economic Research.

Figure 1 clearly shows an important characteristic of advertising mail: it is highly sensitive to the business cycle. What is not shown is that this sensitivity varies significantly by industry of sender. Using data from the Household Diary Study (HDS), RCF identified advertising mail from financial services firms as far more cyclical than advertising mail from other sectors.[7]

6 Christopher J. Goodman and Steven M. Mance, "Employment Loss and the 2007–09 Recession: an Overview," Monthly Labor Review, April 2011, http://www.bls.gov/mlr/2011/04/art1full.pdf.
7 HDS data for FY 2015 were not yet available at the time of publication.

Figure 2: Household Advertising Mail Growth by Industry of Sender



Source: OIG – Analysis of RCF Economics and Financial Consulting.

Clearly, industry dynamics are a significant determinant of the intensity of use of advertising mail.

Another element of cyclical nature of advertising mail use is the difference between relationship (sometimes called retention) and prospecting mail. The former deals with maintaining existing business relationships; the latter refers to finding new customers.

In good times, prospecting mail grows faster than relationship mail. When times are tough, businesses curtail their search for new customers. RCF's analysis of HDS data confirms this. Prior to the Great Recession, prospecting mailings grew 3 percentage points faster than relationship mailings. A significant contributor to this growth was credit card acquisition mail. During the recession, prospecting mail fell at nearly twice the rate as relationship mail. After the recession, relationship mail volume is down slightly, but there is healthy growth in prospecting mail.

Table 2: Relationship vs. Prospecting Mail Volume and the Business Cycle

	2001-07	2008-09	2010-14
Relationship	16%	-13%	-1%
Prospecting	19%	-25%	11%
Not Stated	9%	-2%	-8%

Source: OIG – Analysis of RCF Economics and Financial Consulting.

Not surprisingly, the HDS indicates that relationship mail is read at about twice the rate (60 percent) as prospecting mail (about 26 percent). In addition, prospecting mail is much more likely to be discarded without reading than advertising mail from a business with which a household already does business. These characteristics have remained unchanged over time.

Advertising mail has interesting age demographics. Households with older residents tend to be more mail-intensive compared with younger households. Older households tend to have higher income and wealth. Their longer history of economic activity means that their names appear on more mailing lists. As the baby boom ages, older age cohorts will grow. In the long term, however, the younger, more digitally-oriented households will control the destiny of advertising mail.

Taken by itself, the recent stagnation in advertising mail is disturbing. It is even more troubling when coupled with the ongoing loss of First-Class Mail to electronic alternatives. First-Class Mail generates the most contribution to institutional cost of any postal product. Moreover, the average piece of First-Class Mail generates about three times as much contribution as the average piece of Standard Mail. Cast in this light, growth in Standard Mail volume is of the utmost importance to offsetting the loss of First-Class Mail contribution.

Advertising Mail and the Advertising Market

Another way to analyze the history of advertising mail is in the wider context of the advertising market. The RCF analysis contains historical advertising revenue by medium. The size of total advertising spending has changed over time. Within that market interesting shifts have occurred.

In 1995, the first year before Internet advertising data were reported, direct mail advertising held a 12 percent share of a $184 billion total advertising market, as measured in constant 2015 dollars. Newspapers, which are close competitors of direct mail advertising dollars, held a 31 percent market share. The Internet share was, of course, zero. This left 57 percent of the market for other advertising media.

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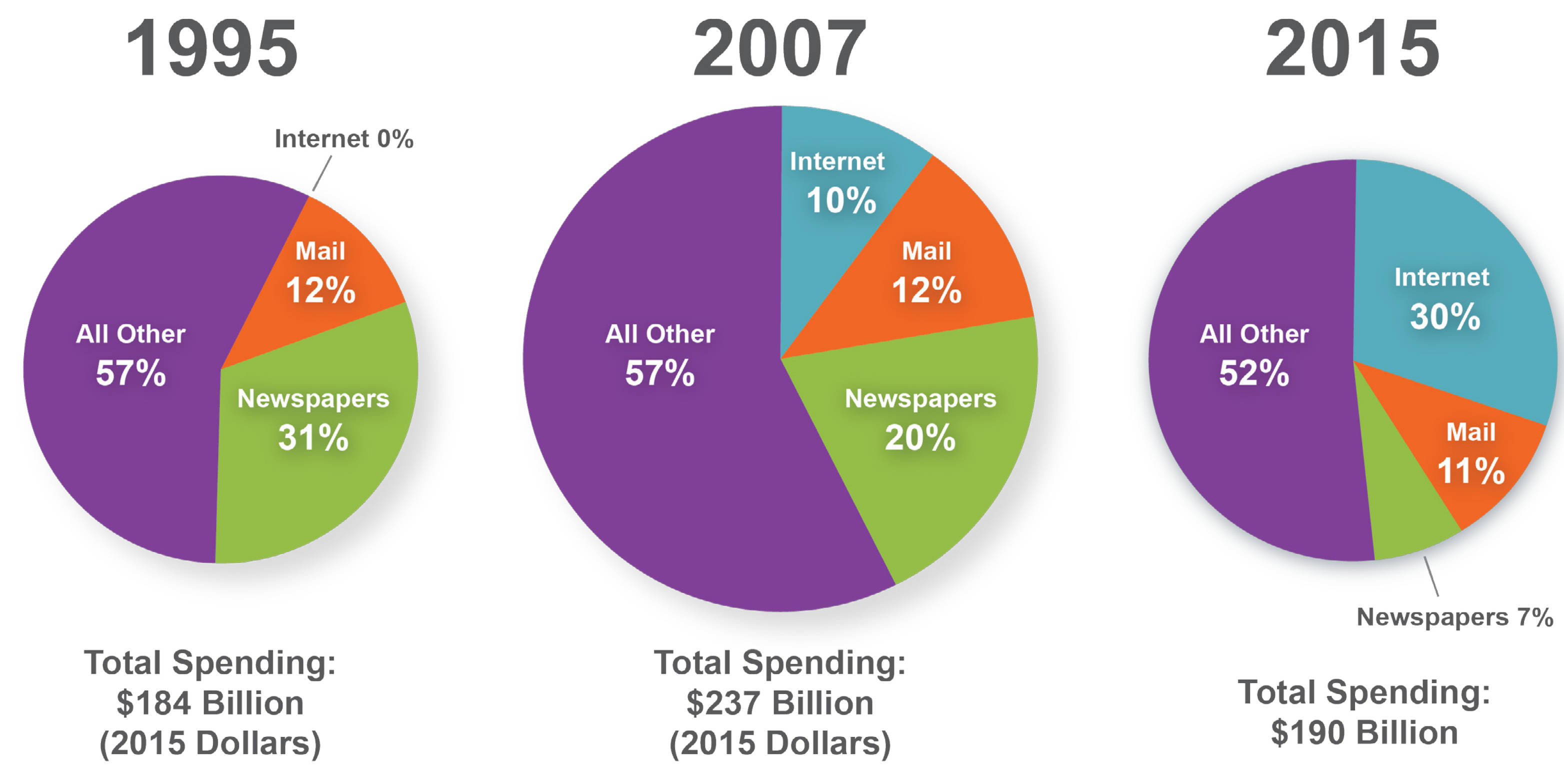
Figure 3: Advertising Market and Market Shares 1995, 2007, and 2015



Source: OIG - Analysis of RCF Economics and Financial Consulting.

By the peak of direct mail advertising in 2007, the Internet was becoming a significant advertising medium. The entire advertising market reached $238 billion (again in 2015 dollars). Internet advertising, including all mobile, search, email, and social media, had achieved a 10 percent market share. Direct mail advertising's share had remained at 12 percent. The 20 percent market share of newspapers represented a loss of 11 percentage points of their market share, nearly identical to the Internet's gain.

By 2015, the overall advertising market at $190 billion in revenue was 20 percent smaller than in 2007. The Internet now accounted for a 30 percent share of the market. Direct mail had taken a small decrease of share to 11 percent, but newspapers had declined to a mere 7 percent market share. The decline in newspapers' market share is bottoming out. With advertising mail showing signs of weakness, direct mail may follow in the newspapers' wake.

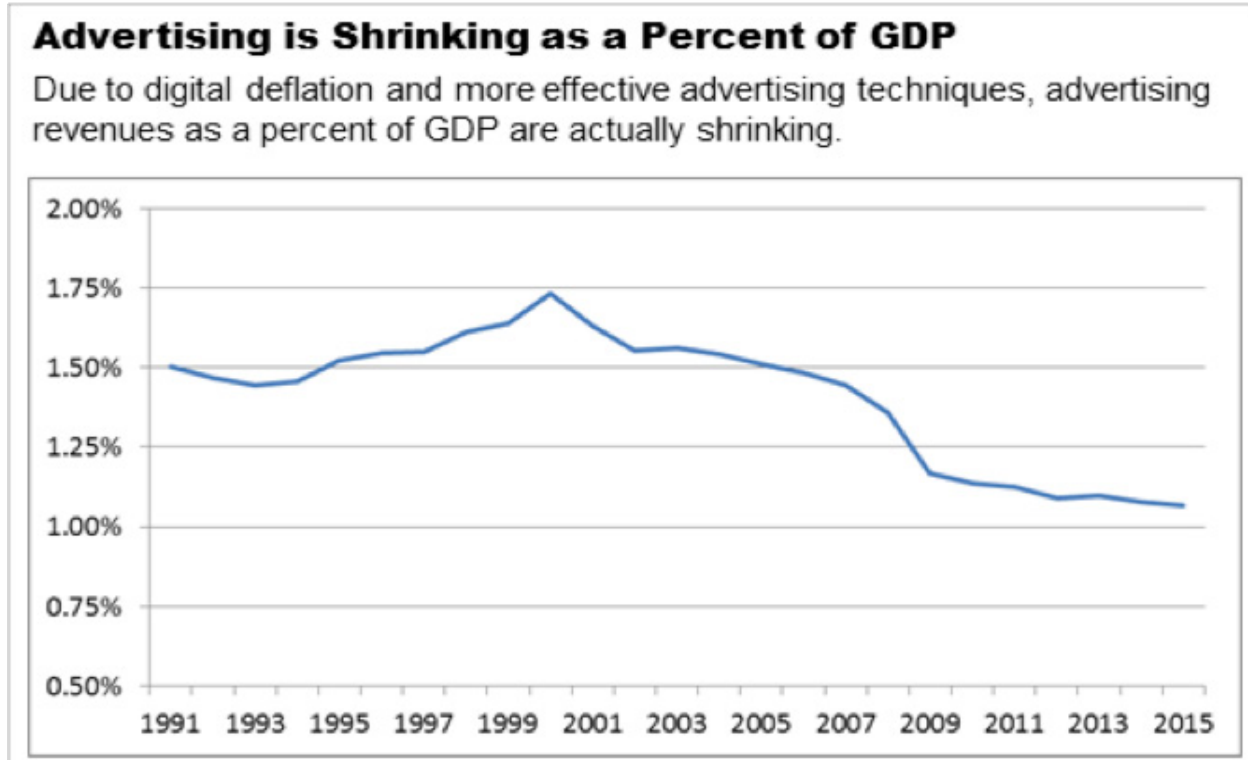
Factors Underlying Historic Trends in Advertising Mail

The analyses of Standard Mail volume trends and advertising markets suggest that a significant part of advertising mail's recent malaise is the result of trends in the market for advertising in general. RCF identifies some alarming trends in the economy that affect the overall advertising market.

Based on its analysis of historic trends, RCF found that much of the recent stagnation in growth in advertising mail volume can be traced to several underlying causes.

Advertising spending as a percentage of GDP has been declining for many years. This might seem counterintuitive given the ubiquity of advertising today, but RCF offers several possible explanations for this trend.

Figure 4: Advertising as a Percent of Gross Domestic Product



Source: OIG – Analysis of RCF Economics and Financial Consulting.

Initially, in the late 1990s, Internet advertising was something of a novelty. Spending on this new medium may have constituted additions to traditional advertising budgets. Since the dot com bust around 2000, Internet advertising has displaced traditional advertising spending. RCF suggests that Internet advertising may be more efficient than traditional advertising if a dollar of Internet advertising displaces more than a dollar of traditional advertising. Thus, the substitution of Internet for traditional advertising contributed to the decreasing size of the advertising market relative to GDP. This "digital deflation" has a secondary effect: it puts deflationary pressure on competing advertising media. These two effects work to lower overall advertising revenue.

A second factor in the trend in advertising shown in Figure 4 is an increase in advertising efficiency. Advertisers have become increasingly sophisticated in their understanding and measurement of the effectiveness of their advertising campaigns. The application of powerful analytics allows advertisers to get more "bang for their buck" in 2015 than they did in years past.

Figure 4 is based on advertising spending. In recent years, a new kind of advertising has emerged that cannot be measured in dollars. This free advertising via social media and by word of mouth can be every bit as effective as measured advertising. Skype, for example, used word of mouth and social media to spread the word about its service:

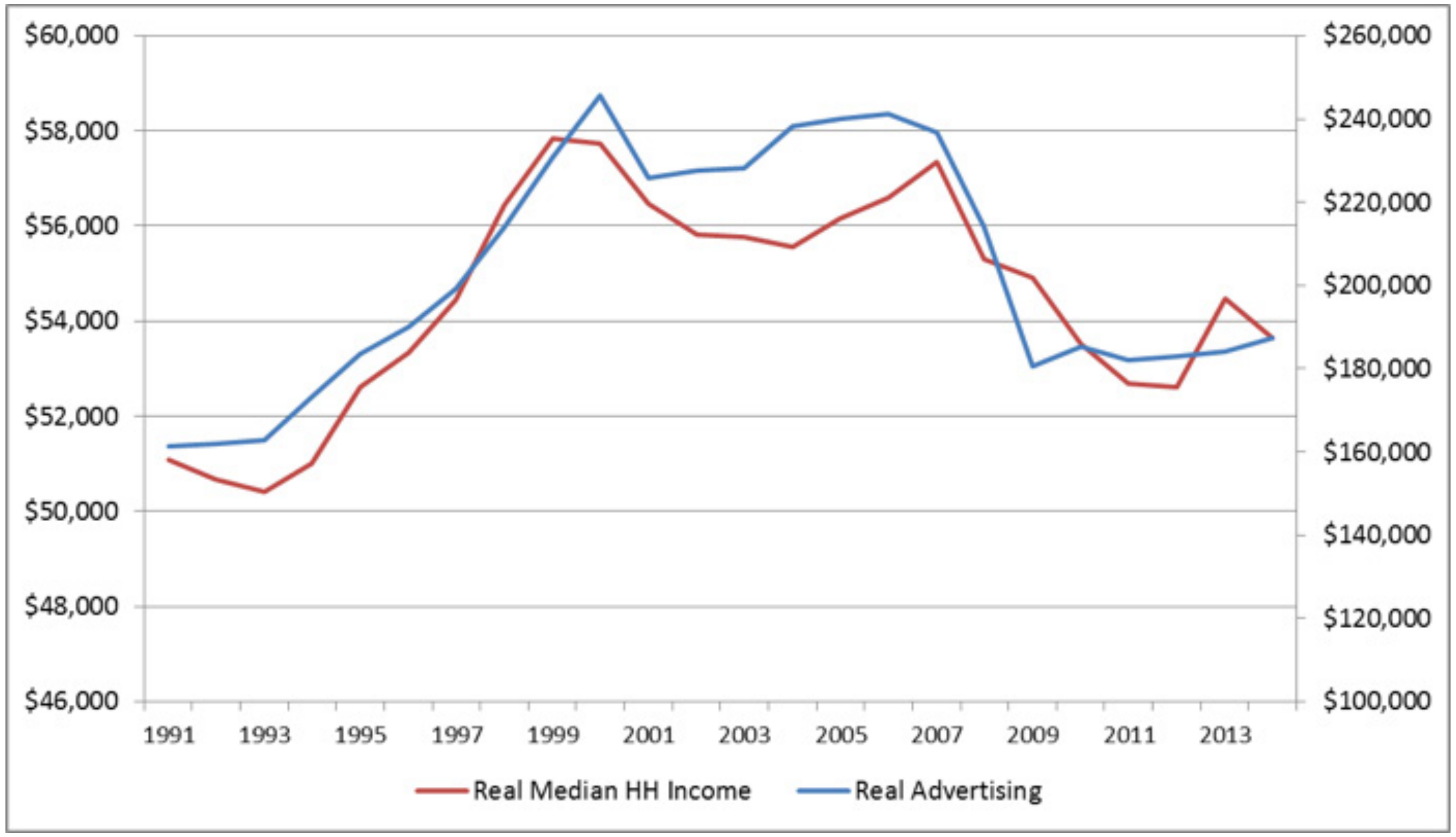
> **"Skype went live in August 2003. Within two years there were more than 100 million user accounts. By the end of 2008, Skype had hit 405 million users and people made more than 2.6 billion minutes of SkypeOut calls. Not a dollar had been spent on traditional, expensive advertising campaigns."**[8]

8 Rachel Botsman and Roo Rogers, What's Mine Is Yours, Collins, London, 2010. p. 201.

Another example is Craigslist. Craigslist is “unmarketed” yet, by one account, was the seventh most popular brand in the world in 2010, ahead of Oprah Winfrey, Amazon, and Coca-Cola.[9]

A final explanation relies on a somewhat different economic metric than GDP. Advertising is intended to influence spending. Spending, in turn, is driven to a significant extent by income. Not surprisingly, advertising spending is highly correlated with median household income. As Figure 5 shows, median household income has declined since the mid-2000s. Perhaps more importantly, like advertising mail, median household income has not fully recovered from the Great Recession.

Figure 5: Real Median Household Income (Left Scale) and Real Advertising Expenditures in Millions (Right Scale)



Source: OIG – Analysis of RCF Economics and Financial Consulting.

Not surprisingly, advertising mail also follows this trend; as Figure 6 shows, higher income households receive more advertising mail than lower income households. This is a relationship that has remained unchanged even as advertising mail volumes have fallen.

9 Ibid, p. 208.

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Figure 6: Standard Mail Received by Household Income (Pieces per Week)

Source: OIG – Analysis of RCF Economics and Financial Consulting.

Obviously, these macro factors are largely out of the control of the Postal Service. As the Internet has taken up more of a smaller advertising market, traditional advertising media such as direct mail are operating in an increasingly competitive marketplace.

Strengths and Weaknesses of Advertising Mail

One key to the future prospects of advertising mail likely rests on the Postal Service's ability, to the extent possible, to exploit advertising mail's strengths while minimizing its weaknesses.

Strengths

Product

- The long history of direct mail marketing allows advertising mail to be targeted based on established history of consumer behavior.
- Advertising mail can go to virtually every household, regardless of a household's use of the Internet, landline telephones, or subscriptions to periodical publications.
- Direct mail can be set aside for future or repeated use and is portable.
- Advertising mail campaigns can be easier to design than television and radio campaigns.
- Unlike most other advertising media, direct mail is targeting a specific address or a specific consumer.

According to a Direct Marketing Association study, the return on investment of advertising mail campaigns is favorable compared to Internet-based advertising.

Financial

- Advertising mail can be tracked and measured, giving mailers direct feedback on its effectiveness.
- According to a Direct Marketing Association study, the return on investment of advertising mail campaigns is favorable compared to Internet-based advertising.[10]

Competitive

- Response rates to advertising mail are higher than other direct marketing channels, except telephone, which is much more expensive.
- Neurological research indicates that direct mail advertising can provide a strong emotional response and is more memorable than digital advertising.[11]
- Advertising mail is regarded as more private than digital advertising for sensitive categories of information such as health and financial.
- Other forms of advertising have a high annoyance factor that limits their effectiveness. Spam email creates little more than visual clutter. Television ads can be skipped using a DVR or similar technology. Internet ads can be blocked. Telephone marketing can be limited by signing up for the Federal Trade Commission's Do Not Call Registry.
- Newspapers, once a strong competitor to direct mail, have declined substantially in recent years.

Weaknesses

Product

- Mailing lists can be difficult to maintain. This is an issue of mutual importance to the Postal Service and its direct mail advertising customers.
- The decline in First-Class Mail and Periodicals, mail that recipients truly need or explicitly ask or pay for, means that people do not regard the mailbox with the same urgency as in years past. Direct mail is often perceived as junk and is considered by some as bad for the environment. This is especially true of prospecting mail, which has a much lower response rate than retention mail.
- Advertising mail make up requirements are complex. Many mailers must rely on intermediaries to access the advertising mail channel.

Financial

- Direct mail is relatively expensive on a cost-per-recipient basis, and there are few economies of scale for direct mail advertising.

10 Direct Marketing Association, 2015 Response Rate Report, 2015, http://www.marketingcharts.com/traditional/direct-media-response-rate-cpa-and-roi-benchmarks-53645/.
11 OIG, Enhancing the Value of Mail: The Human Response, Report No. RARC-WP-15-012, June 15, 2015, http://www.uspsoig.gov/document/enhancing-value-mail-human-response.

Competitive

- Digital advertising can be developed and delivered much more quickly than direct mail advertising.
- People spend an increasing amount of time on the Internet. Digital advertising thus receives attention because digital content is of growing importance.

Fighting Back

Simplifying Advertising Mail

To its credit, the Postal Service has made efforts to stimulate the demand for advertising mail.

To its credit, the Postal Service has made efforts to stimulate the demand for advertising mail. One strategy is to make mail easier for advertisers to use. Mailing regulations and acceptance processes are notoriously complex and esoteric. The recent introduction of Every Door Direct Mail (EDDM), a simplification of the traditional Saturation mail product, generated over $452 million in revenue from nearly 2.8 billion pieces of mail in 2015, only 4 years after becoming a permanent classification in 2011.[12] The success of EDDM suggests that further efforts to make the advertising mail channel easier to use would improve direct mail's competitiveness with other media.

Mail Innovations

The Postal Service may be able to take advantage of the rising tide of digital communication.

For the last several years, the Postal Service has used promotions to stimulate innovations in advertising mail. These innovations are intended to encourage the integration of mobile digital technologies such as augmented reality and QR codes with advertising mail. More than 7 billion mail pieces qualified for these promotions in FY 2015.[13] Revenue from qualifying mail was nearly $1.8 billion. More important than the volume involved, these promotions allow and encourage advertising mailers to benefit from the growth in digital communications. In fact, an OIG white paper contains numerous examples of how ten innovative technologies can enhance the effectiveness of advertising mail like never before.[14] Many of these technologies leverage the power of smartphones to connect advertising mail recipients to Internet-based information and shopping opportunities.

Multi-channel Initiatives

Multi-channel advertising campaigns allow marketers to leverage the strengths of several different advertising media to obtain a higher level of effectiveness. Direct mail is often a key component of such multi-channel campaigns:[15]

> **"Clearly, direct mail is still a very productive and popular way to reach customers. With the buzz around digital marketing, there is a temptation to set direct mail aside as a means of reducing marketing spend. However, in reality, the best results come from the intelligent application and convergence of digital and traditional channels giving customers more and more ways to interact with your brand. Direct mail has been shown to be a key component of multi-channel marketing campaigns. "[16]**

Since it is reasonable to expect that virtually all forms of Internet advertising are likely to grow, the Postal Service should pursue strategies that allow advertising mail to grow as a complement to Internet advertising.

12 OIG Analysis of U.S. Postal Service 2015 Billing Determinants.
13 U.S. Postal Service, Standard Mail Product Development, Presentation to the Mailers Technical Advisory Committee, November 18, 2015, p. 8.
14 USPS OIG, "Mail Innovations." RARC-WP-14-013, September 22, 2014, http://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-013_0.pdf.
15 Chris Hamlin, "Not Dead Yet: Direct Mail Outperforms Digital Channels by 600%," August 17, 2105, http://sourcelink.com/blog/chris-hamlin/2015/08/17/not-dead-yetdirect-mail-outperforms-digital-channels-by-600.
16 Ibid.

The Postal Service must maintain the quality of its advertising mail products and improve service performance.

Repurposing Traditional Advertising Mail

When the Postal Service moved to a shaped-based pricing structure for its products, flat-shaped mail — including catalogs — took the biggest hit.[17] The timing of this large price increase could not have been worse, coming in May 2007, just months before the official start of the Great Recession in December 2007. There was a silver lining in this cloud, however. Mailers redesigned and repurposed many of their flat-shaped mailings to reduce costs. A decade ago, a catalog mailer might send several catalogs each year to an existing customer. Today, that same mailer might send significantly fewer catalogs and send postcards or flyers to remind customers to visit their website.[18] A similar strategy is to send "smaller, teaser catalogs" to drive website traffic.[19] As for the catalogs themselves, some merchants report that catalogs improve customer engagement (including size of order) from their websites.[20] Rather than concede market share to the Internet, the Postal Service should pursue strategies that allow advertising mail to benefit from the growth in ecommerce.

Maintaining and Improving Service

Commerce in the digital age is characterized by immediacy. In order to fit in this fast-paced world, advertising mail delivery must be predictable, consistent, and fast. The Postal Service must maintain and improve the service performance of advertising mail, fix service problems promptly, and improve the mailer experience.

Conclusion

Advertising mail volume growth has stagnated in the aftermath of the Great Recession. This is a troublesome development caused by a complex web of factors, many of which are beyond the Postal Service's control. In the next paper, the OIG will provide Standard Mail volume projections based on assumptions about the future path of advertising spending in general, Internet advertising growth, and the position of direct mail advertising in the marketplace.

17 See, in general, Governors of the U. S. Postal Service, Decision of the Governors on Docket R2006-1. http://www.prc.gov/docs/56/56046/Notice.Govs.Dec.pdf.
18 Dean Rieck, "How to Use Direct Mail to Drive Targeted Website Traffic," August 3, 2010, http://www.marketingprofs.com/articles/2010/3796/how-to-use-direct-mail-to-drive-targeted-website-traffic#ixzz3yZMk1Y6X.
19 Cynthia Boris, "Study Shows the Old Fashioned Print Catalog is Good for Internet Sales," November 8, 2013, http://www.marketingpilgrim.com/2013/11/study-shows-the-old-fashioned-print-catalog-is-good-for-internet-sales.html.
20 Ibid.

Appendices

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Appendix A:
Direct Mail: Challenges and Opportunities for the U.S. Postal Service

Part 1: The History of Direct Mail

Direct Mail:

Challenges and Opportunities for the U.S. Postal Service

Part 1: The History of Direct Mail

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The History of Direct Mail

I. Introduction

Direct mail represents a substantial portion of the Postal Service's revenues and is an important part of the overall U.S. advertising market. In 2015, the Postal Service delivered just over 80 billion pieces of Standard Mail, generating nearly $18 billion of postage revenue.[1] In addition, there were approximately four billion pieces of First-Class Mail that consisted solely of advertising.[2] Combined, advertising mail accounted for over half of all mail and nearly 30 percent of all revenue of the Postal Service. Direct mail postage also equaled about 10 percent of all advertising spending in the U.S. in 2015. A broader measure of direct mail spending, which includes the cost of paper and other inputs in addition to postage, is estimated to be above $45 billion and represent 16 percent of a broader measure of total advertising spending.

While still a significant part of both the Postal Service and the overall advertising market, direct mail volumes have declined considerably since 2007. Standard Mail volume has fallen more than 20 percent from its peak of nearly 104 billion pieces in that year. First-Class Mail advertising has declined even more, dropping in excess of 50 percent. Most of this decline was due to the Great Recession, which had a devastating impact on the advertising market. However, a crucial observation is that despite the modest recovery in the economy over the past several years, Standard Mail volume has remained roughly unchanged at its current 80 billion piece level.

This white paper consists of two separate documents focused on direct mail, Part 1 and Part 2. Part 1 looks at the history of direct mail in general and Standard Mail in particular. Part 2 uses the historical analysis to develop scenarios for the future of direct mail and projects future volumes of Standard Mail under each scenario.

The recent period is in stark contrast to the long-run history of Standard Mail. Standard Mail volumes grew rapidly in the 1980s and increased consistently, albeit at a slower pace, up until the Great Recession. Moreover, while past recessions resulted in declines in Standard Mail volume, it recovered as the economy recovered, ultimately reaching new highs concurrent with the overall economic business cycle. A key question addressed in this white paper is why there has been no recovery in direct mail, and what the past five years, as well as the longer history, tell us about the future outlook of direct mail.

Part 1 of this white paper is organized into eight sections. Following this overview which comprises Section I, Section II looks at the history of Standard Mail and Section III discusses the strengths and weakness of Standard Mail. In Section IV, trends in overall advertising spending are examined and

[1] A very small portion (less than 1 percent) of Standard Mail consists of non-advertising mail.
[2] Although we discuss First-Class advertising mail, the main focus of this white paper is on Standard Mail.

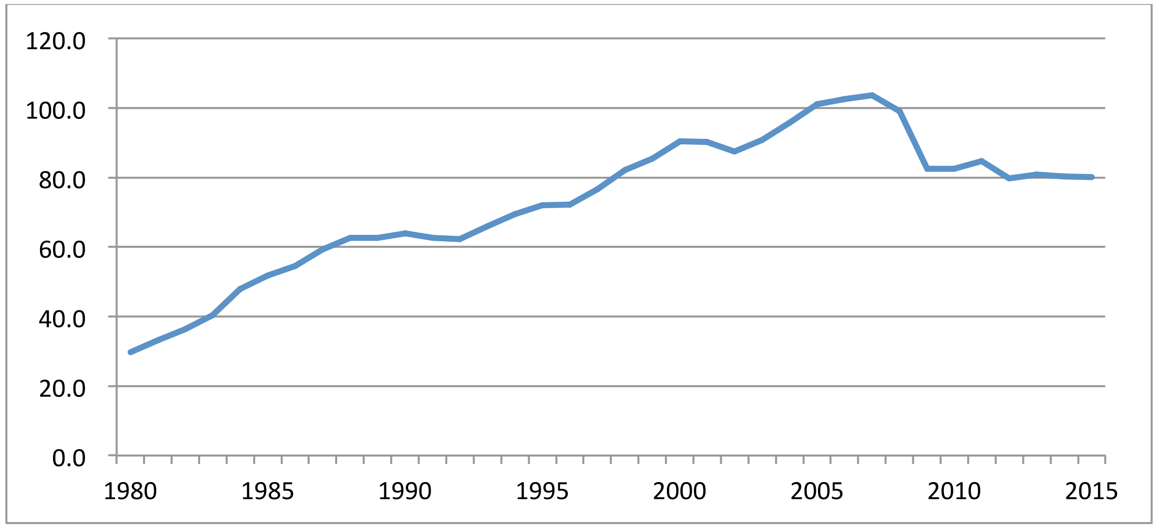
Section V looks at individual advertising media, with special attention given to the relationship between direct mail and internet advertising. In Section VI, senders and recipients of Standard Mail are examined. Section VII provides a brief look at First-Class advertising mail. Conclusions to this paper are presented in Section VIII. A technical appendix follows Section VIII.

II. Standard Mail Volume History

A. Standard Mail and the Macro-Economy

In Chart 1, annual volumes of total Standard Mail (known as Third-Class Mail prior to 1996) are presented from 1980 to 2015, based on the Postal Service's Revenue, Pieces, and Weights (RPW) reports. Annual volumes are reported on a Government Fiscal Year basis which runs from October 1 to September 30 so that the 2015 volume encompasses the period from October 1, 2014, to September 30, 2015.

Chart 1: Total Standard Mail Volume (1980 – 2015) in billions of pieces



Source: USPS RPW Reports

The volume history shows several distinct periods. The first is the period of rapid growth from 1980 to 1988. During this time, Standard Mail grew by an average 9.8 percent per year, far outstripping the average growth in real Gross Domestic Product (GDP) of 3.3 percent.

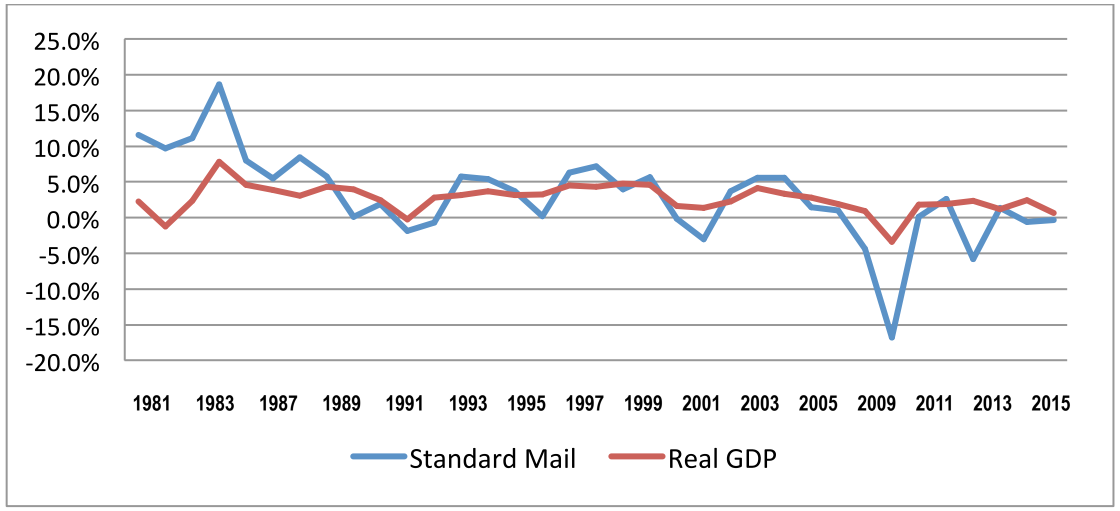
Notably, Standard Mail volumes continued to grow even as the nation went through a severe recessionary period from 1980 to 1982. The rapid growth in Standard Mail during this period is attributed to technological advancements in computerization, which allowed for more effective targeting of Standard Mail, as well as lower production costs. In addition, the Postal Service introduced a series of "workshare" discounts that provided mailers with lower rates if they presorted their mail themselves and/or sent sufficient volume density to qualify for further discounts.

The next period of note runs from 1988 through 2007. During this time, Standard Mail volume generally grew but did decline during the recessions of 1990 and 2001. Overall, volume increased by an average of 2.7 percent per year, approximately equal to the 3.0 percent annual average increase in real GDP.

From 2007 to 2009, Standard Mail volume fell by more than 20 percent. This was the period of the Great Recession which was the worst U.S. economic downturn since the Great Depression. Nevertheless, the decline in Standard Mail far exceeded the decline in the overall economy. The 2007 – 2009 Recession hit the financial sector especially hard with the collapse of the housing boom, the stock market, and the failure of many financial institutions. These components of the economy were particularly large senders of the mail. As will be shown in detail later, financial sector advertising mail fell far more than other types of advertising mail. Another important point is that it was not just advertising mail that was hit particularly hard by the Great Recession; total advertising spending also declined by a substantial amount during this period.

The final period of interest is the years following the Great Recession, from 2009 to 2015. During this period, Standard Mail volume has been essentially flat, while the economy grew by an average of 2.0 percent per year. The noticeable decline in Standard Mail in 2012 is explained by a large drop in credit card solicitation mailings following an increase in these volumes in 2011. The credit card industry likely assumed that with the end of the recession, households would be interested in taking on more credit. When this assumption proved untrue, solicitation volumes declined substantially explaining most of the 2012 decline. Standard Mail volumes by industry will be discussed in a later section of this white paper. Chart 2 shows annual changes in Standard Mail volume and real GDP.

Chart 2: Annual Percent Change in Standard Mail Volume and Real GDP

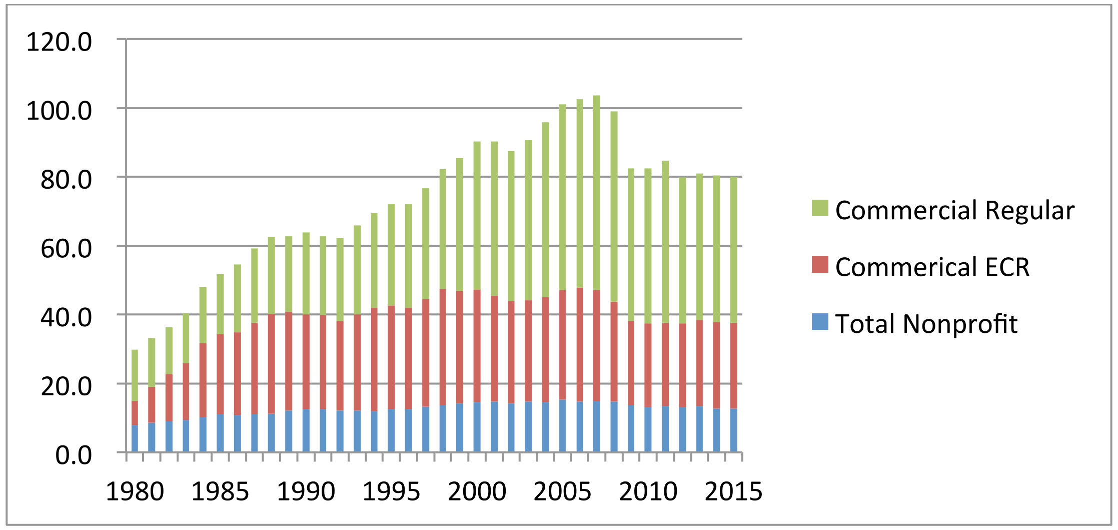


Sources: USPS RPW reports and U.S. Department of Commerce

B. Categories of Standard Mail

The Standard Mail class consists of several individual categories. One distinction is between Commercial and Nonprofit Standard Mail, the latter category representing mail sent by social, charitable, and political organizations that have nonprofit status. By law, Nonprofit Standard Mail rates are set at 60 percent of the Commercial Rate and, as a result, Nonprofit Mail represents a disproportionately smaller share of total Standard Mail revenues. Both Commercial and Nonprofit Mail are further divided into the Regular and Enhanced Carrier Route (ECR) categories.[3] ECR mail is priced lower than Regular Mail but requires a greater density (i.e., a minimum of ten pieces per carrier-route with greater discounts for even greater density). Generally speaking, Regular Mail tends to be more targeted to individual households than ECR Mail. The volumes of Commercial Regular, Commercial ECR, and total Nonprofit Mail are presented in Chart 3.

Chart 3: Commercial Regular, Commercial ECR, and Total Nonprofit Mail Volumes (in billions)



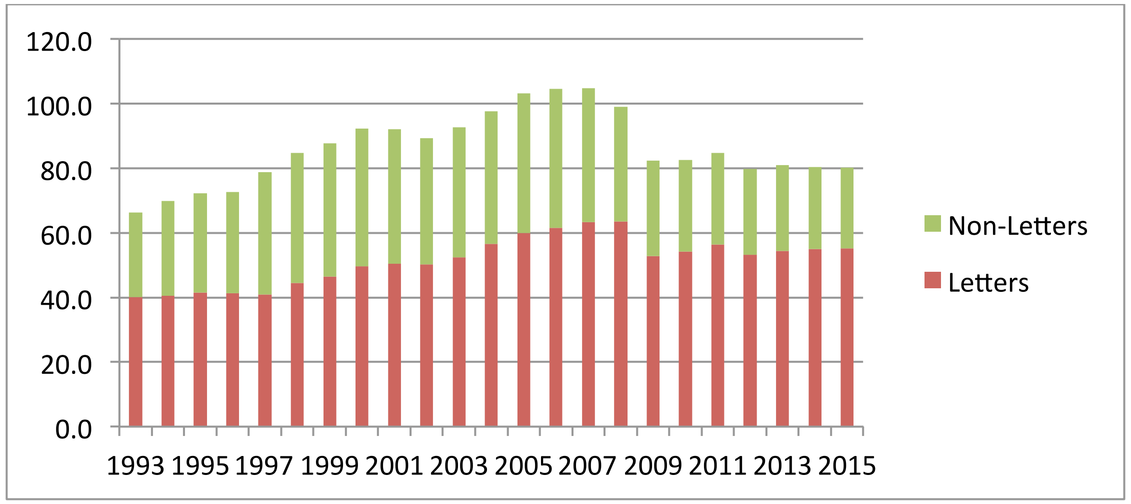
Source: USPS RPW Reports

Carrier-route presort was introduced in the late 1970s and its volume rose quickly and surpassed the volume of Regular Mail (within the Commercial category) in the years from 1982 to 1995. At its peak in 1998, there were 33.8 billion pieces of Commercial ECR Mail. Regular Mail eventually began growing faster than ECR Mail as computerization and the availability of direct mail marketing lists allowed for more effective targeting. Commercial Regular Mail peaked at 56.6 billion pieces in 2007. Nonprofit Mail volume nearly doubled from 1980 to its peak volume of 15.2 billion pieces in 2005. All categories of Standard Mail have fallen from their peak levels. Commercial Regular and ECR Mail are both down more than 20 percent and Nonprofit Mail volume is down more than 15 percent. Another distinction within Standard Mail is letters versus non-letters. Non-letters consist of catalog mailings as well as other mailings that do not fit the criteria for letter mail. The volumes of letters and non-letters are presented in Chart 3, beginning in 1993, which is when the Postal Service began to distinguish these categories in their RPW reports. Non-letter mail volume fell sharply from 2007 to 2009 due to the combined impact

[3] These terms have evolved through the years; we are using current industry designations for convenience. For example, the Enhanced Carrier Route (ECR) and Nonprofit Enhanced Carrier Route (NECR) subclasses were introduced in MC 1995-1. Prior to that time, all carrier route mail was part of the Bulk Rate Regular subclass. The ECR and NECR designations do not formally exist in the Postal Service's current product classification schedule.

of the Great Recession and a relatively large increase in the non-letter mail postage rate that was enacted in 2007.

Chart 4: Total Volume of Standard Mail Letters and Non-Letters (in billions)



Source: USPS RPW reports

Although there are differences in the historical trends of the volumes of Standard Mail by category and by shape, all forms of Standard Mail share the common pattern of growth up until the Great Recession. Moreover, all forms of Standard Mail have failed to rebound since the Great Recession ended more than six years ago. Thus, while distinctions between different types of Standard Mail will occasionally be made, the primary focus of the remainder of this white paper will be on the factors driving total Standard Mail volume in the recent past.

III. Strengths and Weaknesses of Direct Mail

A. Strengths

Direct mail advertising has a number of advantages when compared to other forms of advertising. Direct mail can go to every household whether or not that household has a landline telephone, internet access, or a subscription to newspapers and magazines. Direct mail marketing has an established history of using Zip Code information along with information about a household's past purchase history. Thus, it can be targeted to specific buying groups. Furthermore, some groups, especially older age groups, are often most responsive to direct mail advertising compared to other channels. Data from the Postal Service's Household Diary Study (HDS) show that older households are more likely to read Standard Mail. A 2012 ExactTarget survey shows that of people 65 years old or older, 85 percent had made a purchase based on a direct mail marketing message. For the same age group, 65 percent had a made purchase based on an email message and only 27 percent due to a telephone call or message.[4]

[4] ExactTarget. (2012). *The 2012 Channel Preference Survey.* Available at http://pages.exacttarget.com/SFF14-US?ls

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Compared to some other forms of advertising, such as television commercials or radio advertisements, direct mail campaigns are also somewhat easier to plan and design. Furthermore, direct mail advertising is also comparatively simple to track and measure. This allows companies to more easily gauge response rates, return on investment (ROI), and other metrics of effectiveness. Direct mail's ROI compares favorably to various digital and online advertising media, according to a study by the Direct Marketing Association (DMA). The DMA report found that direct mail had an ROI of 15 to 17 percent, compared with a range of 6 to 23 percent for a variety of different internet-based advertising platforms (e.g., search, mobile advertisements, e-mail advertising).[5]

Direct mail advertising also has a distinct advantage over most other forms of advertising – especially digital advertising methods – when it comes to response rates. Average direct mail response rates declined from 4.4 percent in 2003 to approximately 3.4 percent during the 2006-2012 timeframe.[6] Since then, however, response rates increased slightly to 3.7 percent in 2015 using a targeted (house) list.[7] With a prospect list, the response rate is about 1 percent. Although seemingly low, these response rates far surpass most other forms of direct media advertising channels with the exception of telephone campaigns which are much more expensive.

Direct mail can also be much more informative and convenient to the recipient. The top reasons chosen by respondents in a 2012 Epsilon study as to why they preferred direct mail to email or online communication were: (1) they could read the information when convenient; (2) they could refer back to the information when needed; and (3) they could easily take information to different places.[8]

A recent OIG paper, "Enhancing the Value of Mail: The Human Response" cited neurological research that found that physical advertising, such as direct mail, created a strong emotional response and was remembered better than digital advertisements. Moreover, physical advertising triggered brain activity that is responsible for assessing the value and desirability of featured products, "which can signal a greater intent to purchase." [9]

Additionally, direct mail is often perceived as more safe and private than digital advertising. According to a 2012 Epsilon study, the most personal and sensitive of information categories – health and financial

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[5] Direct Marketing Association. (2015). *2015 Response Rate Report.* Summary of findings available at http://www.marketingcharts.com/traditional/direct-media-response-rate-cpa-and-roi-benchmarks-53645/
[6] Summaries of the Direct Marketing Association's 2010 and 2012 *Response Rate Reports* as well as comparisons to earlier years can be found at http://adage.com/article/media/dma-snail-mail-phone-beat-digital-response-rates/235364/ and http://dmdatabases.com/resources/interesting-articles/direct-marketing-articles/direct-mail-response-rates
[7] Direct Marketing Association. (2015). *2015 Response Rate Report.* Summary of findings available at http://www.marketingcharts.com/traditional/direct-media-response-rate-cpa-and-roi-benchmarks-53645/
[8] Epsilon. (2012). *Channel Preference for the Mobile and Non-Mobile Consumer.* Summary of findings available at http://printinthemix.com/Fastfacts/Show/644
[9] Enhancing the Value of Mail: The Human Response, RARC-WP-15-012, June 15, 2015 https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-012.pdf

information – were the categories in which the highest percentage of respondents preferred direct mail communications.[10]

Other forms of advertising have recently encountered substantial limitations on their effectiveness. E-mail advertising has become pervasive and much of it is regarded as spam. Some traditional forms of advertising have seen the most significant changes. For example, an increasing number of people can now avoid television commercials by using DVRs or streaming applications. A Leichtman Research Group report states that 76 percent of households have a DVR, Netflix, or a streaming device.[11] Similarly, telephone marketing is more limited than it was in earlier years. According to the Federal Trade Commission's (FTC) FY 2014 National Do Not Call Registry Data Book, over 218 million phone numbers have been registered on the do not call list.[12]

Newspaper circulation and readership has declined considerably especially among younger demographics. In 1999, 40 percent of 18 to 24 year-olds were daily readers of newspapers, but by 2014 this figure had fallen to less than 20 percent.[13] There have also been important recent changes affecting the potential effectiveness of online advertising, a marketing channel often cited being in plain competition with direct mail. According to a 2015 PageFair/Adobe report, 45 million Americans were users of advertising blocking software for mobile and desktop applications in 2015, representing a 48 percent increase over the previous year. The report estimates the lost advertising revenue associated with the usage of advertising blocking software will reach $21 billion in 2015 and is forecasted to double in 2016.[14]

Thus, while users of direct mail face the challenge of getting recipients to read and respond to advertising mail, the same problem is present with every other form of advertising media. And no other advertising media has a network system specifically tasked with delivering its product to every household in the United States virtually every day of the week.

B. Weaknesses

Cost is one of direct mail's biggest disadvantages. The cost of design, materials and printing, and mailing can be significant and can exceed many other types of advertising on a per recipient basis. Moreover, there tends not to be much economies of scale for direct mail advertising. A mailing of one million pieces will cost about ten times as much as a mailing of 100,000 pieces.

[10] Epsilon. (2012). *Channel Preference for the Mobile and Non-Mobile Consumer.* Summary of findings available at http://printinthemix.com/Fastfacts/Show/644
[11] Leichtman Research Group. (2013). "DVRs Leveling Off At About Half of All TV Households." http://www.leichtmanresearch.com/press/120613release.html
[12] Federal Trade Commission. (2014). "FTC Issues FY 2014 National Do Not Call Registry Data Book." https://www.ftc.gov/news-events/press-releases/2014/11/ftc-issues-fy-2014-national-do-not-call-registry-data-book
[13] Pew Research Center. "Newspapers: Daily Readership by Age." http://www.journalism.org/media-indicators/newspaper-readership-by-age/
[14] PageFair/Adobe. (2015). *The cost of ad blocking: PageFair and Adobe 2015 Ad Blocking Report.* http://downloads.pagefair.com/reports/2015_report-the_cost_of_ad_blocking.pdf

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Direct mail advertising is perceived by many as “junk mail,” and is also seen as having negative environmental impacts. While much of direct mail is well-targeted to individual recipients, a sizable portion is not targeted and often seen as having little value to the recipient who ends up discarding the mail piece.

Digital advertising can be created and delivered much more quickly than direct mail and can allow recipients to immediately respond by making an online purchase. In contrast, delivery of direct mail advertising pieces takes several days and delivery times can be unpredictable which may have negative consequences for time-sensitive marketing.

The mailing lists which direct mail advertising campaigns rely on can sometimes be outdated or error-ridden, or may include the names of people who have moved or died. And while the USPS is working with mailers to reduce this problem, a possible side-effect of culling names from mailing lists could be a reduction in mail volumes. In addition, the Postal Service has not launched any highly popular new direct mail options comparable to workshare discounts that were put in place in the past. A recent Postal Service initiative, Every Door Direct Mail, accounted for a small percentage of total Standard Mail in 2015.

There is a simple advertising adage – “follow the eyeballs” – that argues that advertising spending should be geared to the media that people use most intensively. Many years ago, those media may have been newspapers or radio, and then television. But in recent years it is clear that more and more viewing time occurs online or via a Smartphone. An eMarketer study found that in 2015, the average American spent more than 5-1/2 hours each day with forms of online material, a two hour increase from 2011.[15] Over that same period, time watching television, listening to the radio, or reading newspapers and magazines declined. The same report also showed that while internet-based advertising spending has increased considerably in recent years, it is still underused relative to the media time spent online versus time spent with other media. This may be especially true for younger people, so-called “digital natives,” who grew up in a time when the internet was ubiquitous, are always connected, and may not have the same traditional connection to postal mail as their parents and grandparents.

Finally, the fact that other parts of the mail stream – notably First-Class and Periodicals – are in decline means that people may have less of a reason to go their mailbox, thereby reducing the effectiveness of direct mail advertising. This may explain some of the observed decline in Standard Mail reading rates in recent years. Practically speaking, if people are paying and receiving their bills online, along with online publications, and more time spent with online social media, they may start to dismiss postal mail altogether.

[15] eMarketer. (2015). “US Adults Spend 5.5 Hours with Video Content Each Day.” http://www.emarketer.com/Article/US-Adults-Spend-55-Hours-with-Video-Content-Each-Day/1012362

IV. Overview of the Advertising Market

A. Advertising Spending and the Macro-Economy

The advertising data used in this white paper come from two related sources: Magna Global from 1990 - 2010 and Pivotal Research Group from 2011 - 2015. Advertising data in some form go back at least as far as the 1930s.

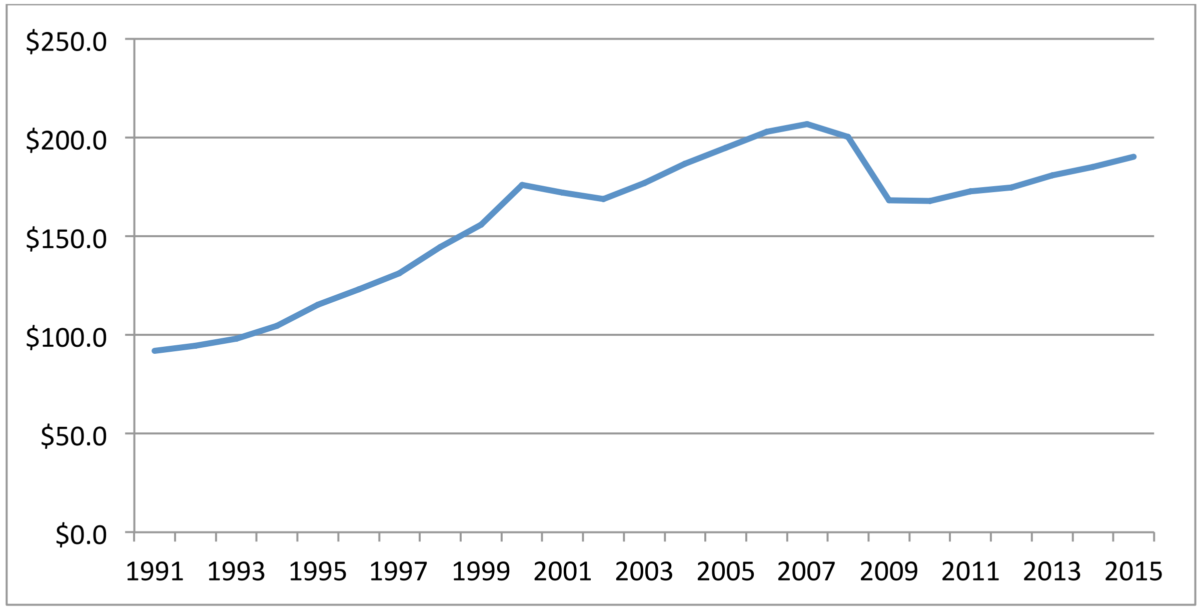
Many advertising analysts present estimates of advertising spending (at times also referred to as advertising revenues) in total and by individual advertising media. Differences in reported advertising spending often occur because different media are included in the total. Some analysts, for example, do not include direct mail in their totals. An important feature of the Magna and Pivotal data is that historical advertising numbers are presented on a quarterly basis which allows for reconstruction of annual data into government fiscal years, aligning the data with the Postal Service fiscal calendar. In addition, these data cover a consistent set of media, allowing of course for the addition of new media advertising that have emerged in recent years.

Winterberry Group is another advertising market analyst that measures direct mail. One difference between Winterberry and Magna/Pivotal is that Winterberry's measure of direct mail expenditures includes spending on non-postage components such as paper and mailing lists. Therefore, Winterberry's measure of direct mail spending is more than twice as large as the Magna/Pivotal measure which includes only postage costs. However, because the ultimate focus of this paper is on the Postal Service, the Magna/Pivotal postage-only measure of direct mail is preferred. The appendix of this report compares the Winterberry direct mail data to the Magna/Pivotal data and shows that while the measures are different, the trends are the same.

Information on total advertising spending is important because it allows for an analysis of direct mail (or Standard Mail's) place within the overall advertising market. Information on spending by individual media (e.g., television, newspaper, internet) makes it possible to determine the extent to which certain advertising media – in particular, direct mail – are gaining or losing market share relative to other media. In Chart 5, total U.S. advertising spending (sometimes referred to as advertising revenue) is presented. The data are converted into government fiscal years to allow for direct comparison with data from the Postal Service. Over this time period, total advertising spending approximately doubled, representing an average annual increase of about three percent per year. [The data are not adjusted for inflation.]

This average annual increase obscures some definite cycles within the advertising market. For example, from 1991 to 2000, advertising spending increased by an average of 7.5 percent per year, with much of the growth late in that period being fueled by the emergence of internet advertising. After declining during the 2001 recession, advertising spending rebounded and reached a peak of nearly $207 billion in 2007. Then came the Great Recession which caused advertising spending to fall almost 20 percent over the next two years. Interestingly, the drop in total advertising spending is similar to the drop in Standard Mail volume, a topic that will be discussed in the next section. From 2009 through 2015, advertising spending has increased by an average of 2.0 percent per year. Despite this recent growth, total spending remains below its 2007 peak according to Magna and Pivotal analysis.

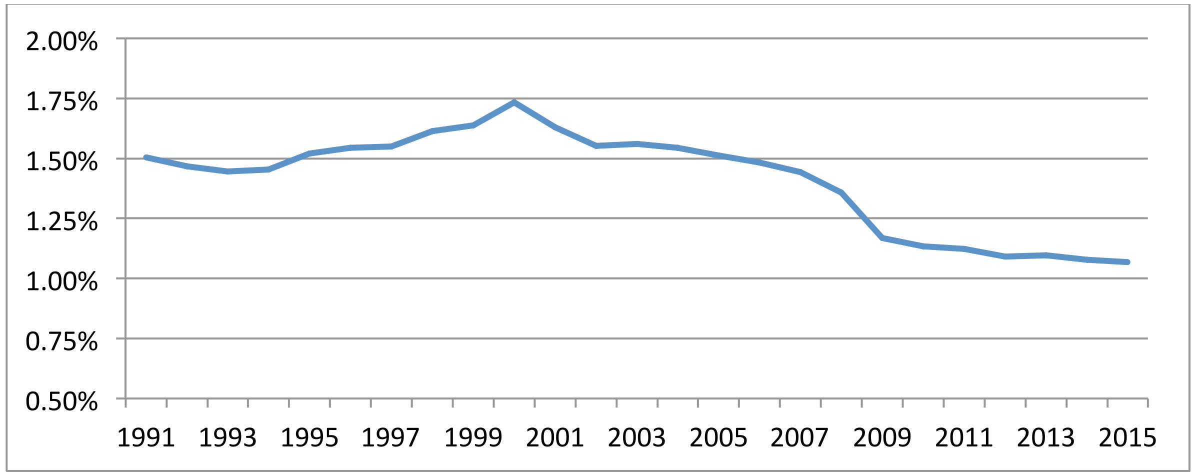
Chart 5: Total U.S. Advertising Spending ($ billions)



Sources: Magna Global and Pivotal Research Group

Another way to assess the advertising market is to look at U.S. advertising spending as a share of total U.S. GDP. These data are presented in Chart 6 which shows that advertising spending grew as a share of GDP in the 1990s and has since declined, with a significant decline occurring during the Great Recession. As of 2015, advertising spending represented just more than 1.0 percent of total GDP down from 1.75 percent in 2000.

Chart 6: Advertising Spending as a Percentage of GDP



Sources: Magna Global, Pivotal Research Group, and U.S Department of Commerce

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B. Reasons for the Decline in Advertising Spending Relative to GDP

One possible reason for the decline in advertising spending relative to GDP is the rise of internet-based advertising which has gone from essentially zero to more than $50 billion over the past 20 years. Increases in internet advertising can have a depressing impact on overall advertising spending because a dollar's worth of internet advertising may displace more than a dollar's worth of traditional advertising. In other words, marketers might be able to replace a $2 million newspaper advertising campaign with $1 million of online advertising, meaning that the shift from traditional to new media advertising reduces overall advertising spending. Vincent LeTang, director of Global Forecasting for Magna Global, refers to this effect as "digital deflation." According to LeTang, "As media usage and ad dollars gradually migrate from traditional media to digital media and since digital media now represent on average a third of ad budgets, the overall budgets are stagnating and, in some spending categories, shrinking. " Digital Deflation" not only refers to digital media being generally cheaper than traditional media on a CPM (cost per thousand recipients) basis and therefore reducing the overall cost of campaign when growing in the mix; equally important is the deflationary pressure that the shift is exerting on traditional media inventory vendors, some of whom are struggling to maintain prices in the face of shifting demand."[16]
It is worth noting that advertising spending rose as a share of GDP in the late-1990s, which coincided with the emergence of internet advertising. However at that time, the internet was an unproven advertising platform, so it is less likely that marketers would have shifted dollars away from traditional media. Instead, internet advertising spending was likely an add-on to companies' overall advertising budgets, helping to explain the increase in the advertising share of GDP during this time.

A second possible reason for the relative decline in advertising spending is, ironically, that advertising may have gotten more effective in recent years. 19th century department store merchant, John Wanamaker famously declared, "Half the money I spend on advertising is wasted; the trouble is I don't know which half." Wanamaker's comment reflected the scattershot nature of advertising spending in which much of the effort falls on deaf ears, or blind eyes. But if advertisers have found more effective ways of targeting the specific customers they wish to reach, they may be able to achieve the same marketing goals at less cost. Technological advances and better understanding of "big data" metrics are likely to have cut the amount of wasted advertising, to use Wanamaker's term.

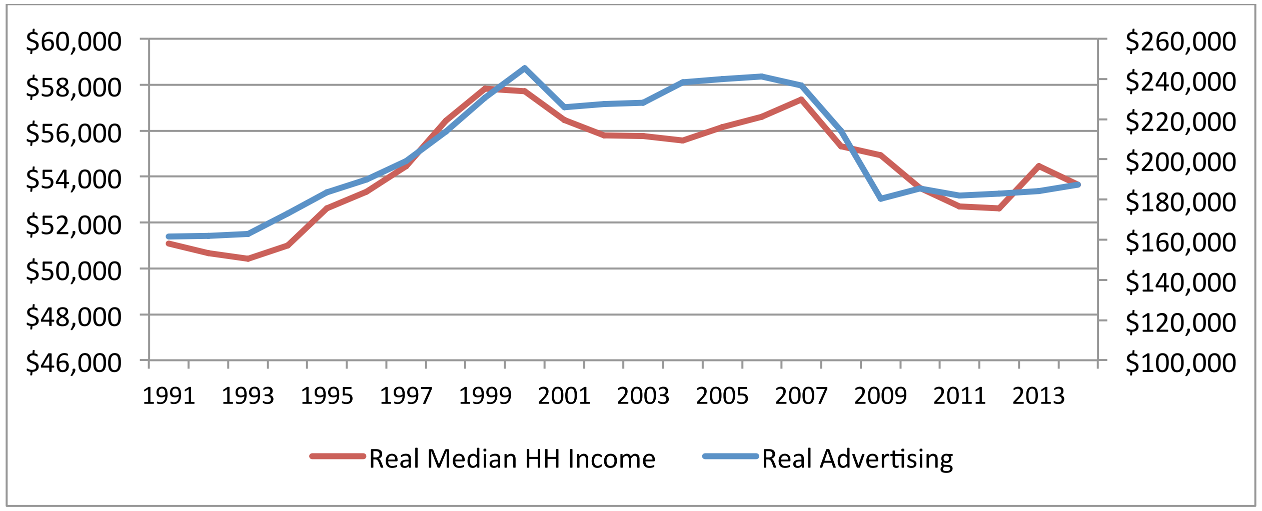
A third factor is that, especially in recent years, there has been an increase in non-measured advertising – activities that serve the purpose of advertising but are not included in advertising spending totals. For example, people have always been influenced by word-of-mouth recommendations and the spread of Facebook and other social media have facilitated these types of communications. A business's mere social media presence can generate attention and obviate the need for a more expensive advertising campaign. Similarly, companies need not spend as much money to promote the positive features of their products if Amazon's customers are willing to do so through their user reviews.

To the extent that these three hypotheses explain the relative decline in advertising spending, it seems likely that all three will continue to act this way in the future. However, another hypothesis produces a

[16] Magna Global press release, December 7, 2015

more mixed outlook. It may be that advertising spending tracks economic factors that have themselves followed a different pattern than GDP. In fact, as seen in Chart 7, real (inflation-adjusted) advertising spending closely follows real median household income. Given that advertising is likely to be focused on the "typical American household," one can understand the connection between the decline in household incomes and advertising spending over the past 15 years. To that end, future advertising spending may depend on future changes in household incomes.

Chart 7:
Real Household Median Income (left scale) and Real Advertising Spending in millions (right scale)



Sources: Magna Global, Pivotal Research Group, U.S. Bureau of the Census, U.S. Bureau of Labor Statistics

V. Advertising Spending by Media

A. Advertising Media Shares

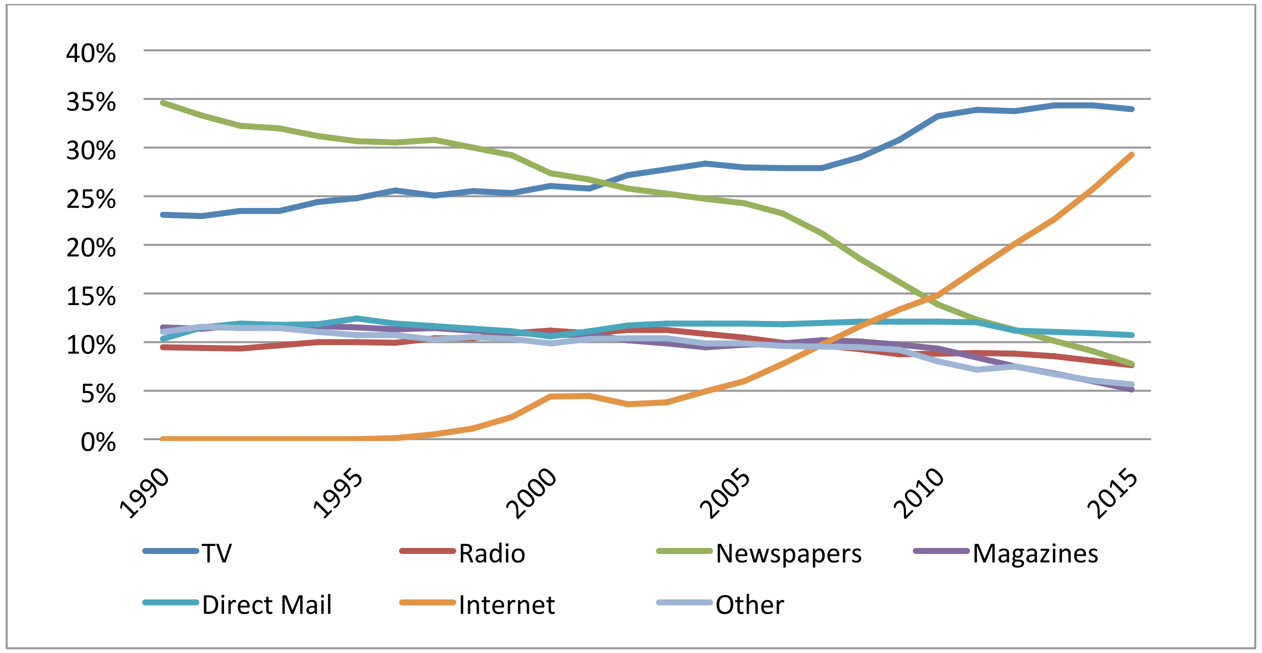
This section focuses on shifts of advertising spending across different media, measured by changes in each media's share of total advertising. The advertising media considered include: direct mail, internet, television, newspapers, magazines, radio, and "other". Direct mail spending only includes expenditures for postage; internet advertising encompasses all related forms, including but not limited to, online banner advertisements, search advertising, e-mail advertising, social, mobile, and digital video. The "Other" group consists of advertising spending not otherwise categorized but is primarily made up of advertising in yellow pages and outdoor billboards. The data come from Magna Global and Pivotal Research Group.

The Magna Global and Pivotal Research Group postage measure includes both Standard Mail and First-Class advertising mail. These analysts rely on the Postal Service's RPW reports for their measure of Standard postage, as well as making their own estimate of First-Class advertising postage.

Our estimate of total Standard Mail and First-Class advertising postage revenue is similar, but not identical to the Magna Global and Pivotal Research Group estimates. Because Standard Mail represents over 90 percent of total advertising postage revenues, it is the main focus of our analysis. We discuss First-Class advertising mail in a separate section of this white paper.

Chart 8 presents advertising shares for the seven media categories listed above from 1990 through 2015. The defining features of this chart are the steady rise in the importance of television advertising, the dramatic increase in internet advertising over the past 20 years and the equally dramatic decline in newspaper advertising over that same period. In Chart 9, media advertising shares for selected years are presented.

Chart 8: Advertising Shares by Media



Sources: Magna Global and Pivotal Research Group, 1990 Calendar Year; all other years Government Fiscal Year (GFY)

As indicated by Chart 9, the direct mail postage share of total advertising spending has been relatively constant over the past 25 years. This is in contrast to newspaper and internet advertising which both saw substantial changes in their advertising shares over this same period.

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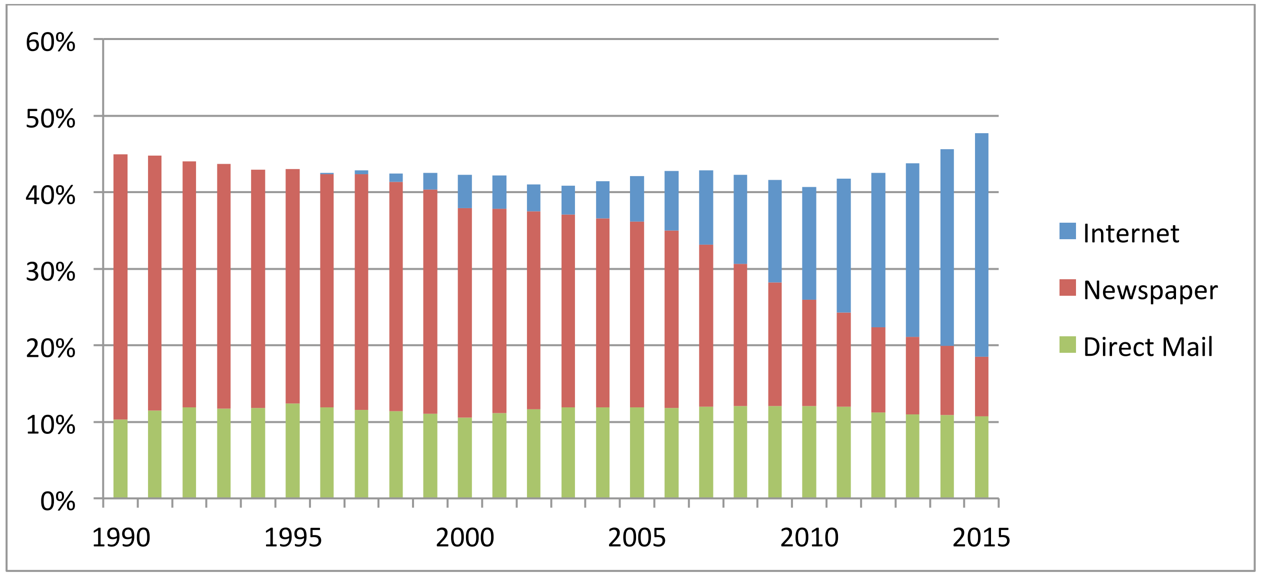
Chart 9: Advertising Shares by Media, Selected Years

	1990	1995	2000	2005	2010	2015
Television	23%	25%	26%	28%	33%	34%
Internet	0%	0%	4%	6%	15%	29%
Direct Mail	10%	12%	11%	12%	12%	11%
Newspapers	35%	31%	27%	24%	14%	8%
Radio	9%	10%	11%	10%	9%	8%
Magazines	11%	11%	11%	10%	9%	5%
Other	11%	11%	10%	10%	8%	6%

Sources: Magna Global and Pivotal Research Group, 1990 Calendar Year; all other years GFY

To further illustrate these developments, Chart 10 looks only at the advertising shares of these three media. One observation from Chart 10 is that the combined share of these three media has been fairly stable. A second observation is that it appears that virtually all of the increase in internet advertising has come at the expense of newspaper advertising with little, if any, impact on the direct mail advertising share, at least when viewed over the 25-year perspective.

Chart 10: Internet, Newspaper, and Direct Mail Advertising Shares



Sources: Magna Global and Pivotal Research Group, 1990 Calendar Year; all other years GFY

The almost one-to-one correspondence between the increase in internet advertising and the decline in newspaper advertising is strong evidence that the former successfully took away business from the latter. Moreover, newspapers and direct mail have long been considered competitors, based on the fact that they are both print media physically delivered to households. As such, the rise of internet advertising at the expense of newspaper advertising may have provided an indirect benefit to direct mail by weakening the effectiveness of one of its key competitors. This may explain why the rise in internet advertising appears to have had very little impact on direct mail's share of the overall advertising market.

However, now that newspaper advertising has fallen to less than 10 percent of the overall advertising market, there is less of it to be siphoned-off to the internet. In that regard, it is possible that continued growth in internet advertising could begin to divert direct mail spending. Looking back at the past five years in Chart 9 , the direct mail share of total advertising has declined, suggesting perhaps that internet advertising may finally be having an adverse impact. Alternatively, it may be that new forms of internet advertising such as mobile or social advertising are affecting direct mail in ways that earlier forms of internet advertising did not.

B. Direct Mail and Internet Advertising – A Closer Look

Although direct mail faces competition from many other advertising media, it is clear that internet advertising represents the most significant threat to future growth in direct mail volumes. For our purposes, internet advertising encompasses the wide range of digital media such as online banner advertisements, search, e-mail advertising, mobile and social advertising, as well as new platforms that have not yet emerged.

Electronic diversion refers to the replacement of physical mail with an electronic alternative such as paying a bill online instead of through the mail. Electronic diversion can also affect direct mail if marketers reduce their use of Standard Mail and shift spending to Internet advertising. Diversion can be direct as would be the case where a marketer actively reduces direct mail spending and shifts those funds to the internet. Or diversion can be indirect, where increased spending on internet advertising requires reductions in the funds budgeted for all other advertising media including, but not limited to, direct mail.

The data on advertising shares yielded mixed information regarding the impact that internet advertising has had on direct mail. So far, it appears that most of the gains in internet advertising have come at the expense of newspaper advertising, but there is some evidence that indicates that in the past few years direct mail has come under pressure as well. Indeed, this is a reasonable explanation for the recent stagnation of Standard Mail volumes. Nonetheless, it must be remembered that over the past 20 years, internet advertising has gone from virtually nonexistent to capturing 30 percent of the overall advertising market without having an obviously significant impact on direct mail advertising. Thus, the relationship between direct mail and internet advertising is more complex than a simple substitution of one for the other in marketers' budgets.

In some ways, direct mail and internet advertising may be complements. A direct mail campaign may coincide with e-mail or mobile marketing efforts directed at the same customer. These kinds of multi-channel marketing efforts are increasingly popular as marketers try different ways to reach customers. Direct mail pieces can include a QR (quick response) code that allows the recipient to electronically scan the mail piece with a mobile phone to take advantage of a special offer or discount.

Catalog mail facilitates online shopping, and other direct mail pieces can lead the recipient to an online shopping website. In fact, the Postal Service's Household Diary Study (HDS) data show that households with the internet and households that shop online receive more Standard Mail than other households. This might reflect that these households are better targets for advertising in general, but it shows that increased online activity need not lead to less direct mail.

Thus, a key factor affecting direct mail in the future will be the impact of increased internet advertising as well as the extent that increased internet advertising causes a reduction in direct mail advertising. In that regard, the Postal Service can mitigate the potential losses of direct mail to the internet by enhancing the complementarity between advertising mail and internet advertising.

VI. Senders and Recipients of Standard Mail

A. Senders

Data on the senders of Standard Mail are obtained from the Postal Service's HDS. The HDS is an annual survey of more than 5,000 households which records information about the mail households receive, their attitudes toward the mail, as well as household demographic information. Data from the HDS cover only household-received mail, but this constitutes close to 90 percent of all Standard Mail. Often, HDS data are tabulated on a per-household basis. By extrapolating from the HDS sample to the entire U.S. population, an estimate of total mail received by households is obtained. HDS data for 2015 are still being processed by the Postal Service and so this section relies on HDS data through 2014.

In Chart 11, household-received volumes of Standard Mail by industry of sender are presented for selected years. Note that "social" mail consists mainly of mail sent by nonprofit organizations. Also note that included within the "other" category is Standard Mail sent by multiple organizations, often consisting of a packet of advertisements from a number of different companies. The chart also shows total Standard Mail which includes volumes received by non-households.

Two important trends are shown in the chart. The first is the volatility of financial sector volumes which rose substantially during the housing and credit boom of the early 2000s, collapsed with the financial crash and Great Recession, and then recovered somewhat during the most recent recovery. A second key trend is that volume sent by merchants (e.g., department stores) was flat from 2001 to 2007 even as total Standard Mail increased.Unlike financial sector mail, mail sent by merchants has continued to decline even after the end of the Great Recession.

Chart 11: Household-Received Standard Mail Pieces by Industry of Sender (in billions)

	2001	2007	2009	2014	Percent of 2014 HH Volume
Financial	12.6	17.9	12.8	15.4	22%
Credit Cards	5.6	7.2	3.9	5.9	
Merchants	29.7	29.8	25.3	23.2	32%
Services	9.1	10.9	10.4	11.3	16%
Social	10.6	13.8	12.3	12.7	18%
Other	10.1	11.0	9.8	8.9	12%
Total Standard*	92.1	104.7	82.4	80.4	

*Total includes Standard Mail received by non-households
Sources: USPS Household Diary Study and RPW reports

The chart also shows the volume of Standard Mail sent by the credit card industry, often referred to as credit card solicitations mail. The full pattern of credit card mail volumes differs somewhat from the rest of the financial sector. According to the HDS, credit card solicitations mail received by households peaked at 8.8 billion pieces in 2005 and then fell below 4.0 billion pieces by 2009. Volume rebounded to 8.7 billion pieces in 2011 and then dropped again to 6.0 billion pieces in 2012 where it has remained ever since. The increase in credit card volumes in 2011 and their decrease in 2012 explain much of the volatility in total Standard Mail over those two years.

This pattern was corroborated by Andrew Davidson, senior vice president at Mintel Comperemedia, a company that tracks credit card solicitation mail, who noted in June 2012 that "April [2012] marks a new low for the credit card direct mail decline that began in December 2011. The last time volumes were lower was back in March 2010. At that time, a come-back in direct mail was gathering steam following severe cut backs during the recession. That come-back turned into a two-year period of expansion that peaked in June 2011."[17] Most likely, credit card marketers assumed that the end of the recession would cause households to increase their demand for credit. When this did not happen, credit card solicitation volumes fell and remain about 30 percent below their pre-Great Recession peak.

In Chart 12, percent changes in volume by industry are presented. The extreme cyclical nature of the financial sector's volume of Standard Mail is evident. The recovery of this sector's volume since 2009 is contrasted with the continued decline in volume sent by merchants. *This suggests that Standard Mail volumes are driven both by underlying economic conditions as well as industry-specific dynamics.*

[17] Mintel press release, "April Credit Card Volume hits 25-month Low in April," June 12, 2012

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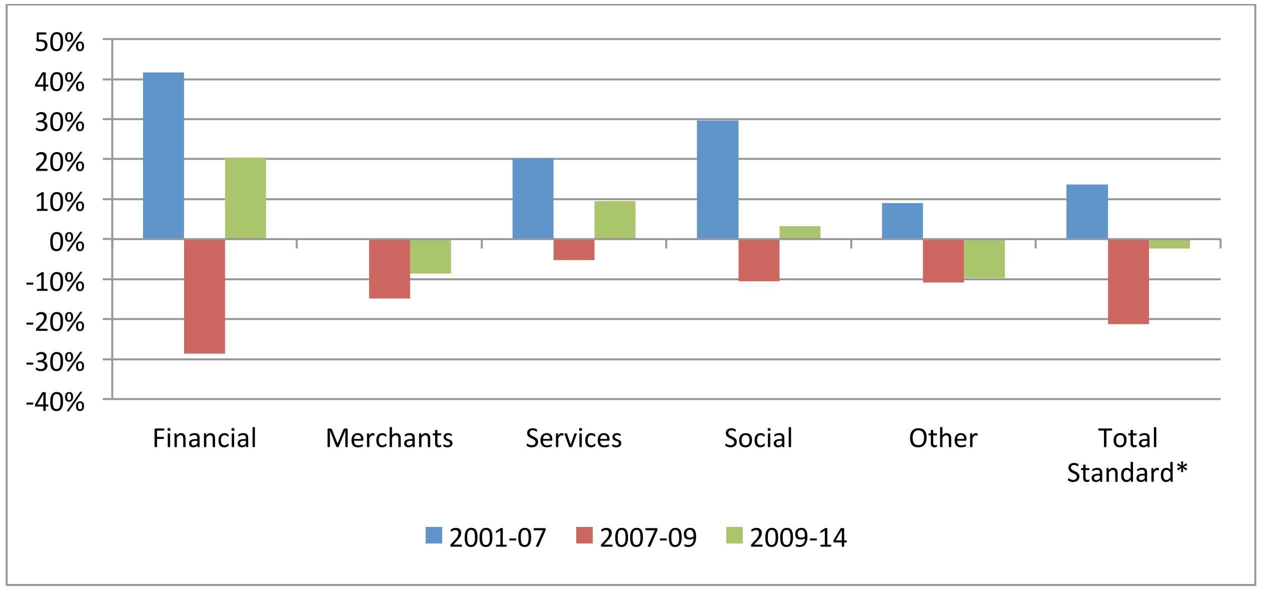
Chart 12: Percent Changes in Household-Received Standard Mail by Industry of Sender



*Total includes Standard Mail received by non-households

Sources: USPS Household Diary Study and RPW reports

B. Relationship vs. Prospecting Standard Mail

Standard Mail can be classified as either relationship mail or prospecting mail. Relationship mail is mail that is sent to a previous customer, whereas prospecting mail is mail sent to a potential new customer. Both are important to marketers. Past customers are more likely to respond to a given direct mail offer, but companies constantly need to attract new customers (i.e., prospects) to grow their businesses. In Chart 13, the volume of relationship and prospecting Standard Mail received by households is presented. [Note that whether the sender has a past business relationship with the recipient is self-reported in the HDS survey. There is also a large volume of Standard Mail for which the HDS respondent did not classify as to whether there was a past business relationship.]

Half of all Standard Mail sent to households in 2014 went to a past customer, a share which is about equal to the average proportion over the past 15 years. However, as shown in Chart 13, prospecting mail tends to be more cyclical than relationship mail, falling more during the Great Recession and rising more during the subsequent recovery. In fact, prospect mail is the only one of the three categories shown in Chart 13 to have increased from 2009 to 2014.

Chart 13: Household-Received Standard Mail – Relationship or Prospecting Pieces

	2001	2007	2009	2014	2001 - 07	2007- 09	2009 – 14
Relationship	35.8	41.5	35.9	35.7	16%	-13%	-1%
Prospect	22.9	27.3	20.4	22.6	19%	-25%	11%
Not Stated	13.5	14.6	14.3	13.2	9%	-2%	-8%

Source: USPS Household Diary Study

One possibility is that marketers are more likely to use e-mail to contact existing customers while finding direct mail to be an effective way to reach new customers. Yet, with prospecting mail representing only about one-third of all household-received Standard Mail, there is a limit to how much additional volume can be generated merely through prospecting activities.

C. Recipients of Standard Mail

According to HDS data, households received over 70 billion pieces of Standard Mail in 2014. Standard Mail volumes are highly correlated with household income and the age of the household head.

The recent "graying" of Standard Mail is a function of the aging of the U.S. population and the fact that oldest households (65+) were the only age group to receive more mail (on average) in 2014 than in 2009. Younger households saw somewhat greater increases in Standard Mail volume from 2001 and 2007 and have seen larger decreases since that time. Another interesting finding is that households over the age of 55 received slightly more than half of all household Standard Mail in 2014, compared with a little more than 40 percent of the total in 2009.

Chart 14: Standard Mail Received by Age of Household Head (pieces per week)

Age of HH Head	2001	2007	2009	2014	2001 - 07	2007- 09	2009 - 14
18 – 34	8.6	9.9	7.9	6.9	15%	-20%	-12%
35 – 44	13.2	13.8	11.2	9.7	4%	-19%	-13%
45 - 54	15.0	15.5	12.2	11.2	3%	-21%	-8%
55 – 64	14.3	15.5	13.4	12.8	9%	-14%	-5%
65+	15.9	15.2	13.7	14.7	-4%	-10%	8%
All Households	13.2	13.8	11.6	11.2	5%	-16%	-3%

Source: USPS Household Diary Study

The age profile of Standard Mail has positive and negative effects going forward. On the one hand, the aging of the baby boom generation will mean that there will be more of these older mail-intensive households in the near future. On the other hand, the longer-term prospects for Standard Mail rest with younger households. It remains to be seen whether these households will see an increase in Standard Mail volume as they age, especially given that younger households are much more digitally connected.

Not surprisingly, household-received Standard Mail volumes are also highly correlated with income. As seen in Chart 15, there has been little change in the relative proportions of Standard Mail received across the different income groups. *Still, the data demonstrate that users of direct mail clearly target higher income households and, as such, the future volume of Standard Mail will depend in part on the future level of household incomes.*

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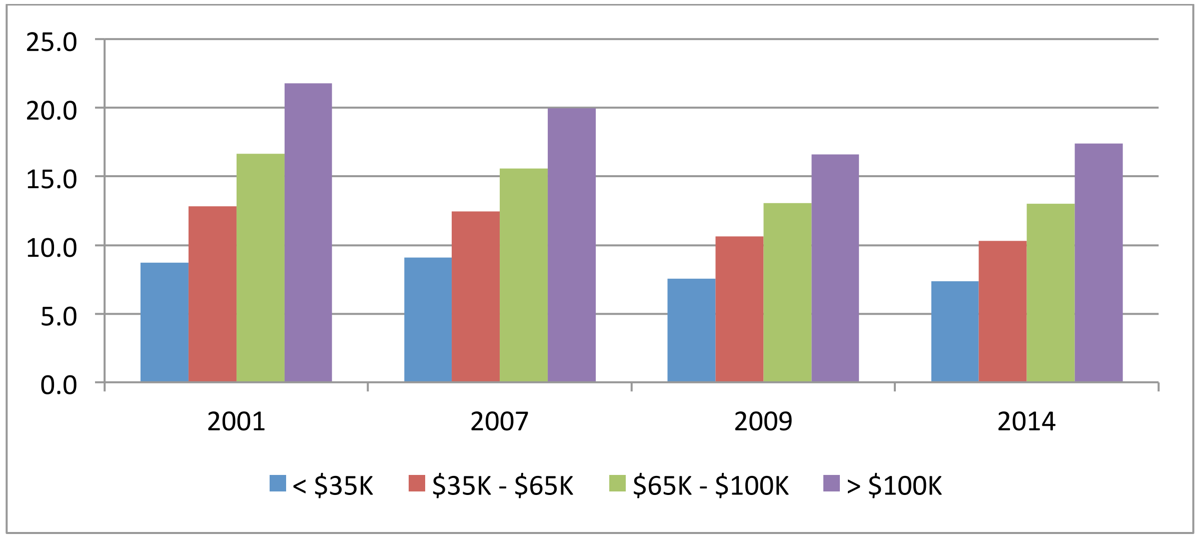
Chart 15: Standard Mail Received by Household Income (pieces per week)

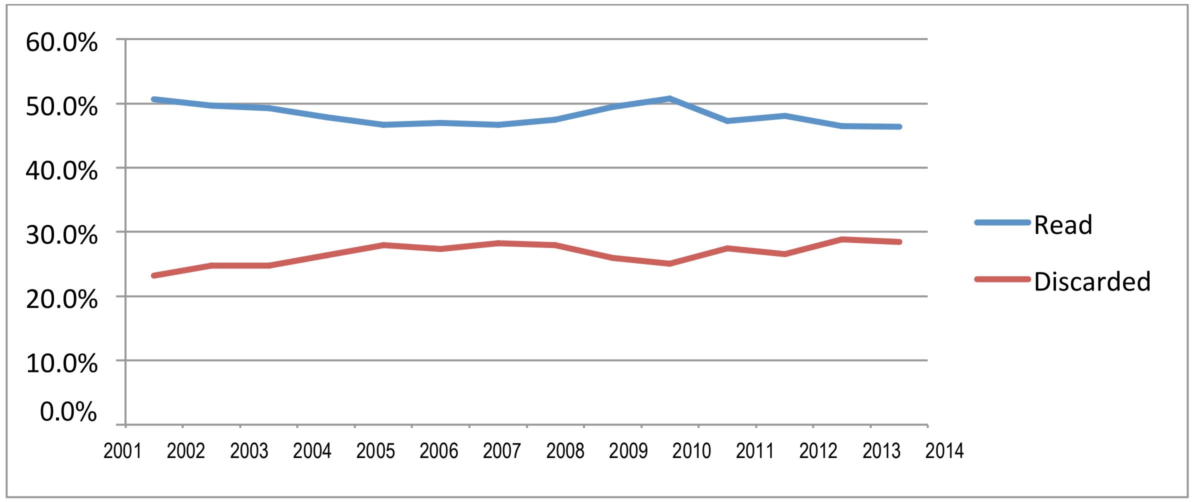


Source: USPS Household Diary Study

D. Household Reading of Standard Mail

Marketers continue to send direct mail because it works. One basic measure of the effectiveness of Standard Mail is whether the mail pieces are ultimately read by the recipient or discarded. According to HDS data, almost half of all Standard Mail pieces are read immediately by at least one person in the household, while a little less than 30 percent of the pieces are discarded. [The remaining pieces are classified as having been "looked at" or "set aside for later," which suggests that the ultimate reading rate is likely to be higher than shown here.] Nevertheless, Chart 16 clearly shows that the reading rate has trended downward since 2001, while the discard rate has trended upward.

Chart 16: Percent of Standard Mail Pieces Read Immediately or Discarded

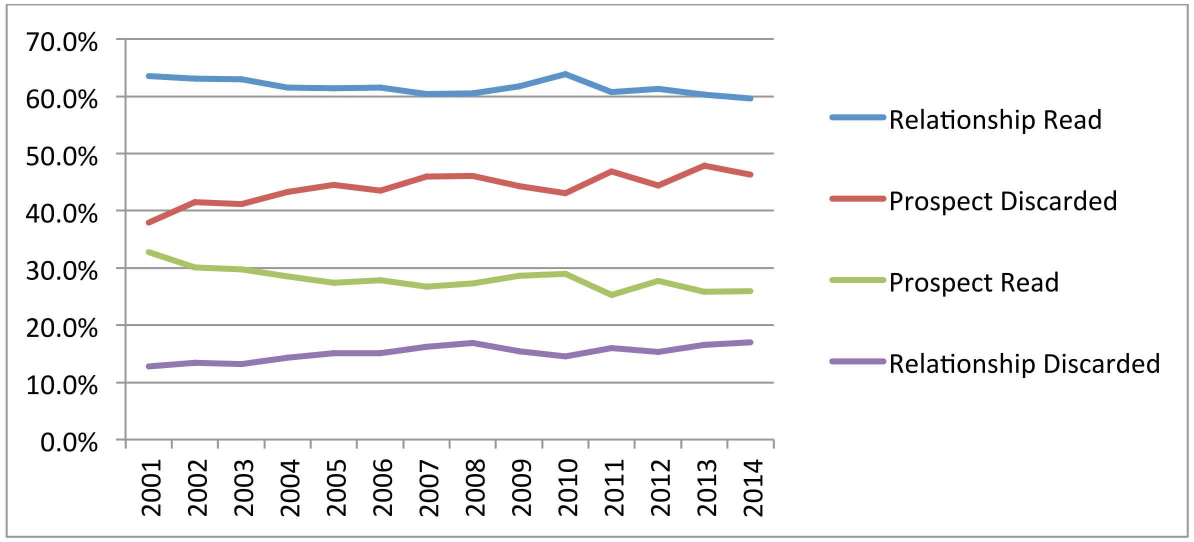


Source: USPS Household Diary Study

There is a wide range of reading rates across different industry senders. In 2014, households immediately read 55 percent of Standard Mail from merchants compared to only 30 percent of mail received from credit card companies. The increase in reading rates from 2007 to 2009 is mostly due to a decline in volume of credit card mail during that time.

There are also large differences in reading rates depending on the household's relationship with the mailer. Households that have a past business relationship with the mailer immediately read 60 percent of this mail whereas households read only 26 percent of mail from senders with which they did not have a past relationship (i.e., prospecting mail). Similarly, only a small fraction of relationship marketing mail is discarded; more prospecting mail is discarded than immediately read. Chart 17 shows the reading and discard rates for relationship and prospect Standard Mail.

Chart 17: Percent of Standard Mail Pieces Read Immediately or Discarded



Source: USPS Household Diary Study

E. Summary of HDS Information about Standard Mail

Among the important findings from the analysis of household-received Standard Mail are as follows:

- Merchants are the largest senders of Standard Mail but merchant volumes have been in a gradual decline for many years.
- The financial sector is the second largest sender of Standard Mail and has exhibited the greatest cyclical variation, rising more during periods in which the economy was growing and falling more during the Great Recession.
- Standard Mail volumes are highly correlated with household age. The age relationship presents some interesting dynamics as the demographic composition of the U.S. population changes. The gradually aging society is a positive for Standard Mail volumes, at least in the near term.

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However, over time, as younger Americans age, they will become the main targets of marketers. It remains to be seen whether this age cohort will receive more Standard Mail as they age, following the pattern of their elders, or if the tilt away from printed material toward digital media will continue into the future and cause them to be less receptive to advertising mail.

- Standard Mail volumes are also highly correlated with household income. Thus, the overall performance of the U.S. economy and changes in household income will be a key factor affecting Standard Mail in the future.

- Almost half of all Standard Mail was read immediately by the recipient in 2014, a slight decline from earlier years. At the same time, the share of Standard Mail that was discarded has increased.

- Reading rates are quite varied depending on the sender. Standard Mail that is sent by a business that has a past relationship with the recipient is more than twice as likely to be read than is prospecting mail and one-third as likely to be discarded. Standard Mail sent by merchants is almost twice as likely to be read than is mail sent by credit card companies. In fact, only about 15 percent of credit card prospecting mail is read immediately while two-thirds is discarded.

These findings reveal some opportunities and concerns regarding the future of direct mail. While recognizing that marketers must continue to prospect for new customers, a proliferation of poorly-targeted prospecting mail can turn households away from direct mail. Direct mail appears to be well-positioned to reach older households but less so with younger ones. These two observations are inter-related. Younger households are less likely to read Standard Mail than older households, but younger households also tend to receive more prospecting mail. Interestingly, younger households read more than half of their relationship Standard Mail indicating that they, like older households, are receptive to direct mail marketing that is targeted to their past purchase decisions.

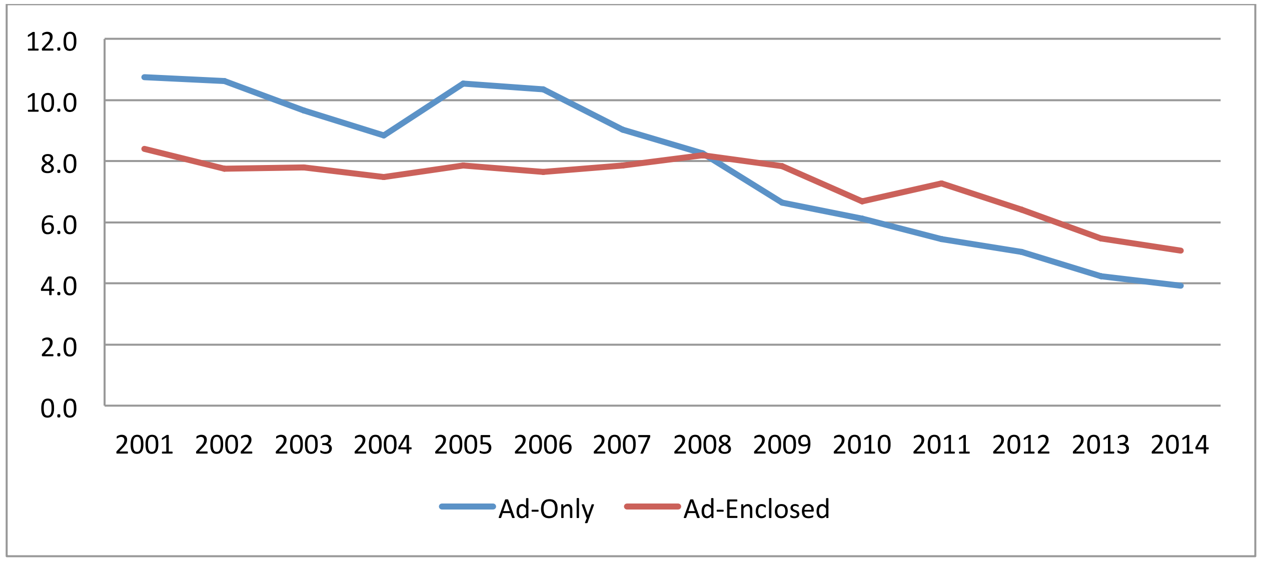
VII. First-Class Advertising Mail

The Postal Service's RPW reports do not distinguish First-Class advertising mail data separately and so, from these data, one cannot obtain a measure of First-Class advertising volumes or postage revenues. However, the HDS does record data on First-Class advertising mail received by households. While the HDS does not provide information on non-household received First-Class advertising mail, it is likely that the vast majority of First-Class advertising mail, like the vast majority of Standard Mail, is received by households.

There are two types of First-Class advertising mail. The first is known as advertising-only and consists of pieces that are solely advertising mail. The second type of First-Class advertising mail is known as advertising-enclosed which consists of mail pieces with some advertising included with a non-advertising piece such as a bill or statement. Advertising-enclosed mail does not provide additional revenues to the Postal Service because in most every case the added advertising does not result in an increase in postage costs. Nonetheless, this advertising provides a value-added product for the sender and is a factor supporting the use of First-Class Mail. Therefore, advertising-enclosed volumes are important to the Postal Service.

Chart 18 presents HDS data on First-Class advertising-only and First-Class advertising-enclosed volumes received by households. First-Class advertising volumes have declined precipitously over the past decade. Advertising-only volume fell 63 percent from 2005 to 2014, and advertising-enclosed volume declined 36 percent over the same period.

Chart 18: First-Class Advertising Mail Received by Households (in billions)



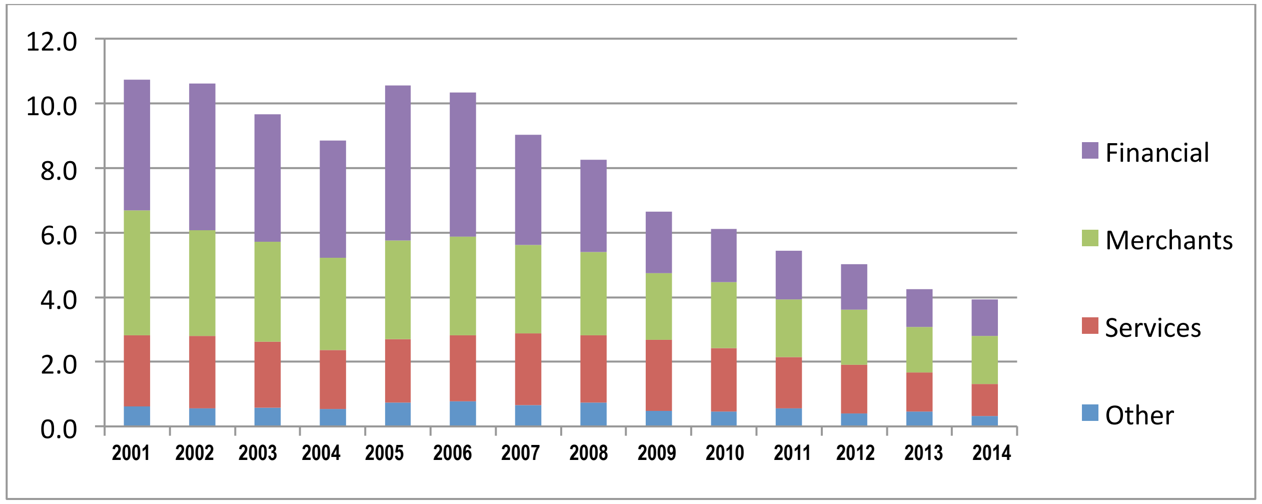
Source: USPS Household Diary Study

Two factors explain this decline. The first is the housing and financial collapse associated with the Great Recession which led to a steep drop in advertising mail sent by the financial industry. The financial industry was a main user of First-Class advertising mail. The second, related, factor is that following the Great Recession, mailers likely became more cost-conscious and shifted advertising volumes from more expensive First-Class to less expensive Standard Mail. There are advantages of First-Class advertising mail. It can be personalized which is an attribute valued by financial mailers. It is also delivered more quickly. Furthermore, First-Class advertising mail can be forwarded if there is a change of address. However, it appears that in recent years, these advantages were not sufficient to offset the cost savings provided by Standard Mail, at least for most mailers. For perspective, a presorted First-Class Mail piece currently costs about 39 cents while a similarly presorted piece of Standard Mail costs about 23 cents.

However, since First-Class Mail postage is higher, it provides a relatively larger proportion of revenues to the Postal Service. In addition, the mark-up of price over cost is higher for First-Class than for Standard Mail, meaning that First-Class Mail also provides a relatively greater contribution to the Postal Service's bottom line. One can estimate total First-Class advertising-only volume (including volume received by non-households) by assuming that the non-household share is the same as it is for Standard Mail. If so, then total First-Class advertising-only volume in 2014 was about 4.5 billion, down from about 12 billion pieces in 2005. First-Class advertising-only postage revenue would therefore be about $1.7 billion in 2014, as compared with almost $18 billion of Standard Mail revenues.

In Chart 19, First-Class advertising-only volumes by industry of sender are presented. The important role of the financial industry in the decline of volume is clear. From 2005 to 2014, industry volume fell 77 percent, dropping from 4.8 billion pieces to 1.1 billion pieces. Even so, this industry still sent 29 percent of First-Class advertising-only mail in 2014, albeit a decline from 45 percent in 2005. For comparison, the financial industry's share of Commercial Standard Mail was about 22 percent in both of these years.

Chart 19: First-Class Advertising-Only Mail Received by Households by Industry of Sender (in billions)



Source: USPS Household Diary Study

First-Class advertising-only mail will continue to provide some revenue to the Postal Service, and advertising-enclosed mail will help maintain the volume of other types of First-Class Mail. Nevertheless, the substantial decline in First-Class advertising mail, and the likelihood of future declines, means that the vast majority of direct mail revenues will come from Standard Mail.

In a separate document, Part of this white paper will present different scenarios for the future of direct mail and make projections of the future volume of Standard Mail under each scenario.

VIII. Conclusions

Standard Mail volumes declined 20 percent during the Great Recession and unlike past recessions, volume failed to rebound as the economy recovered. Three factors appear to be the main drivers of this phenomenon. First, the current economic recovery has been relatively weak with the overall economy growing only about two percent per year and household median income – which may be a more important driver of advertising and marketing activity – still below its pre-recession peak. Second, total advertising spending has been a declining share of the U.S. economy, a development that pre-dates the Great Recession and has continued post-recession. Third, Standard Mail has lost some market share within the overall advertising market, likely due to shifts of marketing expenditures toward internet and digital advertising. As such, Standard Mail has seen a somewhat lower share of a slowly growing overall advertising market, and, as a result, mail volumes have remained essentially flat from 2009 to 2015.

The most important factor affecting Standard Mail volumes in the future is likely to be the relationship between direct mail and internet advertising. It seems certain that internet advertising will grow considerably over the next few years, but it is not obvious that this growth will come at the expense of direct mail. First, some of the increase in internet advertising could reflect stronger growth in overall advertising. In this case, increases in internet advertising may not take from any other advertising media, but rather, represent additions to total spending.

Second, even if the majority of new internet advertising does come through shifts from other media, it is not necessarily the case that direct mail will bear much of that shift. Until now, direct mail has largely maintained its share of total advertising spending over the past twenty years, a period in which internet advertising has grown tremendously. This suggests that the two media are not natural substitutes, at least so far. In fact, the emphasis on multi-channel marketing suggests that direct mail and internet advertising can work together. Moreover, many of the current technological developments might be greater threats to other forms of advertising. Streaming music and videos can replace radio and television, for example.

Third, regardless of what happens with internet advertising, direct mail will still face competition from other traditional advertising media. The general decline in reading of printed material could adversely affect direct mail, but the impact may be greater on two of its competitors – newspaper and magazine advertising. Direct mail has increased its share of the traditional (non-internet) advertising market and further increases could effectively offset any losses to the internet.

Nonetheless, the expected increase in internet advertising will be a challenge to direct mail's place in the market and, by extension, a challenge to the Postal Service. Importantly, the Postal Service is not powerless to affect the future of Standard Mail. While there is little the Postal Service can do to affect the growth in the overall economy and household incomes, other drivers of future volume are within its control. Perhaps the most important role the Postal Service can play is highlighting the many positive aspects of direct mail.

- For the most part, households read their direct mail and view it more favorably than many other forms of advertising. Contrary to popular wisdom, it appears that younger households are receptive to direct mail advertising if they see it as being relevant and well-targeted to their interests.

- Direct mail's cost effectiveness is on par with many forms of digital and internet advertising. Moreover, other forms of advertising face their problems whether it is the decline in print subscriptions, the spread of online ad-blocking software, the substitution of online music for radio, or the replacement of network television with streaming video.

- Direct mail can serve as a complement to internet advertising and other online activities. Catalog mail facilitates online shopping. Marketers can use direct mail to reinforce advertising messages sent via e-mail or on a mobile phone. QR (quick response) codes can be added to direct mail and allow recipients to scan the mail piece and take advantage of special offers or discounts. Thus, increases in online marketing need not displace mail and could even create new synergies between the two media.

Although direct mail volumes have fallen from their pre-Great Recession peak, direct mail continues to be a significant part of both the advertising market and the Postal Service. Importantly, direct mail benefits from the Postal Service's established delivery network which gives marketers access to every household in America almost every day of the week. As such, it seems likely that direct mail will continue to play an important role for the Postal Service and advertisers alike.

Technical Appendix

The Technical Appendix describes the data files used in this white paper. Three data files are included:

1. Historical Standard Mail Volumes
2. Historical Advertising Expenditures
3. Household Diary Study Data

1. Historical Standard Mail Volumes

This file presents quarterly volumes of Standard Mail by detailed category using data from the Postal Service's Revenue, Pieces, and Weight (RPW) reports. The first worksheet, "Volume Data," presents the quarterly volumes as well as aggregated volumes by category discussed in the main report. Note that third-class single-piece volumes are not included in the total as this now-discontinued category consisted of Standard Mail that was most likely not advertising mail. The second worksheet, "Economic Data," presents the economic data included in this white paper: CPI, GDP, and Real GDP. Data through calendar 2015Q3 are historical and data beginning in 2015Q4 are forecasted from IHS Global Insight's November 2015 forecast. Calendar quarter data are converted to GFY data. These data are used in the other Excel files in the Technical Appendix. The third worksheet, "Charts," presents that data used in the charts included in the main text of this white paper.

2. Historical Advertising Expenditures

This file presents quarterly advertising expenditures in total and by media. Two data sources are used. Data from 1990Q1 through 2010Q4 were obtained by RCF from Brian Wieser in 2010, and updated data through 2010Q4 were obtained from his successor, Vincent LeTang in 2011. Data from 2011Q1 through 2015Q4 were obtained from Wieser's new firm, Pivotal Research Group. Because of Wieser's lead role in both these companies, the data are measured consistently. These data are presented in the first worksheet of this file.

Quarterly data are converted to GFY and Calendar Year (CY) totals in the next two worksheets of this data file. These worksheets also calculate each media's annual share of total advertising spending.

The fourth worksheet of this file presents analysis of advertising spending and the U.S. economy. Included in this sheet are charts of total advertising spending, advertising spending as a share of GDP, and a comparison of real median household income with real advertising spending. The first two charts use GFY data to be consistent with Postal Service data. The third chart uses CY data to be consistent with the Census Bureau's measure of household income. Real advertising expenditures are calculated by adjusting annual expenditures by the annual level of the consumer price index (CPI) as reported by the U.S. Bureau of Labor Statistics. Median income data are from the U.S Bureau of the Census.

The fifth worksheet of this file presents a comparison of advertising data used in this white paper (Magna and Pivotal) with advertising expenditures reported by Winterberry Group. Winterberry's measure of direct mail expenditures includes non-postage expenditures (e.g., paper costs) and is therefore larger than the Magna/Pivotal measure of direct mail which only includes postage costs. That is one reason why the Winterberry total advertising spending measure is higher than the Magna/Pivotal measure. A second reason is that Winterberry includes some media (e.g., tele-marketing) that are not included in the Magna/Pivotal total. However, despite these differences, the overall trends in total advertising and direct mail advertising are similar across the two sources. For example, Magna/Pivotal reports that total advertising spending declined 2.2 percent from 2008 to 2015, while Winterberry puts the decline at 1.6 percent. Both sources show their measure of direct mail revenues declining 13.1 percent over this same period. Standard Mail postage revenues declined 11.2 percent during this period (on a GFY basis). The larger decline in direct mail revenues reported by Magna/Pivotal and Winterberry likely reflects the large declines in First-Class advertising mail.

3. Household Diary Study Data

The third file of this technical appendix presents Household Diary Study data on Standard Mail and First-Class Advertising Mail. The data are presented in the first worksheet and the charts used in the main text of this white paper are presented in the second worksheet.

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Appendix B: Management's Comments

Christopher J. Karpenko
EXECUTIVE DIRECTOR /A
BRAND MARKETING

UNITED STATES
POSTAL SERVICE

March 22, 2016

Renee Sheehy,
Director, RARC Central, Risk Analysis Research Center
U. S. Postal Service Office of the Inspector General

SUBJECT: Final Review Draft- Advertising Mail: Past Present and Prospects
(Project Number 2016RARC001)

Thank you for the opportunity to respond to the final review draft of the white paper, *"Advertising Mail: Past Present and Prospects."*

Like many organizations, the United States Postal Service faces challenges as we strive to adapt in a rapidly changing marketplace. Economic factors as well as technological disruption are now the norm and require increased agility and responsiveness. We continue to respond by evolving advertising mail through improving the customer experience in new product offerings, promotional discounts, and demonstrating its relevancy. Examples include enhancements to products such as EDDM, Irresistible Campaign, USPS promotional calendar, and the most recent announcements at 2016 NPF with the intent to file the offering the 3rd ounce for free and our national rollout of Informed Delivery service.

The report acknowledges many of the factors are outside of the Postal Service's control. We continue to simplify our mailing requirements in order to improve the customer experience with regards to mailing standard mail. We've overhauled our outdated Rapid Information Bulletin Board System (RIBBS) for our industry clients into an updated, easier, digestible, and searchable system called PostalPro. The USPS is embracing the ability to access more data and providing this visibility to their mailing clients. We believe this visibility to mail owners will drive deeper insights and add value to their overall campaigns.

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WASHINGTON DC 20260-5000
WWW.USPS.COM

Christopher J. Karpenko
EXECUTIVE DIRECTOR /A
BRAND MARKETING

This report and management's response does not contain information that should be exempt from disclosure under the Freedom of Information Act.

Christopher J. Karpenko
Acting Executive Director
Brand Marketing

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Director, RARC Central, Risk Analysis Research Center
Sally Haring
Manager of Corporate Audit and Response Management
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