III. INTERNAL TRENDS AFFECTING DIRECT MAIL IN EUROPE

There is a group of charecteristics of the direct mail market that may be of critical importance in the evolution of the demand for this marketing technique. This group of features depend upon the perception and future behaviour of the different postal players acting in this market. This section describes the main expectations and trends in relation to various features other than those depending on external factors, which may imply changes in the future demand for direct mail.

III.1 Attitudes and expectations of Direct Mail Players

III.1.1 The Senders

This section examines the expectations of the senders in connection with a possible further liberalisation of direct mail, and their view of whether such liberalisation could stimulate or jeopardise the use of this marketing technique.

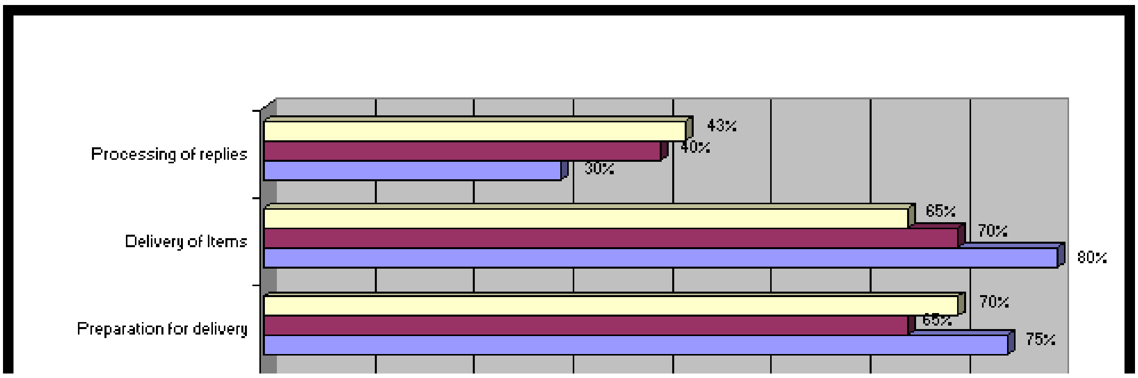
Main trends of senders of direct mail

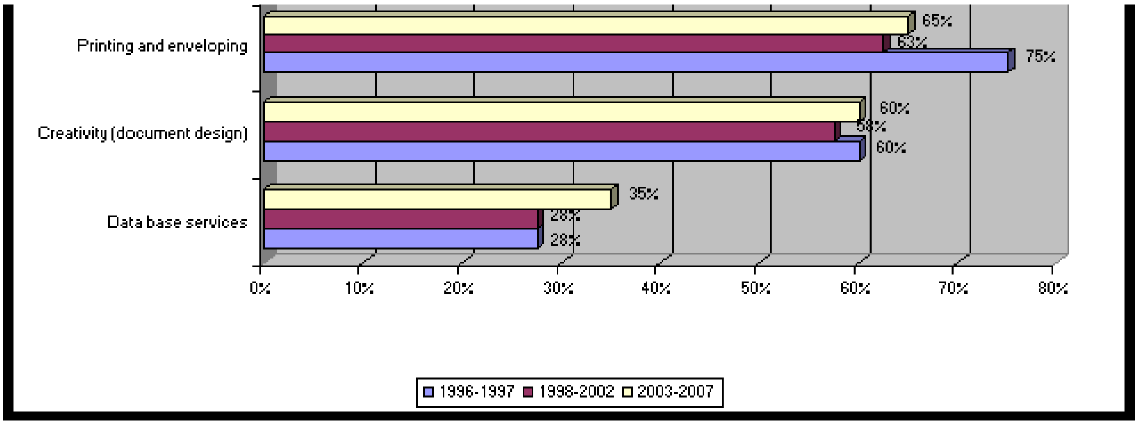
Outsourcing-

Delivery services form part of the whole direct mail value chain. Therefore, the more services the postal operators and direct marketing agencies could provide to the senders of direct mail, the more the direct mail market will grow.

In this respect, database services, processing of replies services and creativity are activities which are in most cases undertaken by senders with their own staff, whereas printing and enveloping and pre-sorting activities are mostly outsourced. Delivery services are in most cases outsourced to postal operators directly or through direct marketing agencies. The tendencies for the coming years, in most cases, show little change from the current situation. Our survey shows that the activity of processing of replies will be outsourced to a slightly greater extent, whereas the activities of printing, enveloping and pre-sorting will be performed by senders' own staff also to a slightly greater extent. However, should further liberalisation be implemented, some senders would possibly become new entrants in the market, then reducing significantly the delivery function that they currently perform through postal operators.

Table III.1.1.1: senders' view of possible outsourcing of certain direct mail activities





Source: Arthur Andersen survey, 1998

Senders of direct mail perceive that further and gradual liberalisation of the direct mail market will increase the number of operators acting in the delivery function.

There is a general perception that the main competitors that public postal operators would have to face would be basically the existing courier companies and other public postal operators from inside and outside the EU. Other senders point out that competition would also come from direct marketing agencies.

Table III.1.1.2: senders' view on the future competitors of public postal operators

Total number of responses	Courier companies	Direct marketing agencies	Other public operators	New companies	Other
42	32	21	27	5	5

Source: Arthur Andersen survey, 1998

In this respect and in general terms, some senders surveyed in Austria, France, Germany, Greece, Ireland and Italy consider that in the next 5 and 10 years more than 20% of the delivery services business (in terms of turnover and number of items delivered) could be transferred to the aforementioned companies to the detriment of the domestic public postal operator, whereas most senders in Portugal and Sweden do not foresee such significant changes.

General trends on advertising expenditure-

The main reasons for choosing this marketing technique, ranked in order of importance, are as follows (Arthur Andersen survey, 1998):

1. Increase sales to current customers

2. Attract new customers

3. Create customer loyalty

4. Support other marketing campaigns

5. Provide additional information

6. Create customer databases

7. Attract distributors

8. Other

Moreover, senders believe that the more interesting advertising techniques in terms of cost-effectiveness, depending on the objectives of each specific campaign, are the following (ranked in order of importance):

Table III.1.1.3: Senders' preferences on advertising techniques

	Increasing turnover	Generating new customers	Increasing brand awareness
Direct mail services	1	2	5
Telemarketing	2	11	9
Press	3	1	1
TV	4	4	2
Magazines	5	3	4
Radio	6	5	3
Internet	7	7	7
Newspapers supplements	8	6	6
Congress and fairs	9	8	8
Inserts	10	10	10
Non-addressed direct advertising	11	9	11
Other	12	12	12

Source: Arthur Andersen survey, 1998

Therefore, senders consider direct mail as a technique of essential importance so as to increase their turnover and customer portfolio. In fact, 25% of the senders surveyed attributed, on average, more than 20% of their turnover to direct mail campaigns.

Economic market trends-

As indicated above, senders of direct mail expect that one of the factor that would be most affected in a scenario of a further liberalisation would be price. Most senders surveyed consider that in such a scenario prices of delivery services could decrease by up to 10% in the period 1998-2002, and by up to 20% in the period 2003-2007. However, there are also senders, mainly located in Germany, the U.K., Greece and Spain, who would expect increases of prices rather than decreases.

Table III.1.1.4: Senders' view on prices under liberalisation

	Total number of responses	Increase more than 10%	Increase from 0% to 10%	Mainte-nance	Decrease from 0% to 10%	Decrease from 10% to 20%	Decrease more than 20%
Period 1998-02	34	2	9	2	15	3	3
Period 2003-07	34	4	5	5	9	9	2

Source: Arthur Andersen survey, 1998

Furthermore, in those cases where the senders consider that liberalisation would lead to a decrease in prices of the direct mail delivery services in the period 1998-2007, an important number of senders (14 responses) consider that such a decrease would be more likely to happen with a sharp drop in the first year and a steady decrease afterwards, whereas some other senders consider that there will be a steady decrease throughout the whole period. In addition to that, most senders surveyed consider that if further liberalisation takes place, their own negotiating power would increase significantly (28 responses).

Impact on volume of items delivered-

Senders surveyed consider that a situation of further liberalisation, which as said before would hypothetically lead to a reduction of prices and an increase in reliability of services, could result in significant increases in the volume of items delivered.

Table III.1.1.5: Senders' view on volumes under liberalisation

	Total number of responses	Increase more than 10%	Increase from 0% to 10%	Mainte-nance	Decrease from 0% to 10%	Decrease from 10% to 20%	Decrease more than 20%
Period 1998-02	27	6	8	11	1	1	0
Period 2003-07	28	11	7	8	1	0	1

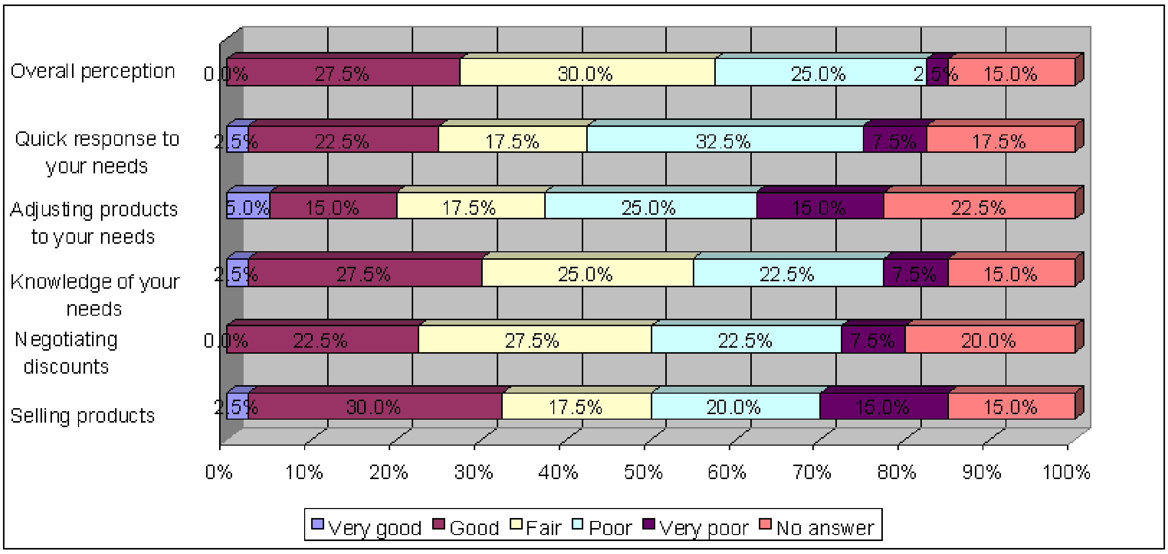
Source: Arthur Andersen survey, 1998

It should be pointed out that in the case of Germany the reduction of the reserved area for direct mail went down to 50 grams. Although some German users have maintained the same volume of items delivered, some other German senders have increased their volumes by up to 10%. Nevertheless, it should be noted that it is estimated that around 50% of direct mail items delivered in Germany weigh less than 50 gr., falling therefore within the reserved area.

Social factors-

There is a debate as to whether the staff of public postal operators have the necessary skills to give added value services to direct mail senders. The table below shows that there is not consensus on these issues. The number of senders not satisfied with the current skills of the staff of public postal operator seems to be important basically in Belgium, Greece, Spain, Ireland and the U.K.(but these last two only when negotiating discounts and adjusting the products to the customer needs).

Table III.1.1.6: senders' view on the skills of the public postal operator staff.

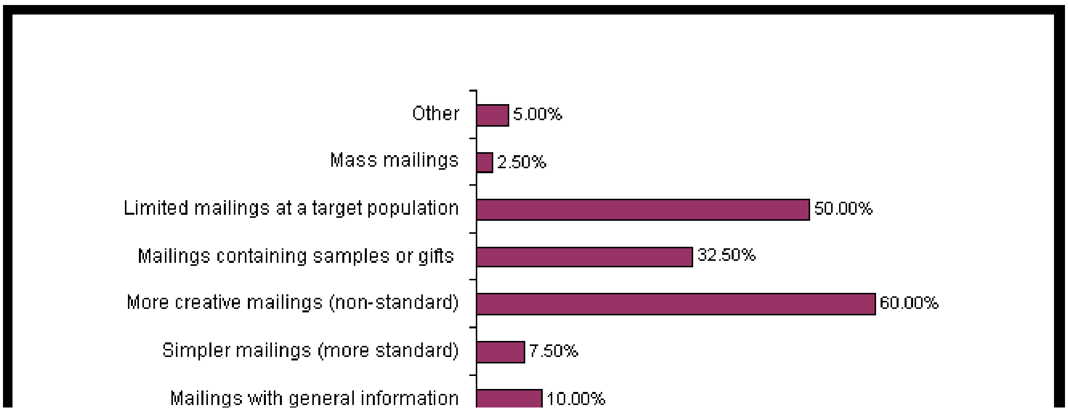


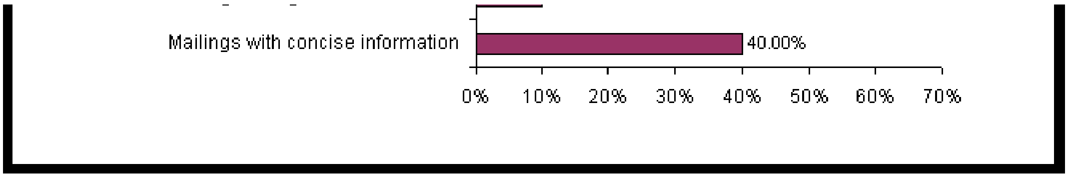
Source: Arthur Andersen survey, 1998

Market attitudes and expectations-

Senders in general consider that the current direct mail market trends will evolve significantly in the next 5-10 years. Such changes will be basically focused on demanding more creative mailings of non-standard sizes and weights, and in producing mailings more directed to specific segments of population.

Table III.1.1.7: senders' view on the type of direct mailing in the next 5-10 years (more than one choice allowed)





Source: Arthur Andersen survey, 1998

In this respect, most senders believe that public postal operators have done too little so far in meeting their expectations in terms of being flexible when asked to accept more creative mailings of non-standard size and weight. Indeed, there is a general perception that in a liberalised scenario public postal operators would react and become more flexible and "customer oriented".

General advertising market trends-

In general, companies consider that the main increases in advertising expenditures in the coming years will be focused on the following media, ranked by order of importance:

1. Internet
2. TV
3. Telemarketing
4. Direct mail delivery services
5. Direct mail (other services)
6. Radio & press
7. Magazines
8. Newspaper supplements
9. Inserts
10. Congress and fairs

As far as direct mail is concerned, there is a general perception that the expenditures will increase in the coming years in spite of the fact that if liberalisation occurs prices will go down, this effect being outweighted by the expected increases in volume.

Table III.1.1.8: senders' view on the evolution of direct mail expenses under liberalisation

	Total number of responses	Increase more than 6%	Increase from 4% to 6%	Increase from 2% to 4%	Increase from 0% to 2%	Remain stable	Decrease
Period 1998-02	33	3	10	11	5	4	0
Period 2003-07	34	8	13	6	3	4	0

Source: Arthur Andersen survey, 1998

However, when further liberalisation took place in Germany, 66% of the companies surveyed pointed out that no increases in expenditure took place, whereas the rest of the companies surveyed highlighted that there was an increase in expenditure of up to 2%. In the case of Sweden, the companies surveyed pointed out that there was an increase in expenditure of up to 6%.

General conclusions-

Positive impacts of liberalisation		Negative impacts of liberalisation
It will encourage competition (alternative delivery networks to public postal operators) Prices will go down Broader range of services Increase of quality of service and reliability It will stimulate the public postal operators to be more efficient It will stimulate economic growth It will stimulate employment growth It will encourage more flexibility Easier international mailings and encourage unification of mailings within the EU The negotiating power of senders will increase Increase in the use of databases Improvement of the direct mail image It will foster investment It will benefit from other technologies, such as internet		The existence of suppliers with insufficient experience will lead to offer semi-professional services New postal networks are expensive Complex tariff policies In certain circumstances prices would increase Mailing-houses could have agreements with public postal operators and advertising agencies could have contracts with different operators, this resulting in a too fragmented market Existence of delivery operators that only take specific types of mail Reaction against too many operators: confusion / too fragmented market

III.1.2 The Users/Recipients

Consumer's position as "senders"

The position of individuals with regard to the liberalisation of the direct mail market could be described by analysing their feelings and preferences regarding the quality-price relationship, including issues such as transit times, reliability, regularity, customer service and price.

A survey commissioned by the European Consumers' Association during the years 1992 and 1994 about consumer attitudes revealed the following results concerning the balance between quality of postal services and cost.

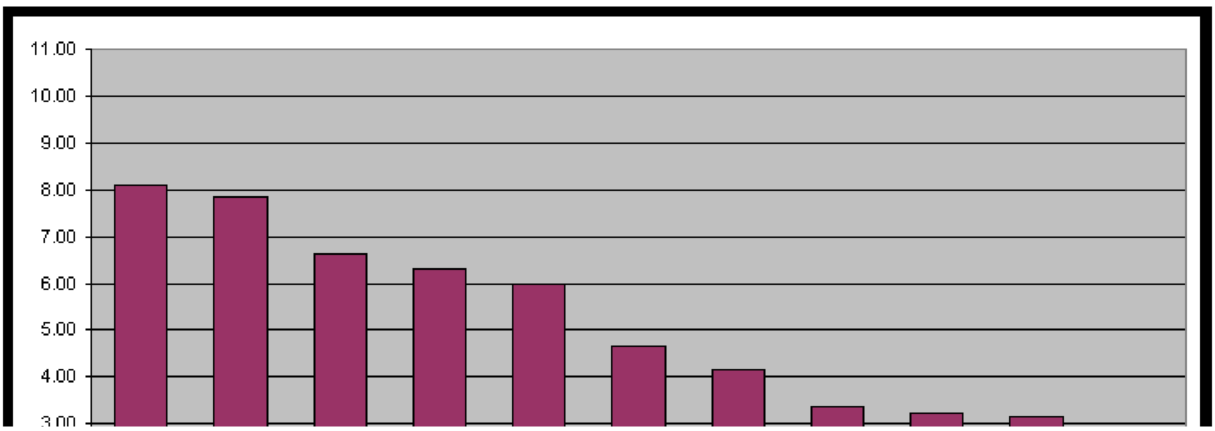
Would pay more postage for an increased number of deliveries	2%
Would pay less postage for a reduced number of deliveries	14%
Would keep postage and number of deliveries the same	82%

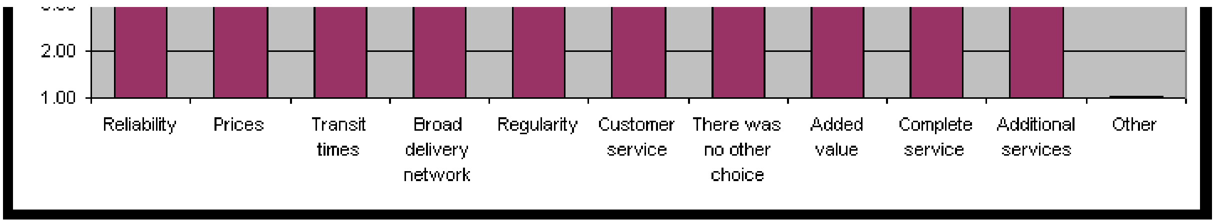
This survey first gives the idea that private consumers are not unhappy with the current situation regarding the price paid and the number of weekly deliveries, which although it is not the only quality indicator, is one of the most valued by consumers. This has been reaffirmed in some other surveys throughout the European Union. In 1994 a survey of consumers revealed Royal Mail as the second best utility in terms of value for money and quality of service, only behind British Gas, while only a mere 5% said the Post Office offered the worst value for money and quality of service, being the best rating of the eight organisations surveyed.

According to our survey companies share quite the same view as consumers, ranking reliability and price among the most valued indicators for the mail services.

These results are resumed in the chart below.

Table III.1.2.1





Consumer's position as "receivers"

Consumers are certainly affected by the postal tariffs applied to direct mail items because one way or another these tariffs are included in the price that the final consumer pays for the products obtained through direct mail advertising.

Some recent surveys already mentioned, such as the ones conducted in France and Germany (see IV.3.1) indicate a positive attitude of consumers about receiving direct mail. As we have already commented, 66% of the people surveyed in France indicated that they do like receiving direct mail items at home, and 54% stated that they buy products as a result. Likewise 74% of the final recipients surveyed in Germany indicated that they usually read the direct mail items.

It should also be considered that the EU direct mail market has clear potential for growth, if we compare it with other markets such as Canada or the U.S.

As was stated by Paul Overdijk in the Fourth biannual conference on postal and delivery economics:

> "*There is considerable scope for further development of direct marketing in the Netherlands. American households, for example, receive nearly twice as many direct mail pieces a year as Dutch households. And although we do not know whether the American level will be reached in the Netherlands, we can see that the growth of direct mail expenses has already surpassed the growth in general advertising expenses*"

On the other hand, our research shows that senders of direct mail are the only profile which considers that consumers could be weary of receiving too much, addressed non-targeted direct mail, whereas there is general consensus about the positive acceptance of targeted direct mail.

Table III.1.2.2: Do you consider consumers to be weary of receiving addressed non-targeted direct mail?

Answer	Public operators	Private operators	DM companies	Senders
Yes	41,67%	36,36%	50%	70%
No	50%	63,64%	50%	20%
No answer	8,33%	0%	0%	10%

Source: Arthur Andersen Survey, 1998.

In this connection, it should be noted that in the Netherlands an organisation developed a "Yes-No" and a "No-No" sticker which can be stuck on the mailboxes. "Yes-No" means "Yes" to free local unaddressed newspapers and magazines, "No" to unadressed mail. "No-No" means no to both. Although the sticker has no legal status, it is deemed that the wishes of the users are almost always fulfilled.

Finally, other issues concerning consumers, such as the implementation of Robinson List systems, the existence of self-regulatory codes to protect consumers' rights and the ways to handle claims, which clearly vary throughout the EU, have been thoroughly assessed in section II.3 of this report. In this connection, the self-regulatory codes of practice that FEDMA is working on, related to telephone marketing, on-line services and general data protection issues are seen as significant efforts towards the protection of customers' rights.

III.1.3 The Direct Marketing Companies and Associations

What is expected is that full liberalisation of direct mail would definitely lead to the provision of even better services, something deemed essential in order to ensure that this marketing technique will continue to one of those most preferred by advertisers in the future.

The possibility of having the direct mail market fully liberalised from 1 January 2003 has been considered as fairly reasonable by most direct marketing companies and associations surveyed, although a significant number would consider this pace as too slow or even too late.

Table III.1.3.1: Direct marketing national associations and companies' view of full liberalisation of direct mail on 1 January 2003

Total number of responses	too fast	reasonable	too slow	Should have been liberalised already	Should not be liberalised
20	0	11	4	6	0

Source: Arthur Andersen survey, 1998

The main factors that direct marketing associations and companies expect would be improved in a scenario of full liberalisation of direct mail would be first, more reliability of the services rendered; second, more flexibility of postal operators in order to accept highly customized (in formats, size of items, contents, etc…) direct mail campaigns; and third general improvements in the range of services provided, including "one stop-shop" services.

All these factors are of the utmost importance if it is considered that "in the 21st Century customers will have more access to suppliers but will require greater proof of personal benefit and added value, and will be less loyal and patient in the case of slow delivery" (FEDMA magazine, June 1998).

As regards prices, there is no consensus among direct marketing companies and associations about the likely impact of liberalisation. Although most responses to our survey indicated a reduction of prices as a result of liberalisation, various participants pointed out the opposite.

Table III.1.3.2: Direct marketing associations and companies' view on prices if liberalisation is put into practise on 1 January 2003

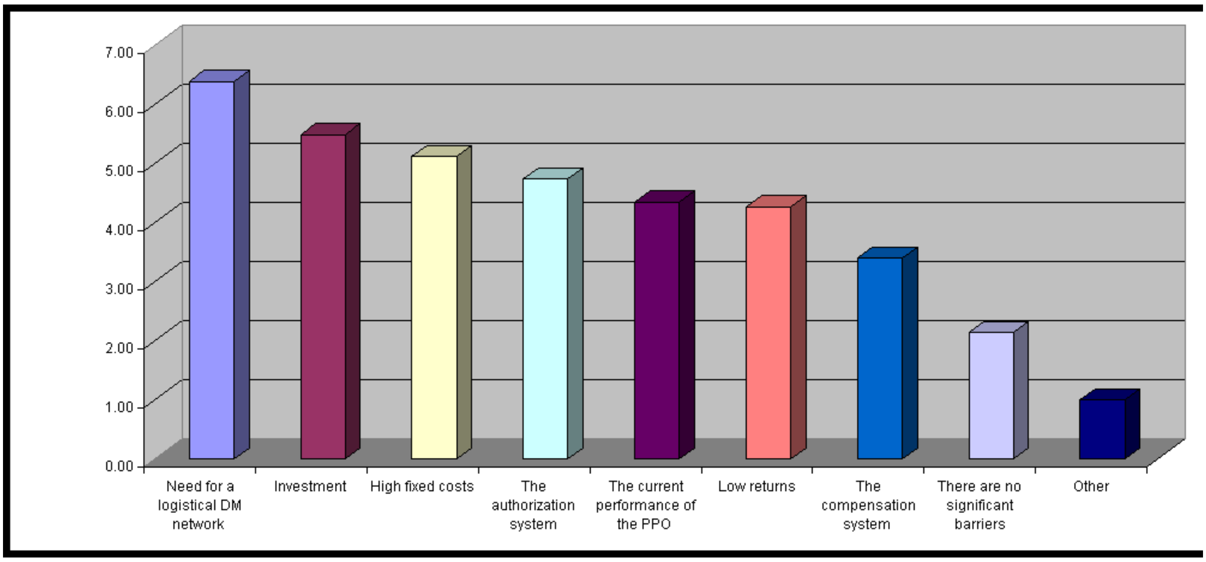
Total number of responses	Increase more than 10%	Increase from 0% to 10%	Mainte-nance	Decrease from 0% to 10%	Decrease from 10% to 20%	Decrease more than 20%
15	1	5	1	3	3	2

Source: Arthur Andersen survey, 1998

These different opinions as regards the evolution of prices could be explained by the specific reactions that public postal operators may have in a liberalised scenario, for either some could offer new value added direct mail services, then having room for price increases, or else some other operators could try to retain market share by lowering prices on their traditional direct mail delivery services.

In this connection, direct marketing companies do not point out low returns as a significant barrier hindering the entrance of new postal operators in a liberalised scenario, but place more emphasis on the logistical network, investments and fixed costs required.

Table III.1.3.3: Main entry barriers to entry of new operators in the direct mail market



Source: Arthur Andersen survey, 1998

Positive impacts		Negative impacts
It will encourage competition (alternative delivery networks to public postal operators) Increase of quality of service and reliability Broader range of services It will stimulate public operators to be more efficienct and flexible Improvement of the direct mail sector image Lower advertising costs In the short term may slow the increase in advertising in other alternative media (TV) A way towards the creation of a truly single market: Greater economies of scale		Reaction against too many operators: confusion / too fragmented market Small mailers may have to pay higher prices should PPO react by increasing its margins in the universal service area The broad delivery networks of public operators and the huge investments needed to build-up alternative ones will delay some of the benefits of liberalisation for a long period of time

Conclusions

As stated above, direct marketing companies and associations clearly favour the full liberalisation of the EU direct mail market. The impacts that such liberalisation may have are summarised in the table above.

III.1.4 The Public Postal Operators

This section examines the expectations of the public postal operators in connection with the liberalisation of direct mail, and their view of whether such liberalisation could jeopardise the provision of the universal service with the principles of affordability, quality of service and accessibility adopted in the Directive. It should be noted that the debate on the liberalisation of direct mail goes along with the debate about lowering the price and weight thresholds established in Article 7.1 of the Directive.

General position of the public postal operators

The different positions of the public postal operators as regards the liberalisation of direct mail should be assessed taking into account the following matters:

1. The likely impact of liberalisation on their economic viability.

2. The technical difficulties that could arise as a result of liberalising a segment of the broader bulk mail business, preventing abuses of the exclusive rights granted to the universal service providers,

3. The impact of liberalisation in the quality standards and public acceptability of direct mail industry as a whole, and

4. The fact that the direct mail market has grown significantly over the past years in most EU countries, regardless of their respective level of liberalisation of direct mail, something attributed to the efforts of most public operators to meet the expectations of senders of direct mail.

It is well known that the position of public operators as regards the advisability of fully liberalising the direct mail market varies greatly, something pointed out again by our own survey. When asked about the reasonableness of fully liberalising the market from 1 January 2003, the answers were clearly divided.

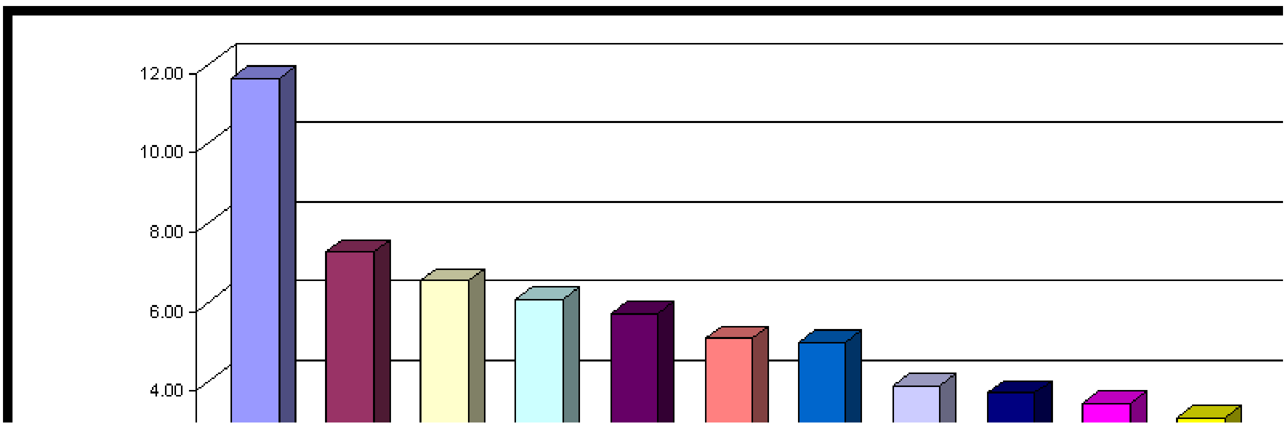
Table III.1.4.1: public operators' view of full liberalisation of direct mail from 1 January 2003

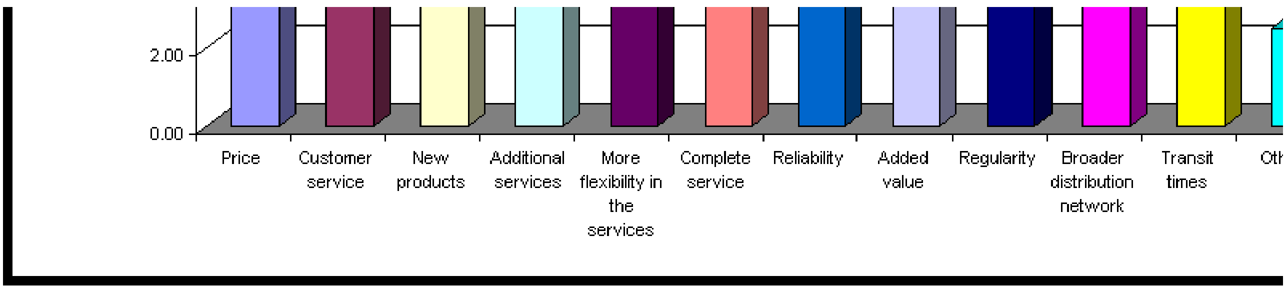
Total number of responses	Would be too fast	Would be Reasonable	Would be too slow	Should have been liberalised already	Should not be liberalised	No Answer
15	4	4	0	3	2	2

Source: Arthur Andersen Survey, 1998

Public operators consider that the main factors that would be affected in a scenario of liberalisation of direct mail, would be firstly reductions in price levels, and secondly various matters related to better meeting customer'expectations, such as the development of new products and the provision of additional services, as shown in the Table below.

Table III.1.4.2: Likely impacts on direct mail services as a result of full liberalisation





Source: Arthur Andersen Survey, 1998.

The impact of liberalisation on public postal operators

Different possibilities could be envisaged as regards the impact of liberalisation on public postal operators, which are summarised in Table III.1.4.3 below.

Table III.1.4.3: Summary of impacts to public operators

Negative impacts	Positive impacts
Liberalisation will imply price reduction of direct mail, thus forcing to increase the prices of the reserved services	Liberalisation will give the universal services operators greater commercial freedom and the use of a more efficient pricing structure
Liberalisation will lead to cost reduction exercises, then lowering quality of service	Liberalisation will lead to operating efficiency improvements, thus improving quality
Liberalisation will allow "cream skimming" of more profitable routes, then reducing the overall profitability of the universal service providers, threatening their long-term viability and their ability to provide a universal service at a uniform and affordable price	Liberalisation could raise the overall profitability of the universal service providers, thanks to development of new services (i.e. entering into the unaddressed segment of the market) and strategic alliances
Liberalisation will erode the reserved area (control difficulties to prevent the fraudulent distribution of bulk reserved mail, due to the difficulties of enforcing a content-based definition)	Effective postal regulator policies will prevent significant fraudulent erosion
Liberalisation will have negative effects in PPO's employment	More competition may expand direct mail market and raise employment, some of this outside the public sector

When wighing these pros and cons, other factors should also be taken into account, such as:

1. the freedom of the public postal operators to behave in a commercial manner (e.g. to offer incentives to their commercial force or negotiate prices with customers) also varies significantly.

2. public operators not only face competition from potential private operators but also from other forms of direct marketing via telephone, fax or electronic mail.

3. many public postal operators, such as in the U.K., Germany or the Netherlands do not differentiate direct mail items from other bulk mail items.

4. estimating the volume of direct mail items, as defined by the Directive, by public postal operators could be rather difficult, since many of them do not have in place a content-based definition for direct mail items.

The positions of public postal operators as regards these matters could hardly be more different, as can be seen in the examples provided below.

1. The operator in the Netherlands maintains that direct mail "should be liberalised unconditionally and at the earliest" (PTT post comments to the Draft Notice). Direct mail is fully liberalised in the Netherlands. It is considered that including direct mail in the reserved area does not make sense economically, since direct mail is also part of the advertising market.

2. For a long time the operator in Spain has been facing an environment of full liberalisation of direct mail, although the public operator would probably have preferred a more restrictive situation. Nevertheless, the Postal Act of 1998 has clearly confirmed the full liberalisation of direct mail in Spain, and has introduced more clarity in defining the rights and obligations of each operator, improving also the mechanisms of control, inspection and sanction.

3. The operator in Germany also faces a more liberalised scenario than other EU Member States. The provisions of the German Postal Act of 1998 have actually reduced the reserved area for direct mail to items wighing less than 50 grams, while the general weight threshold for the reserved area in the Directive is 350 grams. Deutsche Post maintains that liberalization of direct mail is particularly important for the European common market and for free trade, as direct mail is an important marketing tool for mail order companies throughout the Union. In fact, they maintain that direct mail is almost exclusively sent by corporate clients, who do not require any sector-specific protection in their relation to the universal service provider. They also consider that since direct mail is price-sensitive, not even a legal monopoly can create significant monopolistic gains (that some claim existent and necessary for the universal service). On the contrary, a legal monopoly for direct mail may result in substandard quality and inefficient production processes. Direct mail is a growing market which has the potential to attract investors and create employment. Such positive effects depend on a liberalised regulatory framework, due to the fact that regulated economies do not usually appeal to private investors. Deutsche Post stands ready for an entirely liberalised direct mail market, and they firmly believe such a liberalisation to be in the best interest of all stakeholders as the benefits of better quality at lower relative prices as a consequence of liberalisation will be significant.

4. Direct mail is seen by the Portuguese public operator as one of the market segments that show better prospects for future growth. It is highlighted that it plays an important part in the occupation of the universal postal service and, consequently, in the stability of the public operator prices and costs per unit due to

the economies of scale. Full liberalisation of direct mail would cause, in the medium-term, loss of the most profitable traffic flows and would jeopardise the possibility of maintaining the universal service at an affordable and uniform price. Therefore, any loss of profitability connected with the reduction of the economics

of scale (due to new entrants in the most attractive segments) should be compensated for by appropriately defining in the licensing process the contribution of those new entrants to the compensation fund.

5. The position of the U.K. public operator hinges on the difficulties that the content-based definition adopted in the Directive may imply in terms of adequate monitoring and control of a more liberalised market. Royal mail considers that the definition contained within the Postal Directive is open to a wide degree of interpretation. Without certainty of definition effective regulation becomes extremely difficult. A consequence of this, compounded by the normal requirements of the inviolability of mail, is the significant risk of fraudulent distribution of bulk reserved mail due to the difficulties of enforcing a contents-based definition. These, compounded by the risk of cream-skimming and the adverse impact on the financial viability of the Universal Service Provider (which in the case of the U.K. is recognised explicitly within the report) will begin to call into question the ability of the Universal Service Provider to provide the Universal Service Obligation and maintain the Uniform tariff structure. Furthermore, in the event of liberalisation of Direct Mail, the Universal Service Provider would need to have freedom to price commercially, implicit within which a retreat from the structure of uniform tariffs as currently applied would have to be recognised by all parties. In this scenario the way in which the Universal Service Provider and the direct marketing industry are regulated would be a more important factor in the development of the industry than liberalisation per se. In the light of the problems associated with liberalisation of Direct Mail, it is the view of the U.K. Post Office that the calendar and procedure established in the Directive is not the most efficient way of liberalising postal markets and that progressive reduction of the Price and Weight threshold is a better way of moving forward. There is a major Post Office review in progress (expected to be completed in autumn 1998), which will assess, among other issues, the impact of further liberalisation of direct mail. Finally, a further disadvantange of potential customer confusion over service and billing options with alternative providers is pointed out, with the need to prevent bad practices which could harm the direct mail industry as a whole.

The French postal operator maintains that the German, Spanish and Dutch examples of liberalised markets, should be seen in a true perspective. They consider that the liberalisation of the German market (5% private operator share) is too recent for any conclusions to be drawn, whereas liberalisation in the Dutch market has been timid (significantly, Médianet does not engage in direct mail but rather press distribution). On the other hand it is hard to argue that the de facto liberalisation of the Spanish market (15-20% of the market held by private operators) has not placed the Spanish postal service in difficulty considering that the Spanish postal service has been making a loss for several years.

6. The Irish operator shares the concerns pointed out in the U.K. Direct mail is the

fastest growing mail in Ireland in terms of volume and sales. It is considered that further or even full liberalisation of direct mail would, as a consequence, have a

profound negative effect in the public postal operator revenues. If volumes of urban mail (of which direct mail is a higher proportion than the national average) decrease there will be problems with maintaining a common tariff. Finally, it is also considered that liberalisation could provoke inconsistency in level of service: each operator will provide services at different and varying levels and this will cause annoyance to customers.

7. The operator in Denmark expects that liberalisation of direct mail would have negligible advantanges and disadvantages for the national economy as a whole. On the other hand, for the postal market liberalisation would be an advantage/driver for product development. On the other hand, liberalisation would be a disadvantage for maintaining an effective reserved services area to finance universal service obligations. Also the total market value for direct mail would decrease.

8. The operator in Belgium points out that liberalisation of direct mail will favour the development of more services and the development of local business, also stimulating public operators to be more productive. However, small markets such as in Belgium could be the victims of alliances and mergers, which would lead to a situation in which large postal companies would impose their rules, then creating a significant gap with local business, and leaving no profitable services to the public operator.

9. The operator in Austria mentioned the advantages of liberalisation in terms of market growth and innovative products, with higher quality as a result of competition. However, it would also imply the need for more regulation and administration, and would endanger the financial equilibrium of the public operator.

In this connection, it should be noticed that the position of regulators as regards the likely impact of liberalisation of direct mail on the provision of the universal services has a high degree of consensus: all nine regulators answering that question in our survey stated that they do not consider that the liberalisation of direct mail would endanger the provision of the universal services.

Case studies: Postal deregulation in Germany and Spain

The postal deregulation process undertaken in Germany since 1990 could provide with some lessons when assessing the pros and cons of liberalisation of direct mail. Until 1990, Deutsche Bundespost was the largest employer in Germany, providing both postal and telecommunication services. The telecommunications market, and to a lesser extent, the postal market, were considered to be key factors for national competitiveness in Germany. Thus, from 1989 the German Government pursued a policy of liberalisation without jeopardising the viability of the incumbent postal operator:

1. Postal Reform I (1989): splitting of Deutsche Bundespost into three units (telecommunications, postal services and postal savings bank), with the Ministry of

Post and Telecommunications as postal regulator.

2. Postal Reform II (1995): converting Deutsche Bundespost Postdienst into a limited company (Deutsche Post AG).

3. Postal Act (1998): gradual market liberalisation, including direct mail items wighing more than 50 grams and letters wighing more than 200 grams.

4. Future plans: Further postal market liberalisation by year 2003. The German Finance Minister recently announced that Deutsche Post AG will be floated on the stock exchange by the year 2000 (Post-Express, July 15, 1998) as part of the current German Government privatisation scheme.

While the deregulation process was taking place, Deutsche Post underwent significant restructuring, with a complete revamping of its logistics systems and substantial reduction of its workforce, both supported by high levels of capital investment, estimated at an average of 2 billion DEM annually in the period 1990-1996. The revamping of logistics systems included parcels (completed in 1995), letter mail (to be completed at the end of 1998) and outlet network.

Therefore, the postal deregulation undertaken in 1995 was not a drastic process. Furthermore, Deutsche Post prepared itself for postal deregulation, through a progressive series of measure started in 1990 to reach the date of deregulation in the best possible situation, which involved the above mentioned restructuring measures.

Table III.1.4.4: Postal deregulation in Germany

	1990	**1996**	**Variation**
Workforce (people)	379,000	285,000	(94,000)
Revenues (bn DEM)	18.6	26.7	+44%
Profits / (Losses) DM million	(624)	576	

Source: IIR mail and express services markets conference, London, February 1998

The 1998 Postal Act, which reduces the public operator´s reserved area, is estimated to represent, at least initially, an annual drop in revenues of DEM 2.7 billion (PostEurope, March 1998).

Nevertheless, after the restructuring process, profitability has been achieved and Deutsche Post is adopting three approaches to bring about further growth: the provision of new value added services, extending the express business, and internationalisation of its activities. The recent acquisition of a 22.5% stake of DHL in 1998 is part of this strategy. Indeed, at the end of June 1998, the European Commission approved this transaction.

Since its tranformation in 1991 into an autonomous body, the Spanish public operator, Correos y Telegrafos, has also undertaken significant changes, improving its average delivery times and achieving higher operating productivity. Since 1991 the total mail volume of Correos has grown steadily, from 4,000 million postal items to 4,400 million items in 1997, while total workforce has almost remained stable (65,600 people in 1992 and 64,900 people in 1996). Turnover also rose from ECU 783 million to ECU 1,028 million between 1992 and 1997, operative losses were significantly reduced (from ECU 274 million in 1992 to ECU 136 million in 1997), and Government subsidies have also been reduced significantly.

Table III.1.4.5: Spanish public operator operating results

	Year (Million of ECU)						
	1992	1993	1994	1995	1996	1997	1998 (*)
Turnover	783	791	849	894	929	1,028	1,165
Expenses (not including depreciation)	1,057	1,053	1,040	1,090	1,149	1,164	1,219
Operating results (losses)	(274)	(262)	(191)	(196)	(220)	(136)	(54)

(*) Estimate

Source: Correos y Telégrafos annual reports 1993-1997 and Strategic Plan, 1998-2000.

During 1997 Correos has made significant efforts to reduce its operating losses while increasing its investment in its logistic network, which reached ECU 67 million.

In 1998 Correos y Telégrafos has been transformed into an autonomous state-owned company, which will provide the organisation with more commercial freedom and operational independence. Correos has also finished its Strategic Plan for the period 1998-2000 in 1998, which puts emphasis on actions oriented to meet customer´s demands while achieving higher efficiency. Finally, Correos is currently working in a five-year contract with the Spanish Govermment, the main goals of which are to significantly increase total mail volumes (which are expected to rise steadily from 4,410 postal items in 1998 to 4,700 in the year 2000), investment of ECU 333 million in postal infrastructure, and achieving financial equilibrium by the year 2000, while maintaining its workforce of 65,000 people.

III.1.5 The Private Operators and Potential Entrants

One of the effects of introducing liberalisation in a segment of the mail market such as direct mail would be encouragement for the development of new alternative delivery networks. The economic viability of such alternative delivery networks would depend upon, basically:

1. Their revenues, linked directly to volumes carried and tariff structure.

2. Their costs, inversely related to volume, pre-sorting systems, and density of delivery points.

3. Their capability of delivering not only direct mail items but also other items outside the reserved area (such as courier services, non-addressed items, newspapers or magazines).

Needless to say, all EU postal operators have nationwide delivery networks (that is, universal service coverage), in-depth knowledge of operating in the postal market, and a very wellknown name (although not in all cases a good reputation). This starting point could be considered a significant barrier when private operators assess whether to establish alternative delivery networks. In fact, the existence of a nationwide network seems to be a major problem for new entrants, if it is considered that:

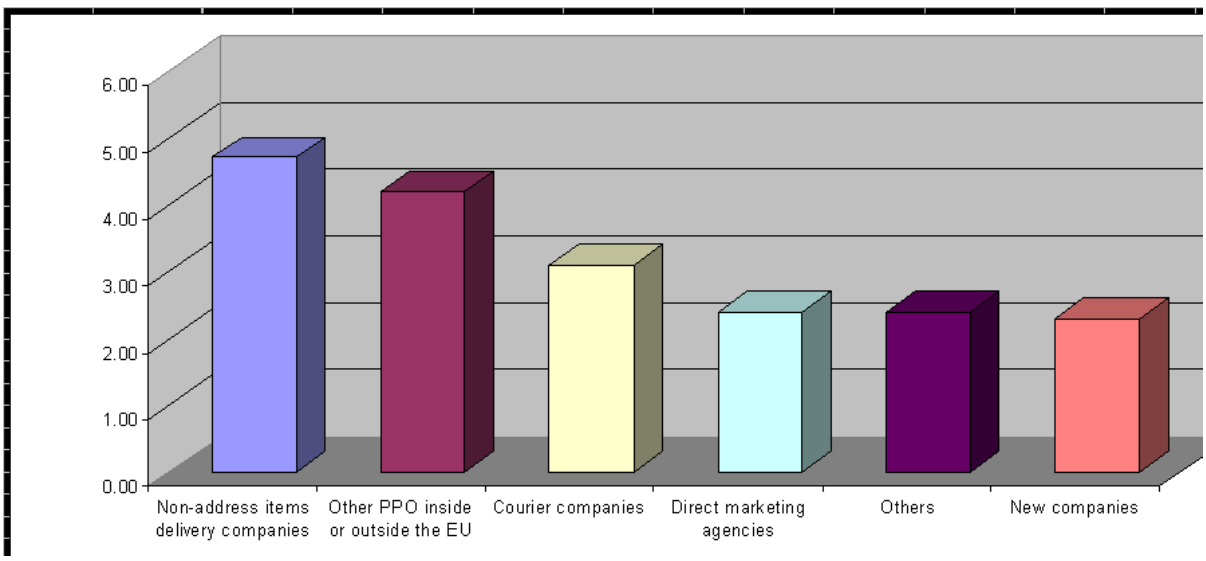
- In many countries direct marketing campaigns are in most cases nationwide. New entrants may be interested in giving nationwide coverage, but not necessarily meaning universal service. Therefore, part of their business may be subcontracted to the public postal operator.

- The cost of maintaining a nationwide direct mail dedicated delivery network would be too high, whereas the public postal operator has the option of using the ordinary mail delivery network for direct mail deliveries thus achieving operating efficiencies.

- The know-how of the public postal operators in providing nationwide services has allowed most of them to build up a logical and efficient logistic chain.

Most public operators expect that their likely competitors in their direct mail national markets as a result of liberalisation would be mainly existing non-address items delivery companies, as well as other public operators from inside or outside the EU, rather than completely new entrants.

Table III.1.5.1: Likely competitors in a scenario of liberalisation of direct mail expected by public postal operators



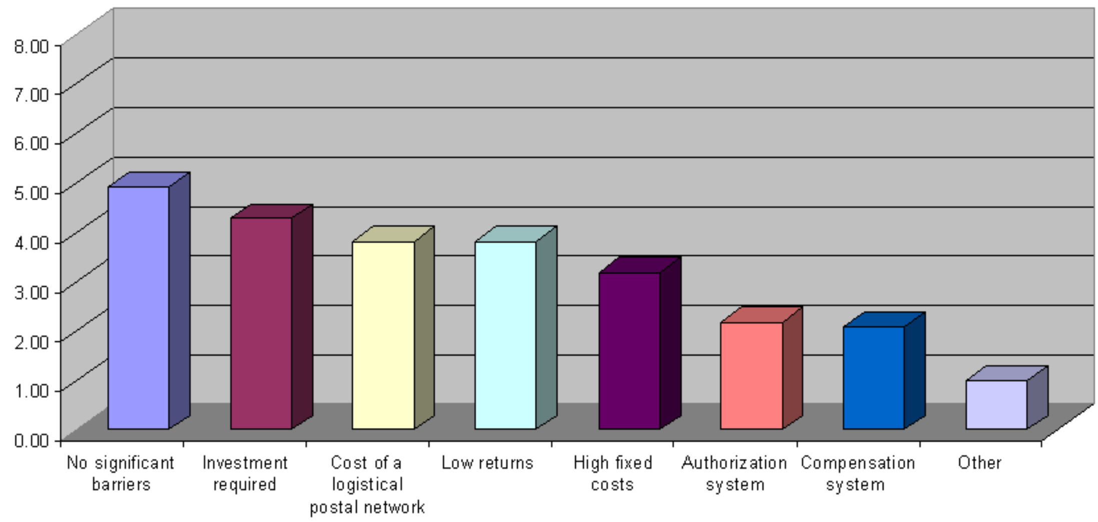
Source: Arthur andersen Survey, 1998

Among "other competitors", some public operators mentioned large vertically-integrated organisations with direct selling expertise.

The level of investments required for providing direct mail services and the expected low returns per item are considered by most public operators as discouraging factors for other types of potential competitor.

Nevertheless, most public operators consider that they would not be significant barriers hindering the entrance of new competitors should the direct mail market become fully liberalised.

Table III.1.5.2: Entry barriers in the direct mail market pointed out by Public Postal Operators



Source: Arthur Andersen survey, 1998

However, some direct mail experts consider that non-address items delivery companies and courier companies would be faced with significant barriers when entering the direct mail market. Those barriers could be summarised as follows:

Non-address items delivery companies-

As we mentioned before, in the EU there are already many operators acting in the unaddressed mail market, where the market share of most public postal operators is low. Those companies usually have unskilled or casual personnel. For those companies, which could certainly be interested in also delivering an addressed direct mail item service, the operational strategy would be training the personnel to make them capable of merging direct mail items with unaddressed items at the delivery end and delivering both together. In such a situation they could benefit from their experience in delivery rounds and local knowledge of businesses and households. However, those companies would not be able to give nationwide coverage since they usually operate locally, this being an important disadvantage when attempting to gain economies of scale in large urban centres. On the other hand, they would have to increase the frequency of services in order to provide them in a reasonable time, and boost their reputation to gain direct mail market share.

Courier companies-

In the EU there are already many operators acting in the express market, where the market share of most public postal operators is also low. Those companies usually have highly-skilled staff, who could easily be retrained to deliver other categories of

mail products. However, their networks are basically built up mainly to serve businesses rather than private addressees, which represent approximately three-quarters of the direct mail business. Courier companies could consolidate express and direct mail deliveries to businesses, the delivery of direct mail to individual addresses might be a major financial burden on them and could even jeopardise the quality of services given in the express services.

Experiences in countries with a higher degree of liberalisation than stated in the Directive show how new entrants have tried to overcome the barriers to creating alternative delivery networks mentioned above. Those entry strategies vary significantly in the different countries tested, depending upon the characteristics of each market in a given moment.

III.1.5.1 Experiences in the Netherlands

Medianet is a company specialised in subscriptions and responsible not only for sales but also for distribution of all consumer magazines published by the VNU Group, the largest magazine group in the Netherlands and Europe, plus the distribution of other periodicals of other publishers. All distribution is carried out through its own delivery network.

The delivery to final recipients is carried out through 250 retail agents spread all over the country working on a franchise basis. The delivery process is described below:

Medianet implements delivery of the magazines to the 250 retail agents (franchisees of the Company) in a tight time schedule by means of a company specialised in transport. Each retail agent is mostly staffed by students. Those agents have their districts divided into rounds, which are covered by the different delivery staff.

It is estimated that approximately 40% of households in the Netherlands have a consumer relationship with Medianet and its franchisees. The country is split into districts using as a parameter the number of households/subscribers by square kilometre. Each district agent (franchisee) covers in most cases 20,000-25,000 households, and in practise 7,500-10,000 customers/subscribers. The process from the collection of items by the transport company to the final recipient lasts 2-3 days (1 for transportation and 1-2 for the door-to-door delivery).

The franchisor (Medianet) and the publishers have obvious interest in generating volume and sales, thus determining and supporting publicity, promotion, etc. So, the franchisees can concentrate all their efforts on their local markets, in getting to know its territory and customers, and in guaranteeing optimal distribution, administration, marketing and quality of service. At the same time, the process of claims is easy to handle, going from the franchisees to the franchisor and vice versa.

This organisation reaches an average yearly turnover amounting to 1 million Hfl. per district and profit of 80,000-100,000 Hfl. However, rural areas cause high costs, and Medianet has to spend a certain amount of money on postal delivery. However, it is estimated that the cost of delivery using this formula is 50-60% lower than the cost of the formula used by the public postal operator.

This example shows that alternative delivery networks through a system of franchisees is feasible in the mail market. Nevertheless, experts consider that a learning curve is needed to reach the level of efficiency achieved by Medianet and its retail agents.

III.1.5.2 Experiences in Germany

The creation of alternative delivery networks in Germany was headed by the German Magazine Publishers’ Association VDZ, together with seven leading German mail order companies. Those companies and associations founded AZD GmbH (Alternative Delivery Ltd.) few years ago and started their operations with a pilot site. The company obtained a special license of exemption which allowed it to operate in the market without any price limits in the pilot site.

The pilot site was developed as follows:

Two areas of Germany were selected to develop the pilot site. Delivery to final recipients was carried out in each area by qualified "partners", experienced in the distribution of regional daily papers, instead of building up a new organisation. Results showed that those distribution centres were dynamic organisations and could easily adapt to changing volumes, whereas the public operator had a less flexible structure.

The conclusions reached in the pilot site created the basis for the development of the alternative delivery network, which is being organized as follows:

> The distribution centres in each region implement the delivery of the magazines to the retail agents (which may be franchises), who have their own delivery service. This system is deemed very efficient since those agents directly participating in the value creation process, are close to the product and carry major responsibility for quality assurance.

It is planned to have 35 distribution centres to cover all of Germany in over 5 years time. The catchment zone of a distribution centre will be based on a combination of metropolitan and rural areas, to be served by existing retail agents. Those distribution centres will be basically newspaper-home and wholesale distribution companies with previous experience in the delivery of other products. Parcel delivery services companies are also seen as suitable distribution centres. However, is not considered suitable the use of unaddressed items delivery companies, since their staff do not have the required skills.

The main issue raised by this formula for alternative delivery network was the need to handle sufficient volume, otherwise profitability would be impossible.

Again, experts consider that a learning curve is needed in order to be effective and to reach targeted market share. In fact, this company found it difficult to hire qualified delivery staff at a reasonable cost in those areas where the service company had not been active previously. This situation caused quality problems at the very beginning of operations.

This organisation, after less than three years in operation has successfully cornered 24% of the infopost market and 12% of the newspaper post market in the regions in which they are operating. Now services for unaddressed mail and direct mail services are under consideration.

III.1.5.3 Experiences in Sweden

Sweden provides another example of alternative delivery networks. This network was built up by a company called "City Mail", which started operations in 1989 in the Stockholm metropolitan area. However, while claims to the Courts were made by the public operator, it finally took ownership of City Mail for a certain period of time, something which proved that City Mail was a real threat to the business of the public operator. Coincidentally, the proceedings at the Courts proved that, in accordance with data provided by the public operator, mail delivery in Stockholm was much more expensive than in rural areas. This surprising statement, which could reduce the fear of potential "cream-skimming" practices, was attributed to the fact that in rural areas there are fewer problems related to incorrect addresses, the possibility of sharing the mail network with other retail businesses (such as bakeries), and the absence of safety problems.

III.1.5.4 Experiences in France

In France, there were some attempts to develop an alternative delivery network for newspapers. Publishers tried to set up an alternative delivery service, starting operations using six different regional networks.

However, this experience was challenged by the existence of a relationship between the public operator and the publishers, which is supported by State subsidies. This agreement includes a subsidy for the press, which is paid as follows: one third by the Government, one third by the publishers and one third by the public operator. In spite of that, most of the press editors do not use the public operator for the distribution of the press (the amount entrusted to La Poste is stagnant).

III.1.5.5 Preliminary conclusions

It appears that the development of alternative delivery networks seems to be more feasible when offering delivery services plus other value added services, such as warehousing, express services, etc. The offer of fewer restrictions on shape and content, individuality and better marketing possibilities are the real elements for ensuring the success of alternative operators.

Experiences from the Netherlands and Germany show that the development of alternative delivery networks to public operators may be feasible from the financial and operational points of view. However, there are some additional considerations to be borne in mind:

1. Building up an effective and efficient delivery network takes a long time. Difficulty in hiring qualified delivery staff and problems of quality of service may be faced at the very beginning of operations. In fact, the full development of the alternative delivery network existing in the Netherlands took almost 30 years of intense work.

2. Nationwide coverage neither not seems to be feasible nor interesting from a financial point of view to potential new entrants. Therefore, companies which would operate in selected areas, providing service through different local agents would be more likely to enter the market. Those agents would be local delivery companies linked to the operator through systems of franchises or contractual agreements. The main benefits of such structures could be summarised as follows:

    a. the local distributor would be very close to the final recipients and would know their expectations

    b. this relationship with the final recipients would make the local distributor very concious and committed to the quality of service given

3. The examples analysed above show that the financial success of alternative delivery services is highly dependent on economies of scale. Insufficient volumes would certainly make the existence of alternative delivery networks very difficult.

III.1.5.6 Final assessment of entrance of new operators in the direct mail market

Once the success of the strategies followed by some private operators in the Netherlands and Germany is proven, the likelihood of new operators entering the direct mail market in a situation of full liberalisation would depend on various factors which could be grouped into two categories as set out below.

- the attractiveness of the direct mail market in each country
- changes in the regulatory framework towards new entrants

Attractiveness of the direct mail market-

The attractiveness of the direct mail market varies significantly among EU countries, depending on their peculiarities and features.

- Future demand-

    The expected demand for direct mail delivery services in the coming years is a factor of capital importance for potential new operators entering this market. The success of new entrants is certainly related to volumes and economies of scale. Furthermore, the trends of demand are closely related to other internal and external factors, such as economic and demographic growth, improvements in quality of service, evolution of prices, etc. For further details, see sections IV and the attached Appendices, where those factors affecting the demand for direct mail delivery services are described in detail.

- Prices-

Price is an essential factor for senders of direct mail when choosing not only the operator to provide the service, but also when choosing the advertising tool. Therefore, the lower the prices fixed by the public postal operator for direct mail deliveries, the less room for new entrants to gain market share by reducing tariffs. Needless to say, price should not be considered in absolute terms, but related to quality. For example, in Spain, the success of Correos y Telégrafos in retaining its market share in a situation of full liberalisation is closely related to its tariff scheme (see section I.3.3.4).

The survey and research undertaken by Arthur Andersen on the mix of prices and discounts that public operators are applying to their Direct Mail customers show that in most countries the price for a presorted direct mail item is almost half of the price of a priority letter at standard rate. This statement applies mainly to Austria, Belgium, Italy, Spain and the U.K. In France, Germany, the Netherlands and Portugal it is slightly higher than half. However, in Denmark and Luxembourg there are no big differences between both rates. Indeed, in countries like Austria, Italy and Spain, where the direct mail market is liberalised, the market share of private operators is very low (in Austria and Italy it is almost nil), the low price of the service being the main factors in helping to retain of the market share. However, in countries like Belgium, the current tariff scheme seems to be very attractive for operators entering with predatory practises (the estimated market share of Belgium Post is 85-87% in spite of the fact that the market is reserved).

-
- Reliability of service-

As indicated above, prices of direct mail are closely related to quality. However, the reliability of the services offered, regardless of the tariffs level, is a key element when deciding a promotional campaign. Therefore, the lower the quality of services, the greater chance for new entrants not only to gain, but to create market by offering services of better quality and additional added value services.

- The existing alternative delivery networks

The existing experiences of successful alternative delivery networks in the Netherlands and Germany and in other markets, such as newspaper and magazine subscriptions, would contribute to the creation of direct mail delivery networks as well. Furthermore, the more alternative delivery networks that already exist in other markets, the easier and quicker the creation of efficient direct mail delivery networks will be.

On the other hand, these are some peculiarities and features of the public postal operators in particular, and features of the whole direct mail market in general, that may also affect new operators entering the direct mail market. These features are as follows:

- Population density-

  A low population density and a significant number of households in rural areas make the delivery of any postal item more costly. Such conditions could prevent new entrants from offering nation-wide services, it being more likely to offer services only in selected areas. Therefore, the lower the population density, the more difficult entry into the direct mail market may be.

- Range of direct mail services offered-

  One of the components affecting the quality of services offered is the capability of providing value added, additional services, which would make this marketing tool more attractive to senders. Therefore, the more value added services offered already by the public postal operator, the fewer possibilities new entrants would have of differentiating their offer, and consequently, the more difficult entry into the direct mail market may be.

- The postal infrastructure of the public postal operator-

  The universal service obligation forces public operators to maintain a huge, nation-wide complex postal structure to guarantee the postal service to all citizens. Additionally, in most countries senders of direct mail campaigns usually demand

  delivery services on a nation-wide basis. Therefore, the bigger the postal structure of the public postal operator, the greater the difficulties for new entrants to successfully compete, providing nation-wide coverage services.

Needless to say, there may be other peculiarities in given EU countries that could affect the decision of potential new operators, the assessment of which is beyond the scope of this study.

III.1.5.9 Changes in the regulatory framework towards new entrants-

In section IV.5 of this study we mention that most postal regulators have implemented, or would envisage implementing in the future, measures to regulate the access of new entrants to the direct mail market, should this market become fully liberalised.

These measures would take the form of specific authorisations for entering into the market, based a on a mix of different criteria, such as solvency, experience, level of coverage, minimum investment, price and reliability of services, maintenance of inviolability of correspondence, working conditions of personnel, adherence to existing national legislation on data protection rules and consumer rights, etc.

Obviously, the more restrictive these measures are, the less attractive potential new entrants will find entering the market.

In this connection, the Spanish Postal Act of July 1998 establishes the obligation of new entrants to contribute to the funding of the provision of universal service, should this become a loss-making activity for the public operator, but also establishes a maximum level of contribution one per thousand of the total postal revenues of the new entrant. In other countries, such as Finland, these kinds of provisions are deemed to be much more discouraging for new entrants. Indeed, although a private operator has been granted a license to deliver direct mail items in the Helsinki metropolitan area, it has not started operations yet, something attributed to the high compensation fee (20% of turnover) that must be paid to contribute to the funding of the provision of universal services.

In Section IV an econometric model is presented that quantifies the market share that new entrants may gain if a situation of full liberalisation occurs. Such quantification has been carried out by measuring the different factors explained above.

Factors affecting the likelihood of entry of new direct mail operators	
Variables affecting the degree of **attractiveness** of the direct mail market	Other variables
• Evolution of Demand	• Population density
• Evolution of Price	• Range of products offered
• Existing alternative delivery networks	• The existing postal infrastructure
• Reliability of service	

This model, once all the different variables have been taken into account shows the following results:

Table III.1.5.9.1: Likelihood of entry by new operators

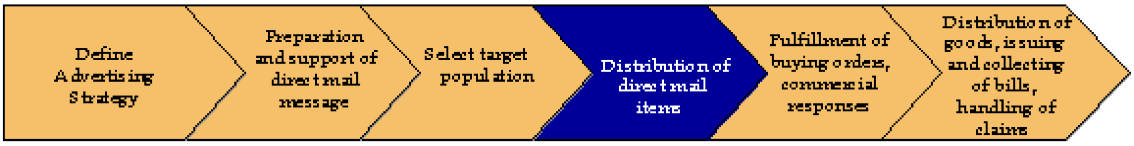
Member State	Likelihood of entry by new operators
A - Austria	High
B - Belgium	High
D - Germany	Low
DL - Denmark	Low
E - Spain	Medium

EL - Greece	Very high
F - France	Medium
FIN - Finland	Medium
I - Italy	Very high
IRL - Ireland	Medium
L - Luxembourg	Very high
NL - Netherlands	Medium
P - Portugal	Low
S - Sweden	Medium
U.K. - United Kingdom	Low

The above table shows the entry of new operators in Greece and Italy, gaining an important market share. This is very likely basically due to the fact that these markets are still not highly developed, important increases in demand are expected, and the quality levels are easy to improve. However, in the U.K., Germany and Denmark, entrance seems to be rather more difficult due to the fact that these markets are highly developed and efficient, and increases in demand and quality levels are not as easy to achieve as in other countries.

III.2 Degree of development of the postal infrastructure

One of the critical steps of the direct mail value chain is the process of delivery.



A highly developed postal network is a key contributing factor in meeting direct mailers' needs and therefore, the use and growth of the direct mail market.

The assessment performed and the experience from previous studies on the market shows that the features of the postal network which are most closely related to the development of the direct mail market are the following:

Postal network features affecting the direct mail market
Range of products and services offered
Tariff structures Percentage of direct mail over total postal items delivered Population density
Other minor factors

III.2.1 Degree of development of the postal infrastructure: Range of products and services offered

As indicated above, the delivery services are just one step in the whole direct mail value chain. Therefore, the more services the postal operators could provide to the senders of direct mail, the more readily this marketing technique will be used.

In this connection, the survey carried out by Arthur Andersen shows that 70% of the public postal operators surveyed provide "preparation of delivery" services (pre-sorting, postage, containerisation and dispatch) and 70% provide printing and enveloping services, whereas only 60% and 40% give database and document design services. Some operators, such as PTT Post (the Dutch public postal operator) give integral services. On the other hand, the service most demanded by senders (apart from delivery services) is the "preparation for delivery" service, followed by printing and enveloping services. That is, there is a correlation among the services offered by the postal operators and the services demanded by users of those operators.

Public postal operators surveyed:	**15**
Delivery services Preparation for delivery	10 7
Printing and enveloping Creativity (design of documents)	7 4
Processing of replies	5
Database services	6
One-stop-shop Other	3 5

Source: Arthur Andersen Survey, 1998.

Furthermore, in a hypothetical situation of a fully liberalised market, 82% of the private operators surveyed are willing to offer "preparation for delivery" services and 64% of them provide reply processing and "one-stop-shop" services. On the other hand, only 27% will give document design services.

Therefore, the good relationship and co-operation among postal operators and direct marketing associations and agencies perceived by the European direct mail market, together with the wide range of services offered by the postal operators, makes the whole environment conducive to growth in the coming years. In fact, European direct mail experts considers that future customer needs are crucial in defining the structure of postal services in the future. Consequently, the attractiveness of the direct mail market in terms of market share will be highly influenced by the services that each operator acting in the market could offer.

III.2.2 Degree of development of the postal infrastructure: "Mail prices" versus "Other media"

There are two critical factors that should be considered in the direct mail market:

1. Direct mail is very sensitive to price: the choice of senders is highly influenced by prices.

2. Letter prices compared to other prices in general, such as telephone calls.

One of the major problems faced by senders when demanding direct mail delivery services is the existence of a tariff structure that is not flexible enough, which in certain situations could make the deliveries very expensive.

Tariffs based on weight scales (for example, from 50 to 100 gr.) with different prices for each scale are not seen as flexible enough (the price of delivering an item wighing 51 gr. is the same as that for an item wighing 100 gr.).

In this respect, the table below shows how the situation varies among countries.

Existence of flexible tariffs	Existence of tariffs that are not flexible enough
Denmark	Belgium
Germany	France
Portugal	Italy
U.K.	Spain

Source: Information obtained through workshops

Therefore, prices are a very sensitive issue for senders (although quality issues are considered even more sensitive – see table III.3.3). Indeed, the survey carried out by Arthur Andersen shows that the more prices go up, the less attractive is the market, having direct effects on the demand, whereas the more prices go down, the more attractive the market becomes. Needless to say that this statement is closely linked with quality, since some senders would be ready to pay higher prices for higher quality levels. In section V.3 (pages V-11 and 12) we have performed a detailed analysis in a country by country basis. Such analysis has been the source used in the economic model built up by Arthur Andersen on demand for direct mail.

III.2.3. Degree of development of the postal infrastructure: Direct mail as a percentage of total postal items delivered

As mentioned in section V.5, the volume of direct mail handled by public postal operators varies significantly among European Union countries.

Consequently, the evolution of demand for direct mail will tend to be higher in countries where the volume of direct mail represents a significant amount of total postal items, since it could be considered that the higher the ratio, the better the infrastructure of postal operators for delivering direct mail. Therefore, it seems that his ratio is directly related to the development of the postal infrastructure for direct mail services.

III.2.4. Degree of development of the postal infrastructure: Population density

As mentioned in section IV.2.2 mail order companies' target customers live mainly in urban areas. Population density is a ratio that is also directly linked to the development of postal infrastructure. The table below shows the relationship between these factors.

Table: III.2.4.1:Population density and average number of inhabitants served by a permanent office

Member State	Number of Inhabitants per Km^2 (1996)	Nº of Inhabitants per Permanent Office (1996)
A - Austria	96	3,128
B - Belgium	333	6,206
D - Germany	230	5,065
DK - Denmark	122	4,218
E - Spain	78	8,951
EL - Greece	79	8,173
F - France	108	3,420
FIN - Finland	15	2,720
I - Italy	191	3,968
IRL - Ireland	53	1,832
L - Luxembourg	162	3,962
NL - Netherlands	379	6,697
P - Portugal	108	2,701
S - Sweden	20	5,140
U.K. - United Kingdom	244	3,040

Source: EUROSTAT, 1996 and Universal Postal Union, 1996

Therefore, it seems that the postal operators better positioned to offer direct mail services from a logistic point of view are the U.K., Portugal, Ireland and Finland, where the number of inhabitants served by a post office is lower. Needless to say this statement has nothing to do with financial and other considerations.

III.3 Acceptance of direct mail

The acceptance of direct mail is one of the most important factors in the development of the direct mail market. The indicators which are most relevant in this connection are the following:

Indicators affecting the acceptance of direct mail
Reliability of service
Development of the retail sales market and the mail order market
Direct mail as a percentage of total direct marketing

III.3.1 Acceptance of direct mail: Development of the retail sales market and the mail order market

Our assessment and previous studies show that the retailing businesses and financial institutions are the most common users of direct marketing techniques in general and direct mail in particular. The retailing business, and more precisely, the mail order business (within the retailing business) is the most intensive market in the demand for direct mail services. In fact, mail order companies are basically distributors of retailing goods. Therefore, the development of direct mail is fully linked to the development of the retailing business.

Certainly, we could say that the mail order market is a portion of the retailing market. Therefore, if the retailing market grows, the mail order grows in the same proportion. Needless to say the mail order business has developed as a major competitor of store retailing services (mail order companies increased their turnover by 36 percent between 1989 and 1994 – EMOTA / AEVPC, 1996). Therefore, the percentage that the mail order market represents in the total retailing market is increasing as consumers become more comfortable using mail order and as consumers become aware of the advantages of this kind of market, which is highly influenced by cultural features of the population and the image of the mail network of the country.

Table: III.3.1.1: Percentage of the total retailing market represented by the mail order market

	(in ECU)	(in percentage)
Member State	**Mail Order per capita (1996)**	**% that mail order represents of the retail market (1994)**
A - Austria	149	3.8
B - Belgium	62	1.7
D - Germany	261	2.6
DK - Denmark	123	3.9
E - Spain	14	n.a.
EL - Greece	n.a.	n.a.
F - France	126	1.7
FIN - Finland	112	4.4
I - Italy	12	0.4
IRL - Ireland	n.a.	n.a.
L - Luxembourg	n.a.	n.a.
NL - Netherlands	67	1.4
P - Portugal	26	1.4
S - Sweden	96	2.5
U.K. - United Kingdom	131	4.2

Source: Direct Marketing in Europe EMOTA, June 1997

n.a.: not available.

The countries where the mail order market is most developed are Germany, the Scandinavian countries (Denmark, Finland and Sweden) and Austria, France and the U.K., whereas the countries where it is still in the process of development are the Latin countries (Italy, Portugal and Spain). The reasons for such a low rate of development vary among countries. In Spain and Portugal there are important cultural features of the population that prevent the success of the mail order business and the fact that the kind of products marketed in the past using this kind of selling technique were low quality products. However, in Italy it is considered that the current level of reliability of the services given by the public postal operator is the main problem for such a low rate of development.

Therefore, this ratio gives an overall idea of how developed the direct mail market is in different countries, but not such a clear idea of the evolution of demand.

III.3.2 Acceptance of direct mail: as a Direct mail percentage of total direct marketing expenses

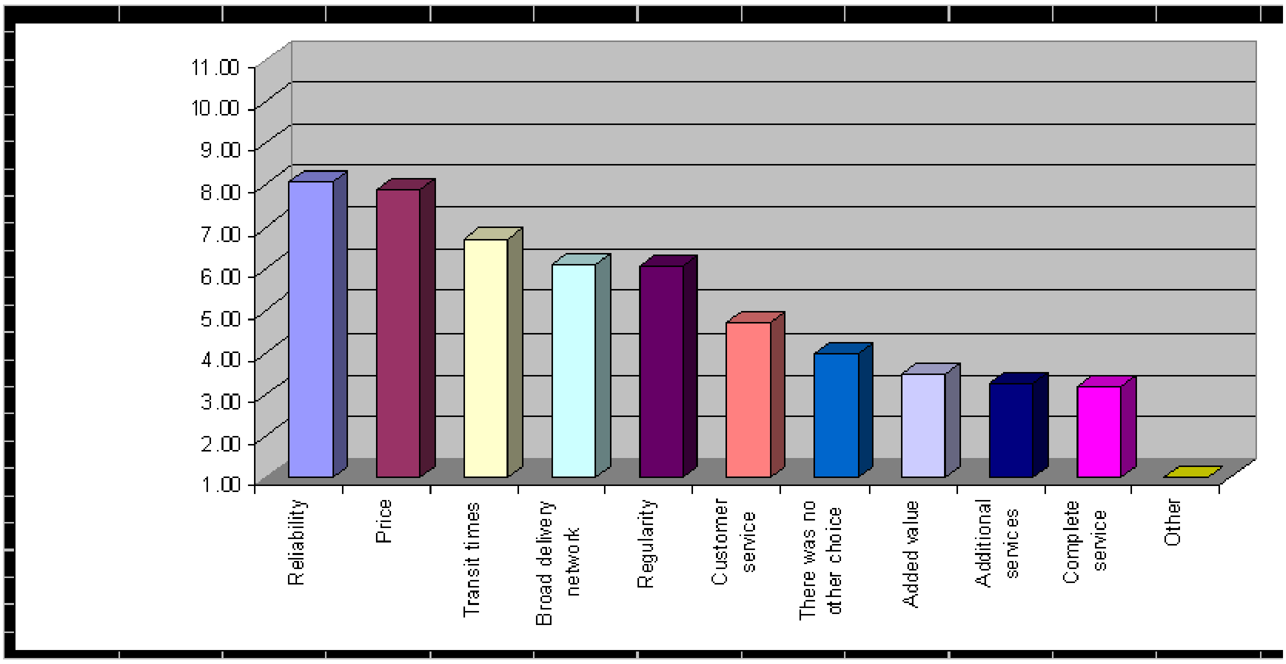
As shown in section II.3, direct mail expenses represent the biggest share of total direct marketing expenditure.

However, some statistical studies show that, although this ratio would increase significantly in countries where direct mail expenses are still low and consequently have an impact on the overall demand for direct mail services, this impact is perceived as not very significant.

III.3.3 Acceptance of direct mail: Reliability of service

The survey carried out by Arthur Andersen on 51 senders of direct mail throughout Europe shows that the main criteria that determine the choice to use the delivery services offered by public postal operators are basically factors related to "quality of service":

Table III.3.3: Criteria determining the choice of senders when using the services of public postal operators



Source: Arthur Andersen Survey, 1998

There is also a high degree of consensus among postal regulators that the current quality of direct mail services provided by public operators and, when allowed to do so, private operators, is fairly good in terms of price, transit times, reliability and regularity of service and customer service.

Table III.3.3.1: Postal regulators' view on current quality of direct mail service levels

Indicator	Number of Affirmative Responses (Good quality of service)
Reliability	13
Regularity	13
Broad delivery network	13
Price	12
Transit times	12
Added value	12
Customer services	12
New products and additional services	11
Completed service (one-stop-shop)	11

Source: Arthur Andersen Survey, 1998.

Quality of service covers not only increased customer service at every step of the value chain (as explained in section IV.5.1), but also reliability of current and future performance of the service. Indeed, the future behaviour of the demand for direct mail services, as well as the attractiveness of the market for new potential entrants, is strongly related to the reliability of the service.

In this connection, there are three main areas which are of capital importance for senders of direct mail. These areas are, as identified not only by senders of direct mail, but also by the whole European direct mail market:

1. Universal service coverage,

2. Transit times: predictability, and

3. Flexibility

Universal service coverage-

A crucial factor closely related to reliability is that universal service coverage, while ensuring affordability and compliance with minimum quality standards, seems not to be a major problem in the different EU member countries, although remarks on the need for some improvements in quality were made. The guarantee of full universal service coverage seems to be a fact, and therefore an advantage for the use of direct mail services.

Transit times-

Postal operators are required to take full responsibility for mail from receipt to delivery.

In this connection, a factor of capital importance for senders is knowing how long mail takes to reach its final destination. In this respect, operators should guarantee "predictability". That is, senders are more concerned about controlling "when" the items will reach the final destination, rather than obtaining deliveries in less than three to four days.

If changes in delivery times are not predictable, the situation could make a marketing campaign fail if it is heavily dependent on delivery by a particular date, and could cause cause the sender to lose certain expected sales and customers.

Needless to say European senders also want delivery times of less that three-four days, but predictability seems to be more important.

Flexibility:

Senders of direct mail increasingly expect flexibility and certain special services tailored to their needs.

In this connection, 89% of the direct marketing companies and Associations surveyed and 83.3% of the senders surveyed believe that an increase in competition in the delivery services market will lead to better direct mail delivery services than those currently provided by the public postal operators.

Table III.3.3.2: Do you think that the increase in competition will lead to better direct mail delivery services than those currently provided by the public operator?

	Direct marketing companies and Associations	Senders
Total surveyed:	20	42
Yes No	17 2	35 5
No answer	1	2

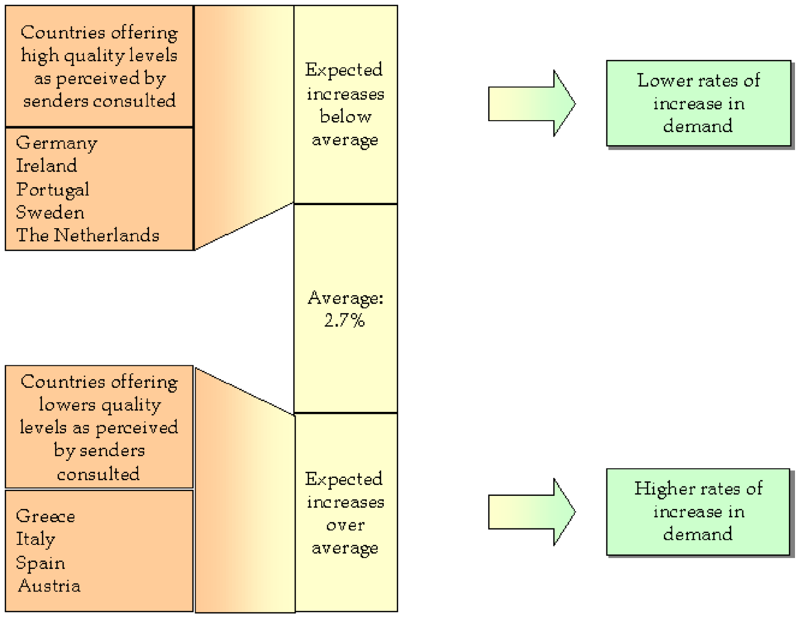
Source: Arthur Andersen Survey, 1998.

Conclusion-

Future customer needs, mainly related to reliability of services, seem to be crucial in defining the structure of postal services in the future to better meet the demand and encourage senders to increase such demand for direct mail services. Therefore, meeting the expectations of senders is of capital importance for the development of mail in general and direct mail in particular (see the assessment on the trends and expectations of senders in section V.1).

In fact, previous studies (such as the Universal Postal Union Study" Post 2005, Core

Business Scenarios") have evaluated that in high-income countries quality is increasing and will increase in the next ten years at an average rate per year of 2.17%. Therefore, it is forecast that the demand for direct mail would grow in line with that trend. Obviously, it is also expected that those countries with comparative lower quality levels would increase their quality levels at a higher rate, whereas in those countries already offering very high quality levels the rate of increase would be smaller.



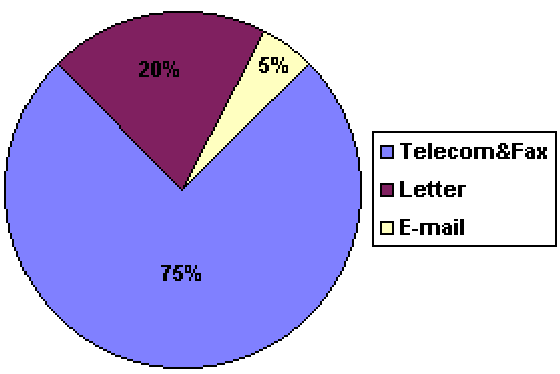
The model in section V has been built up on this basis.

III.4 Other Factors

Wireless telephone, facsimile machines, desktop computing are networks. High speed modes of data transport, increasingly sophisticated software applications, e-mail, and Internet are just some of the technological advance that are changing the way business and consumers communicate, exchange information and are entertained.

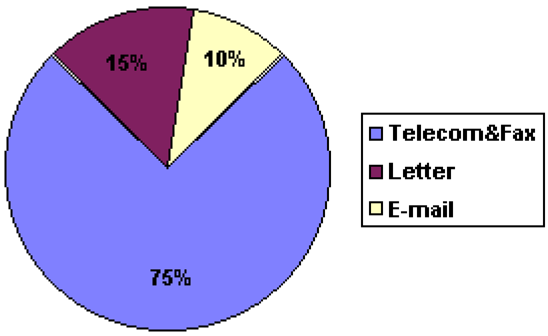
At the same time, these new technologies have altered expectations regarding communication and the dissemination and consumption of information, as shown in the figures below:

Share of communication market (volumes)
Communication volume 1995



Source: UPU Post 2005.

Communication volume 2005



Source: UPU Post 2005.

Within the business community, large businesses have usually been the first to adopt new technologies and related applications to meet their most sophisticated communication and information needs. At the same time smaller businesses represent a vast market for these same technologies and applications, some of which are particularly well designed for small businesses. For these reasons, the ubiquity of these communication technologies is increasing rapidly within this domain.

Therefore these technological changes are not limited to the business environment. On the contrary, the exponential growth of on-line services and Internet access attest to consumers' growing use of electronic interactive communication media.

All of these changes represent potential threats to the traditional use of mail. Business and consumer communication is a highly competitive market where fax, e-mail, overnight delivery, and telecommunications are significant alternatives for delivering information which have been traditionally dominated by mail.

As electronics compete with mail, key transactions are at increasing risk:

•Purchase Orders
•B-B Invoice
•B-B Payments
• Correspondence

•Response to direct mail
•Bill payments: credit card & utility

BUSINESS TO HOUSEHOLD

•Bank Statements
•Bills
•Correspondence/Notices
•Payments

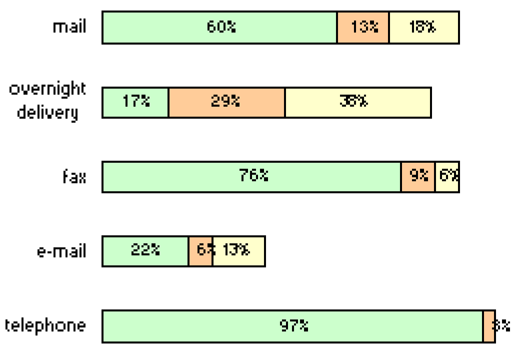
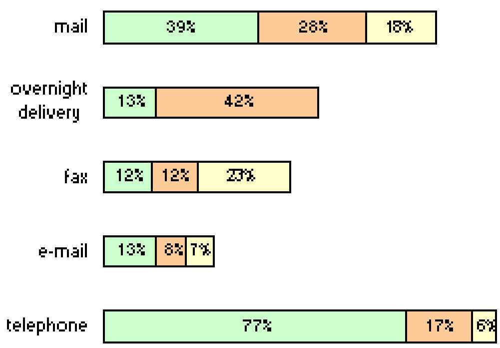
HOUSEHOLD TO HOUSEHOLD

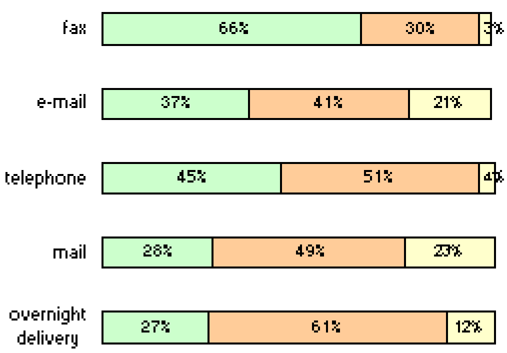
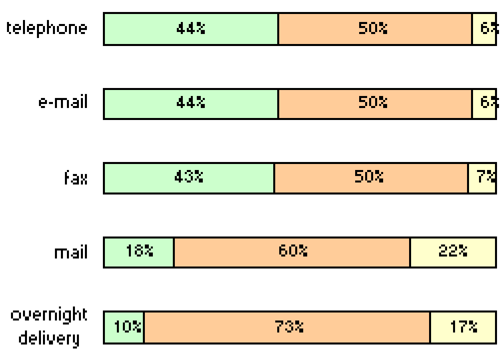
•Correspondence

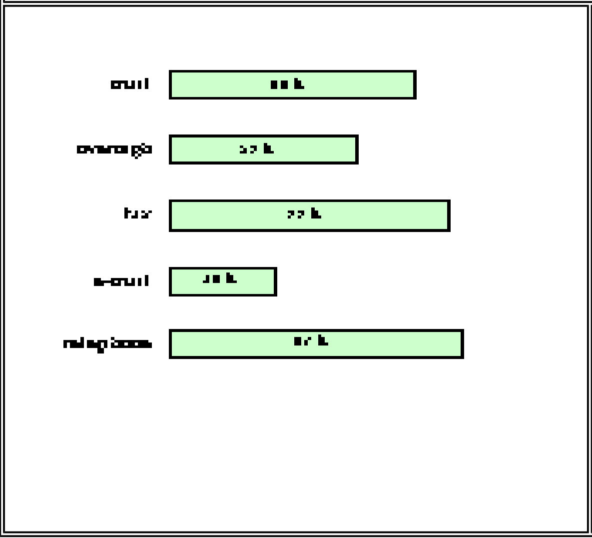
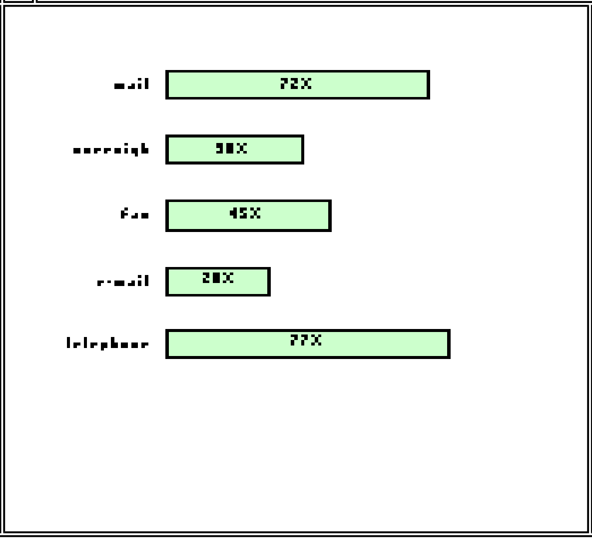
BUSINESS TO BUSINESS | **HOUSEHOLD TO BUSINESS**

Businesses and consumers in a position to make communication choices between mail, fax, overnight delivery, E-mail and the telephone make their selection based upon cost and quality factors.

As the following figures show, businesses and consumers ***behaviour and expectations*** are significantly different from each other:

<table>
<tr><td colspan="2">BUSINESS BEHAVIOR AND EXPECTATIONS</td><td></td><td>CONSUMER BEHAVIOR AND EXPECTATIONS</td></tr>
<tr><td colspan="2">Frequency of communication media use</td><td></td><td>Frequency of communication media use</td></tr>
<tr><td colspan="2">
</td><td></td><td>
</td></tr>
<tr><td></td><td>Daily</td><td></td><td></td></tr>
<tr><td></td><td>2/3 times week</td><td></td><td></td></tr>
<tr><td></td><td>Less than once week</td><td></td><td></td></tr>
</table>

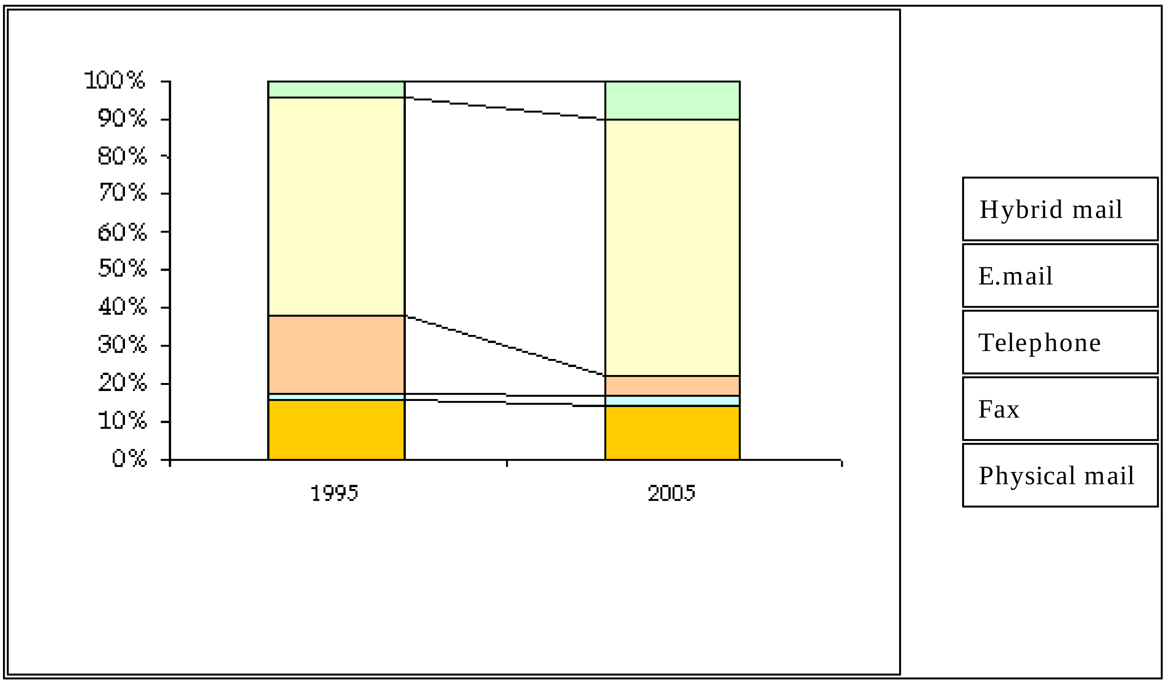
<table>
<tr><td colspan="2">Expected business use of communication media over the next 3 years</td><td></td><td>Expected personal use of communication media over the next 3 years</td></tr>
<tr><td colspan="2">
</td><td></td><td>
</td></tr>
<tr><td></td><td>Increase</td><td></td><td></td></tr>
<tr><td></td><td>Stay the same</td><td></td><td></td></tr>
<tr><td></td><td>Decrease</td><td></td><td></td></tr>
</table>

Communication media worth the cost		Communication media worth the cost
	Most Effective Media 15% 1% 13% 2% 69% —— 100%	

Source: The PaperCom. Allianace, January 1997

At present, about 15 to 20 million people worldwide have access to Internet, it being expected that more than half of all American households will have a computer by the year 2000. With the technology in place, the use of new services such as E-mail will soar, and value perceptions of both old and new communication media will change dramatically.

Breakdown of communication market



Source: UPU Post 2005. Core Business Scenarios, 1997

Effects of the special importance of the communication market-

1. The growth of the communication market due to globalisation and the

introduction of new means of communication.

According to the International Telecommunications Union, the information industry is systematically growing faster than the overall economy, this growth being relatively immune to economic downswings. This trend will probably continue in the future. Another aspect associated with the introduction of new means of communication, is not only the increase in the possibilities available to consumers to obtain information but the creation of a whole series of totally new needs that can be covered by the same means of communication.

2. The complementary nature of the relationship between means of communication

It is also important to note that communication media are not used in a mutually exclusive way. The use of fax, for example, often generates a parallel postal item.

A phenomenon that has become evident in recent years is that the availability of more communication media tends to promote message repetitiveness. Sometimes this repetitiveness is the result of a lack of trust, but usually, just one means of communication may not be sufficient to satisfy the sender or recipient’s needs, and two or more communication choices will be needed and therefore used. This effect, which can be defined as the need for several media to transmit a message in order to meet all communication needs, can be referred to as communication bundling.

3. Substitution effect

The existence of partial substitution problems among media is a fact, especially when a new means of communication is introduced as a result of technological development. In this sense the question of the survival of physical mail, which was explained in the preceding part of this report, has already arisen at least twice: first with the advent of the telephone and secondly when the fax was introduced.

Trends and Forecasts-

Therefore, the repercussions of technological developments cannot be merely reduced to a substitution phenomenon between means of communication. Consideration must also be given to the fact that the introduction of new means of communication expands the communication market as a whole because these means often satisfy additional needs which complement mail or other means of communication.

Communication media are rarely eliminated, rather they take on new definitions. For example the telephone did not replace mail, rather it enhanced the use of mail by generating new uses such as the confirmation of telemarketing orders. Over the years, both mail and the telephone have experienced growth. This trend can be observed in the rate of messaging, which is increasing substantially faster than the usage rates of any communication medium. In other words, senders are not just substituting one medium with another; moreover, the addition of new communication media has increased the number of messages sent.

To a certain extent, the new technologies can help Direct Mail by improving interactivity with the recipient of the message; Internet and digital television are valuable allies of

Direct Mail in the advertising market, since all of them tend toward predominance of micromarketing.

The new media reinforce evolution towards interactive marketing. This recent trend towards database or "dialogue" marketing, which will be accelerated by the advent of the new on line service, has been noted over the last few years by the advertising industry.

1. Internet offers the advantage of segmentation since it is based on personal marketing, not oriented to the mass, but oriented to small groups.

2. Digital television will change advertising techniques : consumers will play a new role, they are not only receivers of commercial messages but take action to receive more information, place orders.

Interactive marketing, or creating a dialogue with the customer, with the help of databases that save all information received from the client, provides a more focused and precise target, leading at the same time to more satisfied and loyal customers.

Conclusions-

1. The effect of electronic substitution will probably depend on the future price / quality rate of traditional postal services such as direct mail.

2. Electronic substitution will probably impact first in more advanced countries with a higher penetration of electronic services and later on, in countries with a low penetration of electronic services. In addition to this, the trends suggest that the worse the quality of postal services is, the higher the growth of electronic substitution will be.

3. Digital interactive electronic technologies are expected to further penetrate homes, business and retail outlets. But at present, it is not clear whether or not emerging technologies will adversely affect the growth of Direct Mail. They may in fact complement Direct Mail and therefore contribute to the growth of the whole industry.