OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Advertising Mail: Future Prospects in Five Scenarios

RARC Report

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OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Executive Summary

Advertising mail volume has stagnated since the Great Recession. What does this development mean for the future? The U.S. Postal Service Office of Inspector General (OIG) worked with RCF Economics and Financial Consultants to generate projections of Standard Mail volume in 2025 under five different scenarios.

These scenarios make different assumptions about the size of the U.S. advertising market, the market share of fast growing Internet advertising, and how advertising mail is positioned within these environments. The scenarios are intended to provide guidance as to what might happen under a variety of situations.

The five scenarios are as follows:

- Growth and Complementarity
- Return to Pre-Great Recession Trends
- Recent Trends Continue
- Internet Boom
- Constant Traditional Share

Each is described briefly below.

Growth and Complementarity assumes that advertising mail leverages its complementarity with Internet advertising and grows relative to other forms of traditional advertising. This scenario effectively repeats the technology synergy that benefited advertising mail in the 1980s. In this scenario, advertising mail grows to 119 billion pieces by 2025, exceeding the 2007 peak volume.

Return to Pre-Great Recession Trends assumes that the advertising market will grow in step with the economy and that Standard Mail will maintain its 2015 market share. The result is a 23 percent increase in volume, from 80 to 99 billion pieces, by 2025.

Recent Trends Continue assumes that the advertising market will grow more slowly than the overall economy. Standard Mail

Highlights

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

RCF developed five 10-year projections of Standard Mail volume — the flagship product for advertising mail — using 2015 as a starting point.

The projections ranged from a high of 119 billion pieces to a low of 53 billion pieces. This wide range of plausible outcomes provides a sense of the business risk and opportunity facing the U.S. Postal Service with its advertising mail products.

is further assumed to lose market share to the Internet at the same rate as recent years. The result is a stalemate: the gain from economic growth is all but perfectly offset by slow diversion to the Internet. Thus, Standard Mail volume in 2025 is virtually unchanged over 2015 and will remain at 80 billion pieces.

Internet Boom assumes the same slow growth of the advertising market as in the second scenario. Unlike that scenario, however, the Internet Boom scenario assumes that the rate of diversion of advertising mail to the Internet increases, resulting in a decline in 2025 projected volume of 64 billion pieces. This is roughly equivalent to volume levels in 1993–1994.

Constant Traditional Share assumes that the advertising market continues to grow slowly as in the second and third scenarios, but the Internet accounts for the growth. Within the shrinking traditional (non-Internet) advertising portion of the market, Standard Mail maintains its market share. In the Constant Traditional Share scenario, the Standard Mail share of total advertising declines to 5.7 percent, about one-half its historic level. Standard Mail volume declines to 53 billion pieces in 2025, approximately the 1984 volume level.

The table below summarizes and compares the scenarios.

Scenario	Total Advertising Spending	Mail Share Relative to 2015 Level	Standard Mail Volume in 2025
Growth and Complementarity	Grows faster than GDP	Higher share	119 billion
Return to Pre-Great Recession Trends	Grows at the same rate as GDP	Same share	99 billion
Recent Trends Continue	Grows slower than GDP	Lower share	80 billion
Internet Boom	Grows slower than GDP	Much lower share	64 billion
Constant Traditional Share	Grows slower than GDP	Much lower share	53 billion

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

These projections provide a range of outcomes that can be viewed as a measure of business opportunity and risk for advertising mail. The Postal Service may be facing an enormous opportunity if it can effectively position advertising mail as a *complement* to Internet advertising. This can be done in a number of ways. One possibility is to use mobile technology to incorporate advertising mail pieces into the online shopping experience. Another strategy is to promote multichannel marketing that uses direct mail to boost the effectiveness of Internet and traditional advertising. These innovations must be built on a solid foundation of excellent delivery service and customer satisfaction. On the other hand, if Internet advertising increasingly develops into a *substitute* for advertising mail, it is reasonable to assume that Standard Mail volume will be less in 2025 than it was at its peak in 2007.

The Internet's mass adoption and continuing technological advancements have changed the nature of businesses and business transactions in ways that could not have been anticipated 10 years ago. Likewise, the future of the Internet is full of uncertainty; applications and uses may develop over the next 10 years that cannot be predicted at this point. No one knows what the future will bring, although it seems highly likely that the Internet will continue to dramatically impact traditional advertising. How much of this growth will cannibalize direct mail and how much will complement it? There are a range of possibilities. The future of Standard Mail has not been predetermined; significantly, a lot depends on the Postal Service's offerings and ability to connect with advertisers in creative ways and to provide predictable, reliable service that attracts and retains customers.

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Observations

Three determinants of advertising mail market prospects are the growth in the advertising market, the growth of Internet advertising, and the rate of diversion of advertising mail to the Internet.

Introduction

In *Advertising Mail: Past and Present*, the U.S. Postal Service Office of Inspector General (OIG) worked with RCF Economics and Financial Consultants (RCF) to examine the history of advertising mail.[1] The prime motivation for this earlier paper was to understand why advertising mail volume growth has stagnated since the Great Recession, in disturbing contrast to previous economic recoveries. The stagnation of advertising mail growth is important for two reasons. Advertising mail makes a substantial contribution to funding the Postal Service's delivery network. Moreover, advertising mail supports activity throughout the broader economy.

Our previous paper identified several historical trends that affected the growth of advertising mail over the last 35 years. This follow-up paper presents five projections of future volume of Standard Mail, the Postal Service's primary advertising mail product. These volume scenarios reflect different assumptions about the continuation of different historical trends.

The purpose of these scenarios is not to provide a single, definitive volume forecast.[2] Rather, these scenarios provide a risk and opportunity assessment as to possible outcomes under a variety of circumstances. This scenario analysis also provides a sense of the potential gains from successful business strategies or, alternatively, the potential cost of failed strategies or inaction.

The Past Is Prologue

The vast majority of advertising mail is sent using the Standard Mail product.[3] Standard Mail volumes declined about 20 percent during the Great Recession, from a peak of 103.5 billion pieces in fiscal year (FY) 2007 to 81.8 billion pieces in FYs 2009 and 2010.[4] In essence, the Great Recession cost the Postal Service nearly a decade of advertising mail volume growth.[5] Volumes of Standard Mail have stagnated, fluctuating between 79 and 84 billion pieces per year since the Great Recession ended in 2009.[6] As our previous paper demonstrated, this stagnation is a departure from the historical pattern of volume growth during economic recoveries.

Advertising Mail's prospects are determined by three interacting factors: the size of the overall advertising market, the Internet share of the advertising market, and the extent to which the growth in Internet advertising displaces advertising mail.

The overall advertising market has been growing more slowly in recent years for a number of reasons. First, the rise of Internet (or digital) advertising has disrupted the marketplace. Internet advertising causes two kinds of digital deflation. Internet advertising is lower in cost per recipient, so $1 of Internet advertising replaces more than $1 of non-Internet advertising. The lower cost of Internet advertising puts downward pressure on the price of non-Internet advertising. Second, with the dawn of high-powered data analytics, advertising is now more efficient than it was in the past. Less money is wasted on advertising directed at uninterested recipients. Third, non-measured advertising, such as word-of-mouth amplified by the power of social media, costs little to nothing, and crowds out traditional, measured advertising. Finally, advertising spending follows trends in median household income, and median household income is lower today than before the recession.

1 U.S. Postal Service Office of Inspector General, *Advertising Mail: Past and Present*, OIG-RARC-WP-006, March 28, 2016, https://www.uspsoig.gov/document/advertising-mail-past-and-present.
2 It should be noted that these scenarios do not use the Postal Service's econometric forecasting model.
3 U.S. Postal Service, *Household Diary Study 2014*, http://www.prc.gov/docs/93/93171/2014%20USPS%20HDS%20Annual%20Report_Final_V3.pdf, p. 43.
4 U.S. Postal Service, "A Decade of Facts and Figures," https://about.usps.com/who-we-are/postal-facts/decade-of-facts-and-figures.htm.
5 Prior to the recession, Standard Mail volume peaked at 103.5 billion pieces in FY 2007. By FY 2009, Standard Mail volume had declined to 81.8 billion pieces. According to the Postal Service's Revenue, Pieces, and Weight (RPW) Reports, the last time Standard Mail volume had fallen below 82 billion pieces was 1997.
6 U.S. Postal Service, "A Decade of Facts and Figures" and U.S. Postal Service, *2015 RPW Report*, http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fy2015.pdf.

Internet advertising encompasses email, banner, social media, mobile, and other forms of digital advertising. From virtually nonexistent 20 years ago, Internet advertising now accounts for 30 percent of advertising spending. Within the advertising market, the Internet appears to have grown primarily at the expense of newspapers, which experienced a nearly identical decline in market share.

Advertising mail's market share has been remarkably stable for most of the last 2 decades. In recent years, there is some evidence that mail has begun losing market share to the Internet. RCF calculates that, from 2010 to 2015, for every 1 percentage point increase in Internet advertising share, advertising mail's market share declined 0.045 percent. This magnitude may sound trivial but, as the analysis below shows, this diversion whittles away at advertising mail volume over time.

Prospects for the Future

The OIG asked RCF to construct volume projections under a variety of scenarios to provide a sense of the level of business risk and opportunity associated with advertising mail.[7] Standard Mail is used for this purpose instead of total advertising mail, because total advertising mail includes First-Class Mail advertising, which is not officially reported by the Postal Service. In any case, Standard Mail accounts for the vast majority of advertising mail. The actual 2015 values of the activity in the advertising market used as a baseline are presented in Table 1.

Table 1: At a Glance: Advertising in 2015

Total Advertising Spending	$190 billion
Internet Market Share	30 percent
Standard Mail Market Share	9 percent
Standard Mail Volume	80 billion pieces

Source: OIG Research, Pivotal Data, Analysis of RCF Economics and Financial Consulting.

Using these baseline values, RCF made various assumptions about the three primary determinants of Standard Mail volume discussed above.

Scenario: Growth and Complementarity

With all the hype about the transformational nature of the Internet, one may be tempted to jump to the conclusion that the extraordinary growth of Internet advertising will come only at the expense of all other media. Rather than causing a grave threat, however, the Internet may pose a historic opportunity for direct mail. This is not merely speculation. There is evidence that advertising mail affects the brain in different ways than other media.[8] This may be one reason why multichannel advertising campaigns can be much more effective than single channel campaigns.[9] The use of mobile apps and innovative technologies can enhance the advertising mail experience in exciting new ways, such as creating a direct electronic link between the physical world of an advertising mail piece and the digital world of an ecommerce web site.[10]

There is an interesting historic precedent for this kind of synergism. In the late 1970s, computer technology was predicted to displace traditional communications, including the mail.[11] A presidential commission based its policy recommendations in part on the presumption that the volume of third-class mail (the predecessor of Standard Mail) would stagnate from 1976 to 1984, growing only slightly from 22 billion pieces to 25 billion pieces over 9 years. Rather than cause stagnation, computers facilitated the expanded use of direct mail, contributing to a doubling of volume to 52 billion pieces in 1985.[12] Computers and technology helped mailers to easily compile, manipulate, and merge mailing lists; improve targeting; measure recipient behavior; and optimize postage by taking advantage of presorting and carrier route rates.

7 The mechanics of RCF's scenario models are described in detail in the Appendix.
8 OIG, *Enhancing the Value of Mail: The Human Response*, Report No. RARC-WP-15-012, June 15, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-012.pdf.
9 OIG, *Advertising Mail Past and Present*.
10 OIG, *Mail Innovations*, Report No. RARC-WP-14-013, September 22, 2014, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-013_0.pdf.
11 Report of the Commission on Postal Service, April 1977, Volume 1.
12 U.S. Postal Service, *Domestic Volume History*, July 1, 2015, http://www.prc.gov/dockets/document/92668.

The Growth and Complementarity scenario is built on three assumptions that reflect these technological synergies and other optimistic developments. First, total advertising spending is assumed to grow more rapidly than Gross Domestic Product (GDP) over the next decade, reversing the recent trend. Second, this growth is fueled by continued growth in Internet advertising. Exploiting its complementarities with the Internet, Standard Mail increases its market share incrementally each year, rising from 9.3 percent to 10.3 percent over a decade. As a result, Standard Mail is projected to grow to 119 billion pieces by 2025, some 16 billion pieces above the previous peak in 2007.

Scenario: Return to Pre-Great Recession Trends

In this scenario, RCF assumes that the advertising market will grow at the same rate as the economy as measured by GDP. RCF uses Global Insight's projection of GDP volume growth for this purpose. Since GDP is projected to grow slightly more slowly than its long-term trend, advertising market growth is slightly slower as well. Within this market, RCF assumes that Standard Mail would maintain its 2015 market share of 9.3 percent and holds its ground relative to Internet advertising. These assumptions very closely resemble the state of advertising mail and the advertising market in the years leading up to the Great Recession. The result of these assumptions is modest volume growth from 80 billion pieces in 2015 to 99 billion pieces in 2025, a 10-year growth rate of 23 percent. Note that even in this somewhat optimistic scenario, Standard Mail volume would still be slightly below its pre-recession peak of 103 billion pieces.

Scenario: Recent Trends Continue

In this scenario, advertising spending continues to grow, but at a slower rate than GDP, as has been the case since 2010. Instead of holding its ground, Standard Mail incrementally loses business to the Internet, at the same rate as has occurred in recent years. As a result, Standard Mail's market share is projected to decline from 9.3 percent to 8.5 percent. In this scenario, the positive effect of the growth in the advertising market offsets the effect of Internet diversion. As a result, Standard Mail volume is essentially unchanged after 10 years.

Scenario: Internet Boom

This scenario assumes the same future for the overall advertising market as the Recent Trends Continue scenario. However, instead of maintaining its 2015 diversion rate to the Internet, Standard Mail's rate of Internet diversion increases. In this scenario, Standard Mail's market share of total advertising falls from 9.3 percent in 2015 to 6.9 percent in 2025. This decline in share results in a nearly 16 billion piece volume loss over 10 years. Under these circumstances, Standard volume would decline from 80 billion pieces in 2015 to 64 billion pieces in 2025. This volume level is comparable to 1993 – 1994.[13]

Scenario: Constant Traditional Share

An indirect result of the assumptions underlying the Internet Boom scenario is that Standard Mail's market share of traditional (non-Internet) advertising grows from 13.2 percent to 15.7 percent. (This occurs because while Standard Mail loses share to the Internet, other forms of traditional advertising lose more.) Now we suppose that Standard Mail maintains its share of the traditional advertising market instead. The result is that Standard Mail's share of the overall advertising market declines to 5.7 percent. Standard Mail volume declines from 80 billion pieces in 2015 to 53 billion pieces by 2025. This is the level of Standard Mail volume in the mid - 1980s.[14] Volume would be slightly more than one-half the historic peak volume of 103 billion pieces after 10 years.

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13 Ibid.
14 Ibid.

Summarizing and Interpreting the Scenarios

Table 2 summarizes the key factors and the resulting 2025 volume projections.

Table 2: Five Scenarios and Their Major Assumptions

Scenario	Total Advertising Spending	2025 Standard Mail Share Relative to 2015 Level	Standard Mail Volume in 2025
Growth and Complementarity	Grows faster than GDP	Higher share	119 billion
Return to Pre-Great Recession Trends	Grows at the same rate as GDP	Same share	99 billion
Recent Trends Continue	Grows slower than GDP	Lower share	80 billion
Internet Boom	Grows slower than GDP	Much lower share	64 billion
Constant Traditional Share	Grows slower than GDP	Much lower share	53 billion

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

These scenarios make clear that very plausible assumptions about advertising market dynamics can lead to a wide range of outcomes for advertising mail. Table 3, below, summarizes the outcomes arising from each of the five scenarios.

Care should be taken when interpreting these scenarios. We do not assign probabilities to these scenario projections. The scenarios are constructed as the product of mutually exclusive events. It could turn out that one set of market conditions could hold for a time before giving way to another.

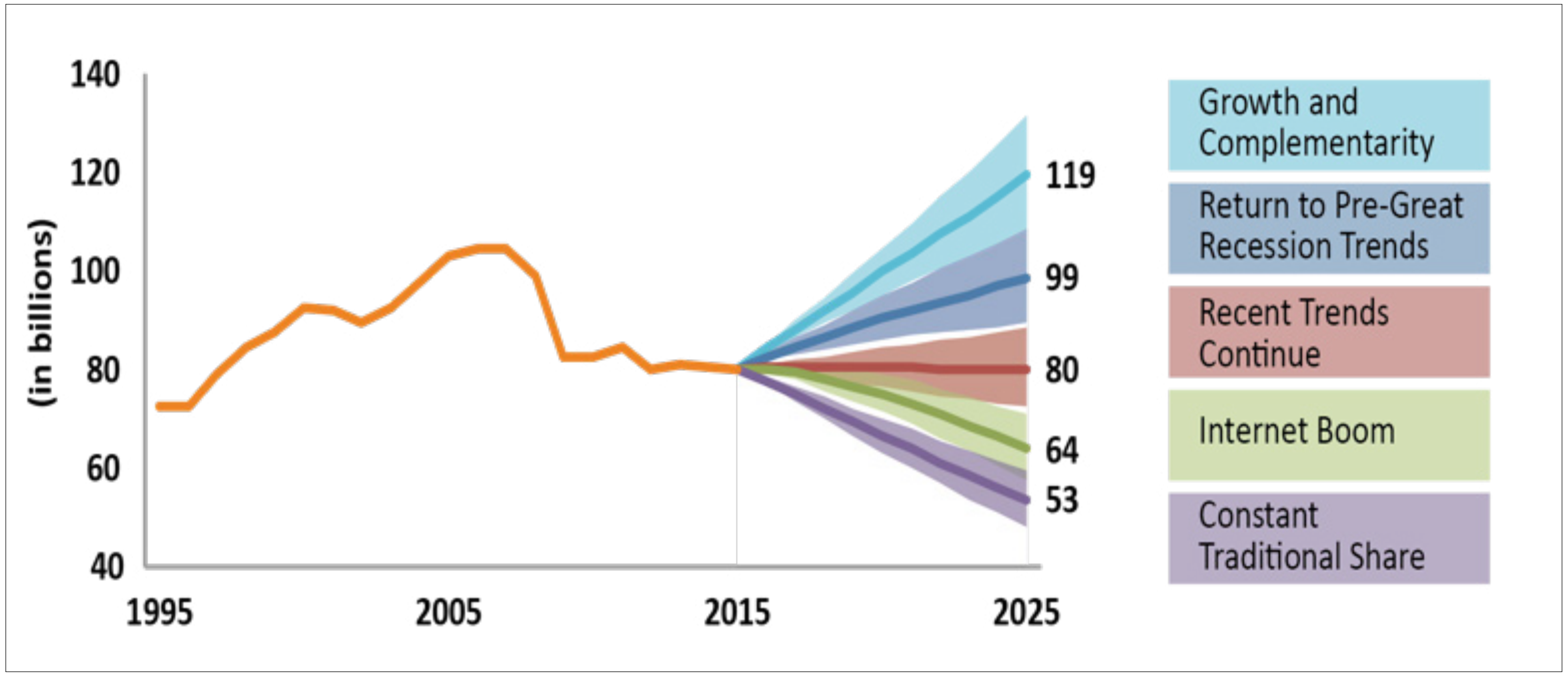
Table 3: Scenario Comparison

2025 Scenarios	Advertising Spending (in billions)	Internet Market Share	Mail Market Share	Standard Mail Volume (in billions)
Growth and Complementarity	$323	56.7%	10.3%	119
Return to Pre-Great Recession Trends	$296	46.8%	9.3%	99
Recent Trends Continue	$262	46.8%	8.5%	80
Internet Boom	$262	56.7%	6.8%	64
Constant Traditional Share	$262	56.7%	5.7%	53

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

The outcome of such a mix of market conditions would be a hybrid scenario, projecting volume somewhere between the extremes delineated by the Growth and Complementarity and the Constant Traditional Share scenarios. RCF deals with these sorts of possibilities by constructing bands around the scenario projections as depicted in Figure 1.

Figure 1: Five Standard Mail Volume Scenarios (in billions of pieces)



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

The scenarios all assume smooth economic growth for the next decade. An unexpected recession or economic boom could alter outcomes. As one can clearly see, the range in outcomes, and the associated level of business risk or opportunity, is considerable.

Implications for the Postal Service

The historical business fundamentals for advertising mail present challenges for the Postal Service going forward. Since advertising mail is a mature product, the extraordinary high growth years of the 1980s are not likely to return.[15] Thus, it is appropriate that even the most optimistic scenario in this report has Standard Mail volume growing at only 4 percent annually. More recent history suggests that advertising mail faces, at best, modest growth. Strong headwinds are quite possible.

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

It would be a mistake, however, to interpret this research and these scenarios as signs that advertising mail is gradually losing its usefulness. What does seem clear, however, is that continuing historic business strategies for direct mail advertising may not be enough to achieve success.

The scenarios are based on three important drivers of advertising mail: the future level of total advertising spending, the Internet share of that future total, and the extent to which increased internet advertising diverts spending away from or toward the direct mail channel. The first two factors are beyond the control of Postal Service management; the third factor — the value of direct mail advertising in an Internet-dominated future — is not.

15 Standard Mail grew at an average rate of 9.8 percent from 1980 to 1988. OIG, *Advertising Mail: Past and Present*.

…but it must maintain the quality of its advertising mail products and improve service performance.

One possible strategic solution would be to increasingly position mail as a complement to digital advertising. The Postal Service's recent incentive promotions, combining some digital marketing vehicles with hard copy advertising mail, are a step in the right direction. Further integration with digital advertising would allow the Postal Service to benefit from growth in the digital sector of the economy. This may mean promoting direct mail to digital marketers as an enhancement to their efforts, along with developing new ways to keep current direct mailers in the mailstream through developing complementary mail-digital products and additional promotions. By continuing to explore how advertising mail can complement digital advertising, the Postal Service may be able to take advantage of the rising tide of digital communication.

At the same time — and critically — the Postal Service must maintain the quality and breadth of its advertising mail products and improve its service performance. Predictability and consistency in delivery is a must when competing in a world of instant communication.

Ultimately, the future of direct mail may depend on the ability of the Postal Service and its partners in the private sector to maintain the value of direct mail in an increasingly challenging digital age. If successful, these efforts could turn a dangerous competitive threat into a powerful growth opportunity.

Appendices

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

Appendix A:
RCF Report: The Future of Direct Mail

The Future of Direct Mail:

Challenges and Opportunities for the U.S. Postal Service

Part 2: Outlook for the Future

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The Future of Direct Mail: Challenges and Opportunities for the U.S. Postal Service
Part 2: Outlook for the Future

I. Introduction

This report is Part 2 of a white paper on direct mail. Part 1 addressed the history of direct mail, primarily focusing on Standard Mail which composes the vast majority of advertising mail delivered by the Postal Service. Part 1 examined volume trends in Standard Mail and First-Class advertising mail, as well as the strengths and weaknesses of direct mail relative to other advertising media. Part 1 also analyzed trends in overall advertising spending, and changes in the share of total advertising spending by different media, with special attention given to the relationship between direct mail and internet advertising.

In Part 2, we build on the information from Part 1 to develop scenarios for the future volume of Standard Mail over the next decade. Key findings from Part 1 that are relevant to the scenario analysis in Part 2 are as follows:

- Standard Mail volume declined 20 percent from 2007 to 2009 due primarily to the Great Recession.

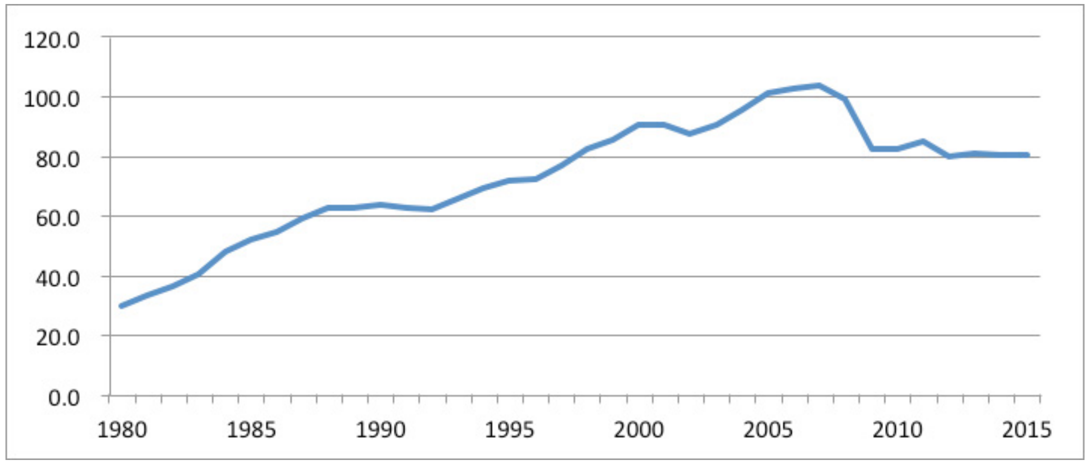
- Volume has not recovered since the Great Recession, despite the recovery of the U.S. economy over the past five years. The past five-year period is in contrast to prior periods of economic recovery when Standard Mail volume did recover. For example, from 1988 to 2007, a period which included two recessions, Standard Mail volume grew at about the same rate as the overall economy.

- Total advertising spending has also not fully recovered from its prior peak. Total advertising spending has been a declining share of GDP since 2000 due in part to weakness in household incomes and “digital deflation” – the growing use of low-cost internet advertising in place of traditional advertising as well as the downward pressure that internet advertising has put on the pricing of traditional advertising.

- Internet advertising, essentially unknown 20 years ago, accounted for 30 percent of total advertising spending in 2015. During this 20-year period, the direct mail share of total advertising has been roughly constant, indicating that most of the gain in internet advertising has come at the expense of other media, primarily newspaper advertising. However, over the past few years, the direct mail share has declined somewhat, suggesting that internet advertising may be beginning to divert some marketing spending from direct mail.

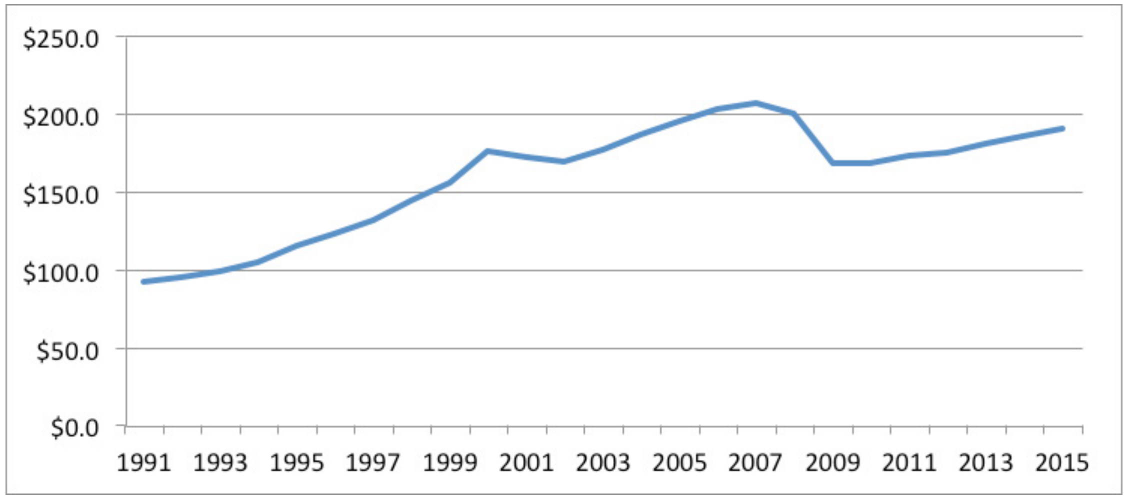
These key findings are shown in the following charts which were originally presented in Part 1 of the white paper. The charts have been renumbered for use in Part 2.

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



Source: USPS RPW Reports

Chart 2: Total U.S. Advertising Spending ($ billions)



Sources: Magna Global and Pivotal Research Group

Chart 3: 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

RCF Economic & Financial Consulting, Inc
The Future of Direct Mail: Challenges and Opportunities for the U.S. Postal Service

II. Overview of Standard Mail Scenarios

Five scenarios for the future of Standard Mail are developed. These scenarios differ with respect to their outlook for total advertising spending and their outlook for Standard Mail's postage share of total spending. The basic approach involves projecting the future level of total U.S. advertising spending and the Standard Mail share of that total. Together, these projections create a projection of Standard Mail revenues which are then converted to Standard Mail volumes based on projections of average postage revenue per piece. A key factor affecting the Standard Mail share of total advertising is the extent to which Standard Mail is replaced by internet advertising. Thus, there are three key variables that drive future volumes in each scenario: 1) total advertising spending; 2) internet advertising spending share of total advertising; 3) the level of diversion of Standard Mail to the internet.

Projections of each of these variables are discussed in turn.

A. Projections of Advertising Spending

Three projections of future advertising spending are developed. The first assumes that total advertising spending grows at the same rate as nominal GDP. The forecasts of GDP are obtained from the macroeconomic forecasting firm IHS Global Insight. Global Insight (GI) projects that from 2015 to 2025 nominal GDP will increase by an average of 4.5 percent per year.

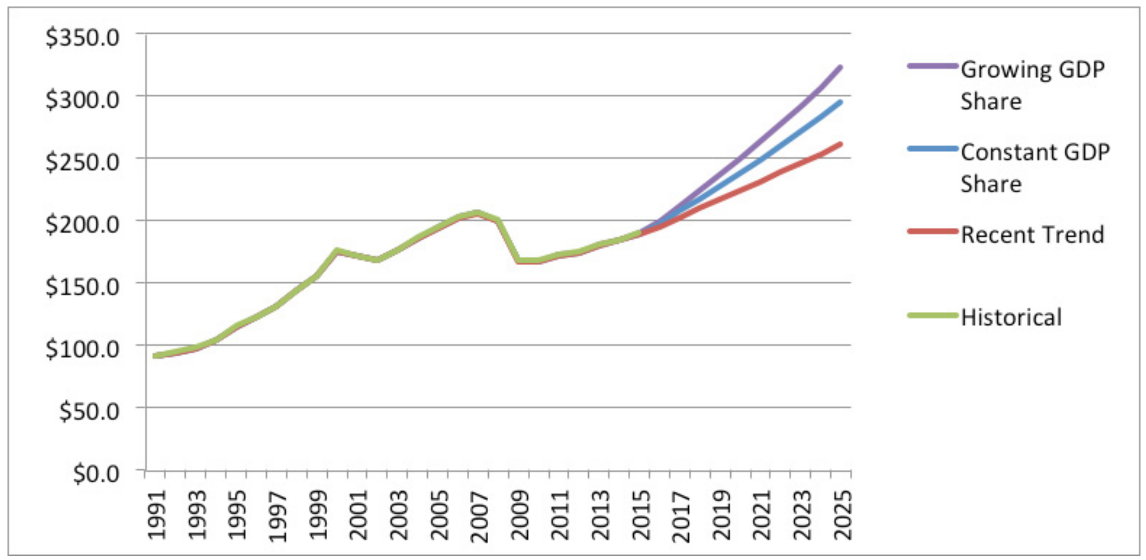
Over the past 15 years, total advertising spending has grown at a slower rate than nominal GDP. As a result, advertising spending has fallen from 1.73 percent of GDP in 2000 to 1.07 percent of GDP in 2015. However, there is evidence that the decline in the advertising share of GDP is abating. Therefore a plausible outlook is that advertising spending will maintain its current, albeit reduced, share of GDP in the future. Indeed, the advertising share of GDP in 2007 (before the Great Recession) was the same as it was 15 years earlier, indicating that a constant share projection is consistent with the pre-Great Recession relationship.

The second projection of advertising spending assumes that spending will continue to grow at a slower rate than overall GDP. From 2010 to 2015, advertising spending grew by an average of 2.5 percent per year while nominal GDP increased at a 3.8 percent rate. Therefore, the second projection of advertising spending assumes that this recent relationship will continue and advertising spending will grow at 1.3 percent less than the projected growth in GDP. If so, the advertising share of GDP will fall to 0.95 percent in 2025.

The third projection of total advertising is that advertising spending will rebound, eventually reaching its 2009 share of the economy. This projection views the large drop in the advertising share of GDP that occurred during the Great Recession to be a permanent decline. However, the modest decline since the end of the recession in 2009 is viewed as a temporary event from which the advertising market will recover. Crucial to this assumption is that strong growth in internet advertising will more than offset declines in some traditional advertising media, thereby increasing total advertising spending's share of the economy. Note that even with this increase, the advertising share of GDP will remain far below its 2000 peak.

Thus, the first projection (Constant GDP Share) is that total advertising spending will reach $296 billion in 2025. The second projection (Recent Trend) is for $262 billion, and the third projection (Advertising Rebound) is for $324 billion. These projections along with historical data are presented in Chart 4.

Chart 4: Scenario Forecasts of Total Advertising Spending



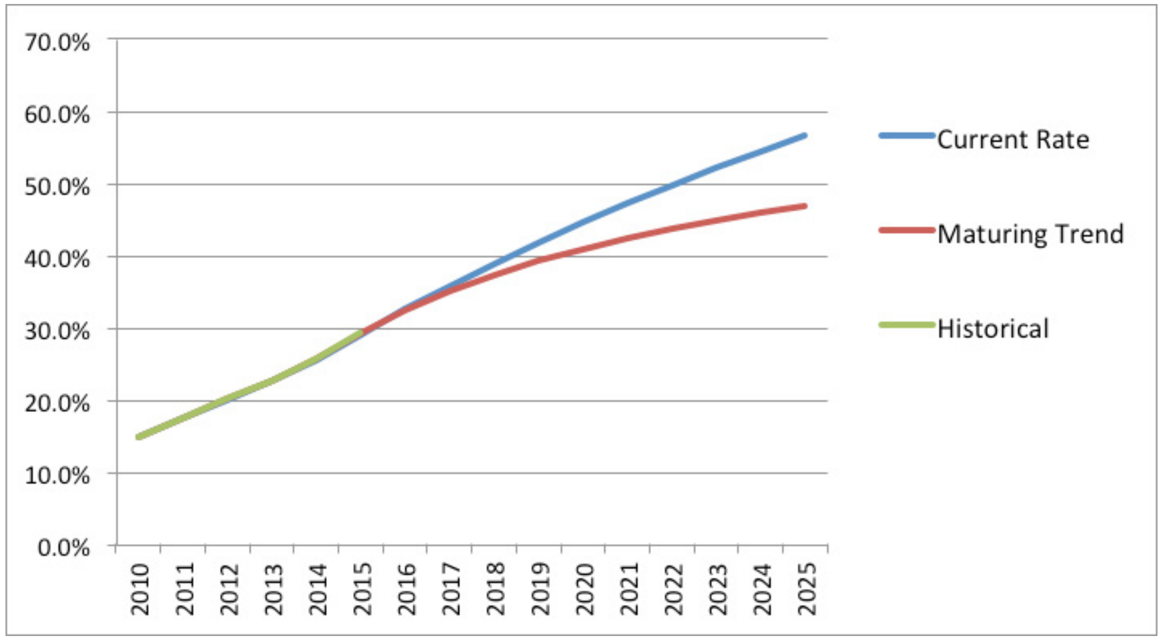
Sources: Historical GDP data from the U.S. Department of Commerce;
Historical Advertising Spending data from Magna Global and Pivotal Research Group;
Projections of GDP from IHS Global Insight; author's projections of total advertising spending.

B. Projections of Internet Advertising

As noted in the introduction, internet advertising represented about 30 percent of total advertising spending in 2015. Internet advertising encompasses all related forms, including but not limited to, online banner advertisements, search advertising, e-mail advertising, social, mobile, and digital video. It seems certain that the internet advertising share will continue to increase but the rate of increase is less clear. To account for uncertainty about the future growth of internet advertising, two projections are developed and shown in Chart 5. The first projects that the internet advertising share of total advertising continues to grow at its recent (2010 – 2015) rate, climbing from about 29 percent of total advertising spending in 2015 to 57 percent in 2025. The second projects internet advertising market growth to slow as the market matures, reaching 47 percent of total advertising spending in 2025.

These forecasts are in-line with forecasts from other analysts. For example, Pivotal Research Group projects that digital (their term for internet) advertising will be close to 45 percent of total advertising spending in 2020. Still, there is considerable uncertainty about the internet's share of future advertising, if for no other reason than that the next decade may bring new applications and advertising media that cannot be predicted at this point. Nonetheless, it seems likely that internet advertising, or more broadly, non-traditional advertising, will acquire a growing share of the overall advertising market.

Chart 5: Internet Advertising Share of Total Advertising Spending



Sources: Magna Global and Pivotal Research Group; author's projections

C. Projections of Diversion of Standard Mail to the Internet

A final key factor affecting Standard Mail in the future will be the impact of increased internet advertising. In Part 1 of this white paper, we discussed how the internet can be both a complement to and substitute for direct mail. Complementarity occurs when marketers combine an internet advertising campaign with a direct mail campaign. E-commerce can also support the volume of mailed catalogs which are often used in conjunction with online shopping. Thus, one possibility is that these complementary aspects will mean that increases in internet advertising will lead to an increase in the direct mail share of total advertising.

However, a greater risk for the Postal Service is that further growth in internet advertising will come at the expense of direct mail. To some extent, this may occur simply because the more money marketers spend online, the less that is available for other forms of advertising, including direct mail. It may also be the case that while direct mail has not so far been particularly subject to diversion to the internet, that relationship could change in the future.

Diversion is measured by the decline in the Standard Mail postage share of total advertising that occurs for every one percent increase in the internet advertising share. The historical rate of diversion is calculated using data from 2010 to 2015. During this period, the Standard Mail share of total advertising declined from 9.96 percent to 9.31 percent while the internet advertising share increased from 14.79 percent to 29.27 percent. Thus, the historical rate of diversion is equal to (9.31 – 9.96)/(29.27 – 14.79) = -0.045. This means that for each 1 percent increase in the internet advertising share, the Standard Mail advertising share declined by 0.045 percent.

The first scenario for Standard Mail assumes that direct mail becomes a complement to internet advertising and the Standard Mail share of total advertising increases. The second scenario assumes no future diversion based on the view that the complementarity between direct mail and internet advertising is sufficient to offset any substitution impacts. The third scenario projects that diversion continues at the recent historical rate. The fourth scenario projects that the rate of diversion grows over time eventually reaching three times its historical rate in 2025. A fifth scenario does not explicitly rely on a diversion measure but diversion is implicit in the projected volumes of Standard Mail, as will be discussed later.

III. Scenarios for the Future of Standard Mail

In this section we present five scenarios for the future of Standard Mail volumes and revenues. Projections of Standard Mail under each scenario are made for the ten-year period from 2015 to 2025. These scenarios provide a structured framework for understanding the key factors likely to drive direct mail in the future, and provide a basis for assessing the Postal Service's business risks associated with Standard Mail in the coming decade.

The basic approach involves two projections: 1) the future level of total U.S. advertising spending and 2) the Standard Mail share of that total. Combining the projections of (1) and (2) we create projections of Standard Mail revenues which are then converted to Standard Mail volumes based on projections of average postage revenue per piece. In some scenarios, the Standard Mail share is determined by a projection of diversion to the internet, which in turn will rely on one of the two outlooks for internet advertising share shown previously in Chart 5. Total advertising spending is projected relative to growth in GDP based on forecasts from the macroeconomic forecasting firm GI as shown previously in Chart 4.

Standard Mail postage revenues are converted into volumes by dividing revenue by projected revenue per piece. The assumption here is that revenue per piece will increase with the Consumer Price Index (CPI) as forecasted by GI. This is consistent with the price-cap under which the Postal Service operates. These future volumes do not account for the April 2016 rescission of the exigent rate increase. Reducing rates would be expected to result in an increase in volume above the totals shown here.

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However, as the focus of this part of the white paper is on long-term trends in the direct mail market, the impact of a one-time rate reduction is a relatively minor matter.[1]

The projections of the key factors included in each of the five scenarios, A through E, are summarized in Chart 6.

Chart 6: Summary of Projections of Key Factors

Scenario	Total Advertising Spending	Internet Advertising Share	Standard Mail Diversion Ratio
A: Growth and Complementarity	Increases as a Share of GDP	Continues Recent Growth Rate	Standard Mail Gains Share due to Complementarity with Internet Advertising
B: Return to Pre-Great Recession Trends	Grows at Same Rate as GDP	Internet Matures	Zero
C: Recent Trends Continue	Continues Recent Declining Trend Relative to GDP	Internet Matures	Recent Rate
D: Internet Boom	Continues Recent Declining Trend Relative to GDP	Continues Recent Growth Rate	Rate of Diversion Eventually Triples
E: Constant Traditional Share	Continues Recent Declining Trend Relative to GDP	Continues Recent Growth Rate	Discussed later in the report

1 The exigent rescission reduced postage rates by about four percent. Given the relatively inelastic demand for Standard Mail the rate reduction might be expected to increase volume by about two percent. Compared to the range of outcomes presented in the scenario analysis, a one-time increase in volume of two percent does not change the overall conclusions of this report.

A. Growth and Complementarity

Scenario A is called Growth and Complementarity and assumes that internet advertising continues to grow at its recent pace but this growth primarily reflects additions to total advertising and not the replacement of traditional advertising. As a result, total advertising spending increases as a share of GDP over the next decade. A second key assumption of Scenario A is that direct mail develops a complementary relationship with internet advertising. As was discussed in Part 1 of this white paper, there are many ways in which direct mail can be used with internet advertising (e.g., cross-channel marketing). Moreover, growth in online shopping can bolster the use of mailed catalogs. A final consideration is that other forms of advertising (i.e., newspaper advertising) have been more easily replaced by the internet and have been experiencing long-term declines. Thus, direct mail may gain at the expense of other traditional advertising media.

The complementarity assumption does not imply that no direct mail marketing shifts to the internet but rather that the negative effects are more than offset by the positive complementary effects. Note that Chart 10 of our previous paper shows that the direct mail share of total advertising in 2015 is actually greater than it was in 1990 (before the emergence of internet advertising) indicating that the dramatic growth in the internet has not meaningfully altered direct mail's place in the overall market.[2] Meanwhile, several other advertising media have clearly seen a decline in their market share. This suggests that it is plausible that direct mail marketing and internet advertising can work together and both can grow relative to other media.

In Chart 7, the projected values of key variables in 2020 and 2025, along with their historical values in 2015, are shown. Scenario A projects that total Standard Mail volume will increase from 80.1 billion pieces in 2015 to 99.8 billion pieces in 2020 and to 119.3 billion pieces in 2025. Volume is projected to increase at an average annual rate of 4.1 percent, driven by stronger growth in total advertising spending and a gradual increase in the Standard Mail share of total advertising.

Chart 7: Scenario A - Growth and Complementarity (data in billions unless otherwise stated)

Year	Total Advertising Spending	Standard Mail Share	Standard Mail Revenues	Standard Mail Volume
2015	$190.3	9.3%	$17.7	80.1
2020	$250.3	9.8%	$24.6	99.8
2025	$323.5	10.3%	$33.3	119.3

B. Return to Pre-Great Recession Trends

In Scenario B, we project a return to the relationships between total advertising spending and the economy and between Standard Mail and overall advertising spending that existed prior to the Great Recession, encompassing the nearly 20-year period from 1988 through 2007. During this time, total advertising spending, though it fluctuated from year-to-year, remained a relatively constant share

2 OIG, *Advertising Mail: Past and Present*, p. 32.

of GDP. If this relationship continues over the next decade, total advertising spending is projected to rise to $295.8 billion in 2025. Note that this is a lower level of advertising spending than projected in Scenario A, which assumed that strong growth in internet advertising would push total advertising spending to a higher level.

Scenario B also projects that Standard Mail postage revenue as a share of total advertising spending will remain constant at its 2015 level, in contrast to the complementarity assumption made in Scenario A, which produces a rising Standard Mail share. In other words, Scenario B projects that there will be no diversion of Standard Mail to the internet, or to the extent that there is some shift between these two media, it is offset by a positive shift into Standard Mail from some other media.

The assumption of no future net diversion of Standard Mail to the internet is driven by the view that while internet advertising is almost certain to grow, other media besides direct mail may be more subject to losing market share. Newspaper advertising is clearly being affected by the growth in internet advertising and this is likely to continue. Digital media advertising is on the rise which would seem to be a more natural replacement for television advertising than direct mail. Smartphone use, combined with music streaming services (and related advertising), compete with radio advertising more than with direct mail. Finally, some amount of new internet advertising will likely serve as substitutes for earlier forms; for example, mobile advertising may be displacing advertising previously received on desktop computers.

Moreover, while it is true that the direct mail share of total advertising has declined somewhat in the past few years, it is not obvious that this decline is due to diversion to the internet. Instead, the declining share may be due to conditions organic to the direct mail market such as the economy's slow recovery from the Great Recession. Indeed, the underlying logic of Scenario B is that the Great Recession was primarily a cyclical event and that the economy, the advertising market, and Standard Mail will eventually recover and return to their long-term upward trends.

In Scenario B, Standard Mail volume is projected to increase from 80.1 billion pieces in 2015 to 98.5 billion pieces in 2025, an annual average growth of 2.1 percent similar to the 2.7 percent average growth rate from 1988 – 2007 (when the economy was stronger than it is projected to be over the next decade).

Chart 8: Scenario B - Return to Pre-Great Recession Trends (data in billions unless otherwise stated)

Year	Total Advertising Spending	Internet Share	Diversion Ratio	Standard Mail Share	Standard Mail Revenues	Standard Mail Volume
2015	$190.3	29.3%		9.3%	$17.7	80.1
2020	$239.1	40.9%	0	9.3%	$22.3	90.5
2025	$295.8	46.8%	0	9.3%	$27.5	98.5

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C. Recent Trends Continue

While Scenario B is based on the period before the Great Recession, Scenario C is based on the period after the recession – 2010 to 2015. This period was characterized by two features: 1) slower growth in total advertising spending than growth in GDP and 2) a modest decline in the Standard Mail share of total advertising. In Scenario B, the decline in the Standard Mail share is attributed to diversion to the internet over this period and it is assumed that the recent rate of diversion will continue into the future.

The historical diversion rate was calculated earlier and found to equal -0.045. This means, for example, that a 10 percent increase in the internet advertising share would result in a 0.45 percent decrease in the Standard Mail share. Scenario C uses the same projection of the future internet advertising share as was used in Scenario B. Assumptions and data projections for Scenario C are shown in Chart 9.

Chart 9: Scenario C - Recent Trends Continue (data in billions unless otherwise stated)

Year	Total Advertising Spending	Internet Share	Diversion Ratio	Standard Mail Share	Standard Mail Revenues	Standard Mail Volume
2015	$190.3	29.3%	-0.045	9.3%	$17.7	80.1
2020	$225.1	40.9%	-0.045	8.8%	$19.8	80.4
2025	$262.0	46.8%	-0.045	8.5%	$22.3	80.0

Not surprisingly, Scenario C produces flat volumes which mimic the recent historical trend. Standard revenues are projected to increase but the increase is matched by an approximately equal increase in average revenue per piece. Compared with Scenario B, Scenario C projects a lower level of future advertising spending ($262.0 billion vs. $295.8 billion in 2025) and a lower Standard Mail share of total advertising (8.5 percent vs. 9.3 percent) due to the projected diversion of Standard Mail to the internet.

D. Internet Boom

In Scenario D, internet advertising is projected to grow rapidly, as was projected in Scenario A, rising to more than 50 percent of the overall advertising market by 2025. However, unlike Scenario A, the increase in internet advertising is not expected to increase overall advertising spending. Instead, the increase comes at the expense of traditional advertising media including direct mail. Specifically, Scenario D assumes that the diversion of Standard Mail to the internet will increase, doubling by 2020 and tripling by 2025. The possibility that internet advertising will dominate the landscape is certainly plausible given the revolutionary changes that it has already brought to the advertising market. New advertising platforms will most likely be developed over the next decade which could boost internet advertising spending.

Similarly the assumption of increased diversion of Standard Mail to the internet is plausible. As noted earlier, much of the gain in internet advertising appears to have come at the expense of newspapers, but with newspaper advertising now a small part of the overall advertising market, it stands to reason that internet marketers will shift more dollars from other media, including direct mail. Assumptions and projected data for Scenario D are shown in Chart 10. Note that Scenario D uses the same projection of total advertising expenditures as was used in Scenario C.

Chart 10: Scenario D - Internet Boom (data in billions unless otherwise stated)

Year	Total Advertising Spending	Internet Share	Diversion Ratio	Standard Mail Share	Standard Mail Revenues	Standard Mail Volume
2015	$190.3	29.3%	-0.045	9.3%	$17.7	80.1
2020	$225.1	44.7%	-0.089	8.2%	$18.5	75.1
2025	$262.0	56.7%	-0.134	6.8%	$17.9	64.0

In Scenario D, internet advertising share is projected to nearly double over the next decade and command more than half of all advertising spending. Bear in mind that the internet share already doubled over the past *five* years. The combination of growing internet advertising and increased diversion would cause the Standard Mail share to fall to 6.8 percent in 2025. However, because of an increase in total advertising spending over the next decade, Standard Mail revenues remain roughly at their 2015 level. Volumes decline due to the projected rise in revenue per piece, falling about 20 percent over the next decade with most of that decline occurring from 2020 to 2025 as the diversion of Standard Mail increases.

E. Constant Traditional Share

In our fifth and final scenario, the advertising market is projected to bifurcate into a rapidly growing internet advertising market and a declining traditional advertising market. In this scenario, Standard Mail must compete with other traditional advertising media for a piece of a smaller and smaller non-internet advertising pie. The assumption is that direct mail is able to maintain its current share of the traditional advertising market throughout the 10-year projection period, which in 2015 equaled 13.2 percent. However because this segment of the advertising market is declining, Standard Mail's share of total advertising declines to 5.7 percent in 2025. Assumptions and projected data for Scenario E are shown in Chart 11. Scenario E uses the same projection of total advertising spending and internet advertising as were used in Scenario D.

A key difference between Scenarios E and D is that Scenario E does not explicitly include a variable measuring the diversion of Standard Mail to the internet. Instead, the premise of Scenario E is that Standard Mail competes only with other forms of traditional advertising within a substantially smaller traditional advertising market. Furthermore, we assume that Standard Mail is no better nor worse positioned than other traditional media (e.g., television, radio, print). Therefore, the Standard Mail share of the traditional market is projected to remain at its current level while Standard Mail's share of total advertising declines because it is part of that substantially smaller traditional market.

The Scenario E assumption that Standard Mail maintains its share of the traditional market differs from Scenario D in which Standard Mail actually gains traditional share, even as it loses overall market share. While Standard Mail is subject to diversion in Scenario D, the diversion of Standard Mail is less rapid than the diversion of other traditional advertising (e.g., newspapers).

Chart 11: Scenario E - Constant Traditional Share (data in billions unless otherwise stated)

Year	Total Advertising Spending	Traditional Advertising Spending	Standard Mail Share of Traditional	Standard Mail Share of Total	Standard Mail Revenues	Standard Mail Volume
2015	$190.3	$134.6	13.2%	9.3%	$17.7	80.1
2020	$225.1	$124.6	13.2%	7.3%	$16.4	66.6
2025	$262.0	$113.5	13.2%	5.7%	$14.9	53.4

In Scenario E, non-internet advertising falls about 16 percent from 2015 to 2025 and Standard Mail revenues decline from $17.7 billion to $14.9 billion over the same time period. 2025 volume is projected to be 53.4 billion pieces, resulting in an average annual decline of 4.0 percent per year. While this outlook is particularly dire, it is not implausible. Keep in mind that over the next ten years there may be technological advancements that could disrupt the advertising market in ways that cannot be foreseen at this time.

F. Scenario Comparison

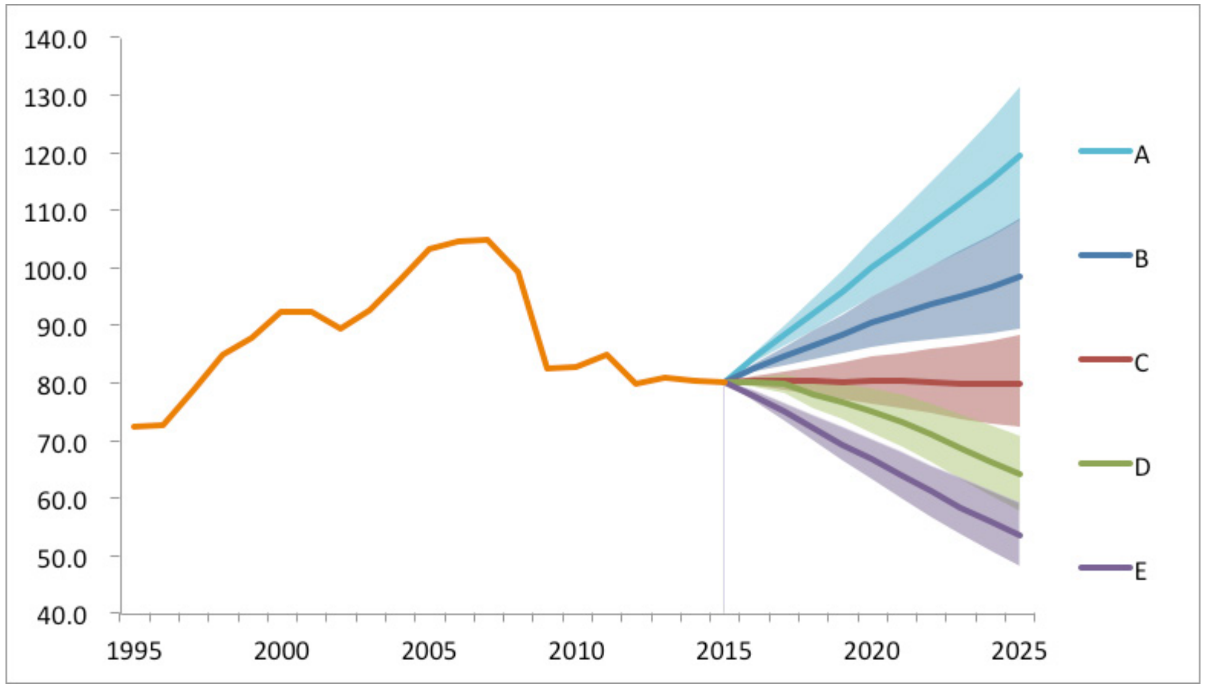
In Chart 12, year-by-year volumes of Standard Mail under each scenario are presented along with historical data back to 1995. To review, Scenario A projects that strong growth in internet advertising fuels a rebound in total advertising spending and a complementary relationship develops between internet advertising and Standard Mail. Scenario B is based on a return to pre-Great Recession trends, while Scenario C is based on the recent period since the Great Recession. Scenario D assumes that internet advertising booms and begins diverting more Standard Mail, and in Scenario E, internet advertising booms and Standard Mail competes with other traditional media for an ever-declining share of the total advertising market.

We do not assign probabilities to any of these scenarios, viewing them all as reasonable projections of the future. If one were to assume that each of the scenarios were equally likely, then the resulting average volume for Standard Mail would be 82.5 billion pieces in 2020 and 83.1 billion pieces in 2025, representing an annual average increase of 0.4 percent over the next ten years. However, this “average volume” is merely presented for illustrative purposes and should not be viewed as the most likely outcome.

Moreover, there is uncertainty regarding future volumes under any given scenario. For example, Scenario B projects that both the advertising market in general and Standard Mail in particular return to their historical relationships with the economy. However, even within this scenario, there is uncertainty about the future pace of economic growth. Thus, one might see volumes that are even higher than those projected by Scenario A and, for that matter, even lower than projected for Scenario E.

To fully appreciate the plausible range in future volumes, both within and across scenarios, Chart 12 presents the individual scenario volumes described above along with in-scenario ranges. For comparison, historical data starting in 1995 are also presented.

Chart 12: Standard Mail Volume History and Projections under Each Scenario (in billions of pieces)



Scenario A: Growth and Complementarity

Scenario B: Return to Pre-Great Recession Trends

Scenario C: Recent Trends Continue

Scenario D: Internet Boom

Scenario E: Constant Traditional Share

A final consideration is that the future path of Standard Mail may end up being a hybrid of more than one of the scenarios presented in this white paper. Volumes might continue along their current path for a few years (Scenario C), return to their historical pattern for a few years after that (Scenario B), and then begin declining as Internet advertising takes a greater and greater share of total advertising spending (Scenarios D or E) or begin increasing more rapidly as a complementary relationship between the internet and direct mail develops (Scenario A).

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IV. Conclusions

In Part 2 of the white paper on direct mail, five different scenarios for the future of Standard Mail have been developed. These scenarios provide a quantification of the potential risks and opportunities for the Postal Service over the next ten years. The range of plausible outcomes is substantial owing to both the ten-year timeframe for which the projections are made as well as the inherent uncertainty regarding the future of the advertising market.

We identify three key factors which will be the most important drivers of Standard Mail volume in the future: 1) the future level of total advertising spending; 2) the internet advertising share of that future total; 3) the extent to which increased internet advertising diverts marketing spending from direct mail. Of these three, we find that the rate of future diversion is the most important. Thus, while it seems certain that internet advertising will grow considerably over the next few years – a projection that is included in all our scenarios – it is not obvious how much if any of this growth will come at the expense of direct mail.

In our most optimistic scenario (Scenario A), Standard Mail grows about four percent per year. Direct mail develops a complementary relationship with the internet so that the projected strong growth in internet advertising leads to an increase in the Standard Mail share of total advertising and an increase in total advertising as a share of GDP.

In Scenario B, total advertising spending and Standard Mail volume return to their pre-Great Recession relationship with the economy, and volume grows about two percent per year over the next decade. In Scenario C, the trends that have developed since the Great Recession continue, and volume remains at about its current level. Scenario D projects a faster rate of diversion of Standard Mail to the internet and in this scenario volume is projected to decline by about two percent per year. Scenario E envisions a future in which new technologies fundamentally change the advertising industry and traditional advertising, including direct mail, fade away. In this scenario, Standard Mail volume declines by about four percent per year.

Importantly, these five scenarios are not mutually exclusive over the next ten years. Standard Mail volumes may proceed along their current path (Scenario C) for a few years and then rebound (Scenarios A or B) or falter (Scenarios D or E). Moreover, there are macroeconomic uncertainties embedded in these volume projections. A severe recession in the future would likely decrease volumes in all scenarios while a period of stronger than expected growth in household incomes would likely increase all scenario volumes.

Ultimately, the future volume of Standard Mail will depend on whether direct mail advertising can effectively compete with and even work as a complement to internet advertising. In some sense, this is no different from the past when direct mail faced competition from newspapers, radio, television, and other media. The internet represents another challenge to direct mail. The Postal Service's response to that challenge, its ability to maintain the value of direct mail to marketers, and marketers' ability to maintain the value of direct mail to their customers, will be the most important determinants of the future of direct mail.

Appendix B: Management's Comments

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EXECUTIVE DIRECTOR BRAND MARKETING

UNITED STATES POSTAL SERVICE

May 3, 2016

RENEE SHEEHY
A/DIRECTOR, RARC CENTRAL RISK ANALYSIS RESEARCH CENTER

SUBJECT: Advertising Mail: Future Prospects in Five Scenarios

Thank you for the opportunity to respond to the final review draft of the white paper, "Advertising Mail: Future Prospects in Five Scenarios."

We agree with the paper's general assessment that the extraordinary growth of Internet advertising has impacted advertising spends across all media.

An argument could be made that as technology develops, more companies appreciate the effectiveness of Omni channel marketing. The Postal Service feels strongly that mail will stay relevant as the consistent way to put advertising directly in the hands of a targeted audience. It is a channel that is 100% indexed into households and arrives through the noise of one's day on their own terms.

Understanding that just stabilizing isn't enough, the Postal Service is determined to be part of the overall market growth and complementary with other channels. As technologies change and evolve, so does the Postal Service. Our approach will be to embrace the perceived threats and amplify efforts that integrate with the disrupters.

Ultimately, the Postal Service's strategic goal is to take advantage of the rising tide of digital communication by implementing a world-class, integrated social media infrastructure that strengthens our brand, and enhances our ability to deliver excellent customer experiences and interactions at every touch point. This platform allows us to hear and respond to the voice of our customers, employees and the communities we serve to establish the USPS as a leader in the digital space.

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

Again, thank you for the opportunity to review and respond.

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