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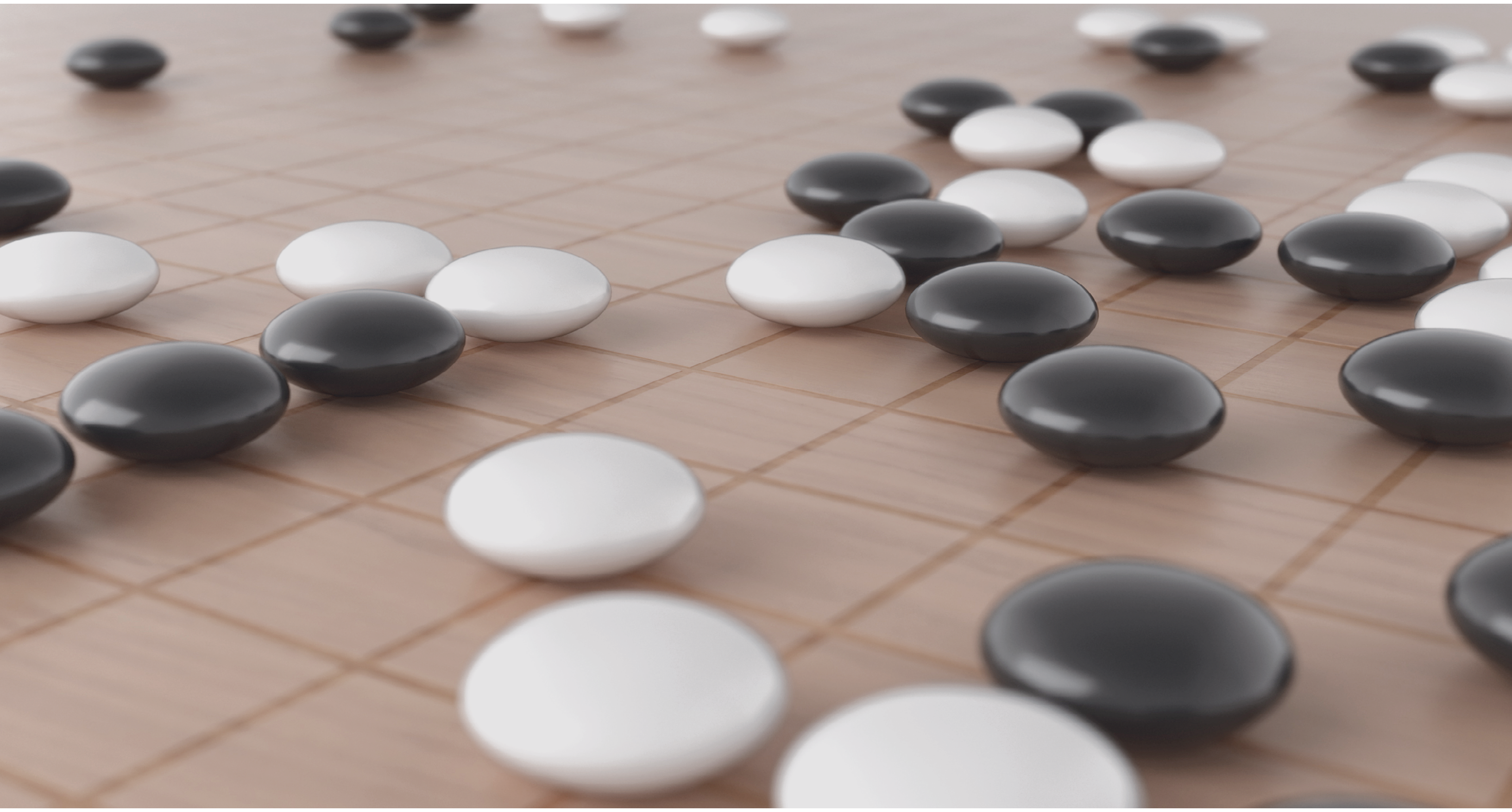
The endgame for postal networks: How to win in the age of e-commerce

The e-commerce megatrend is a big opportunity for postal players, but market and competitive dynamics are squeezing incumbents. Three winning tactics can help these companies stay competitive.

by Patrick Briest, Julian Dragendorf, Tim Ecker, Detlev Mohr, and Florian Neuhaus



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With the rise of new competitors, new technologies, and the inexorable trend towards e-commerce, postal networks face a turning point. Our new report, The endgame for postal networks – how to win in the age of e-commerce, explores the strategic issues at hand and dives deeply into the actions that incumbents should take to stay competitive. This article extracts highlights from the full report to outline a broad overview of the landscape, tactics that can help companies keep pace and cut costs by up to 20 percent, and steps for getting started.

Time for the next move

It's useful to look at the state of play for the broader postal and parcel market and for incumbent companies. The decline of the mail business—the long-standing and reliable cash cow of many incumbents—due to electronic communication is structural and irreversible. Mail revenue share still stands at around 40 percent globally today, but is swiftly declining, as indicated by a shift in volumes: the global volume ratio of letters to parcels has declined from 13:1 in 2005 to 4:1 in 2015 and is expected to reach 1:1 parity by 2025 (Exhibit 1).

In contrast, the e-commerce megatrend will fuel an €8 trillion retail opportunity by 2025, creating opportunities that no postal player should give up without a fight. After all, parcel logistics—from pickup to delivery—is steadily becoming the most crucial enabler of that growth, given that an estimated 70 to 80 percent of all e-commerce purchases are delivered via networks rather than picked up in store. Differences in e-commerce parcel penetration rates point to potential accelerated growth in less developed markets (Exhibit 2), but the general premise is global:

Exhibit 1

Parcel is growing from a small fraction by volume to 1:1 parity with mail by 2025.

Typical postal incumbent mail-to-parcel volume, ratio

Overall market mail-to-parcel volume, ratio

Mail overall market growth, 2000–25, compound annual growth rate, %

Parcel overall market growth, 2000–25, compound annual growth rate, %

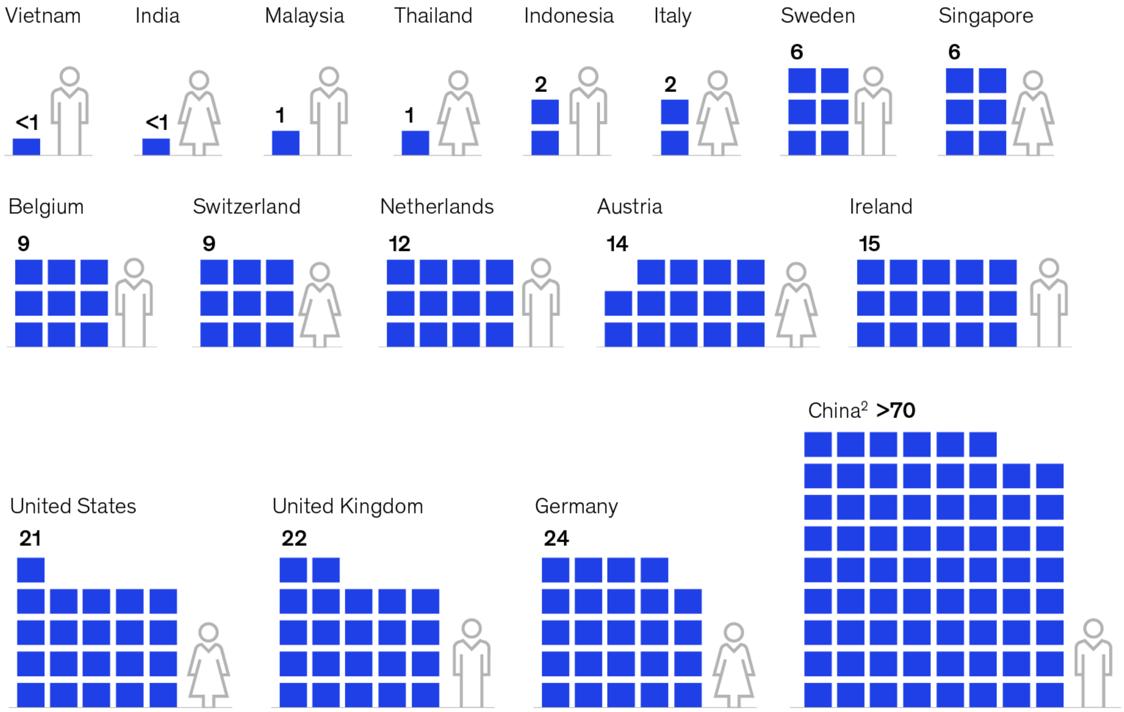
Source: Industry experts; Transport Intelligence; Universal Postal Union; McKinsey analysis capturing a piece of the resultant parcel-volume growth will be crucial for incumbents wishing to protect the unique benefits of their joint mail–parcel operations.

In concurrence with such lofty growth dynamics across global parcel markets, new challenges are pushing incumbents to a tipping point. The entire logistics value chain for parcel handling is up for grabs, as indicated most clearly by the recent and sizable forward integration moves from e-commerce supergiants, such as Alibaba, Amazon, and JD.com (Exhibit 3). These moves include Amazon's order of 20,000 delivery vans in the United States and Alibaba's shift to offering parcel delivery to the broader market. The three supergiants alone now account for around 40 percent of online purchases globally, and the move into parcel delivery seems an obvious choice.In the face of rising consumer demand and competitive pressures, most incumbents are still stuck with structurally uncompetitive labor costs that are 20 to 40 percent higher than those of their new competitors. They also have risk-averse cultures and continue to use legacy IT systems, as new competitors erode their primary sources of competitive advantage: strong brands and scale benefits.

Exhibit 2

Huge differences in e-commerce parcel-penetration rates could translate into growth opportunities for companies in less developed markets.

E-commerce-relevant parcel[1] penetration, 2017, number of parcels per capita



[1] B2C parcels with speeds typical for e-commerce shipments in given country.
[2] Tier 1: Beijing and Shanghai, assuming 70% B2C share.

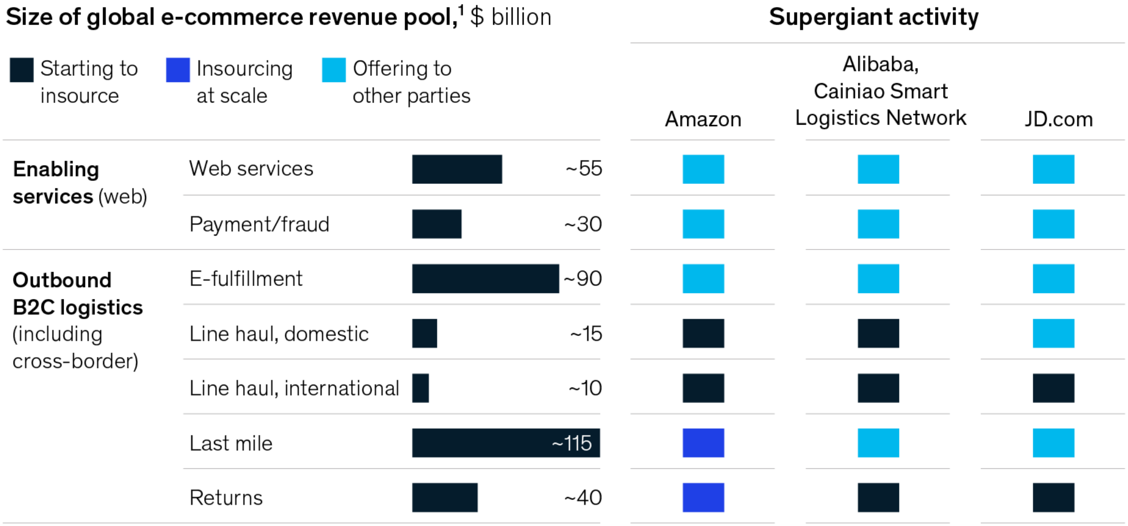
Three winning tactics

Incumbent companies can, however, focus on three tactics when seeking to stay competitive:

Earn the right to innovate. Successful postal incumbents have raised productivity by 1 to 2 percent annually over the last decade. This level of continuous improvement is in fact becoming ever harder to maintain, yet it is more mission-critical than ever in view of current market dynamics. Before focusing on fashionable, science-fiction-like fantasies of delivery drones and robots, postal

Exhibit 3

E-commerce supergiants are entering the battle for B2C logistics, a revenue pool worth approximately $270 billion in 2017.



Size of global e-commerce revenue pool,[1] $ billion

■ Starting to insource
▣ Insourcing at scale
□ Offering to other parties

			Supergiant activity		
			Amazon	Alibaba, Cainiao Smart Logistics Network	JD.com
Enabling services (web)	Web services	~55	□	□	□
	Payment/fraud	~30	□	□	□
Outbound B2C logistics (including cross-border)	E-fulfillment	~90	□	□	□
	Line haul, domestic	~15	■	■	□
	Line haul, international	~10	■	■	■
	Last mile	~115	▣	□	□
	Returns	~40	▣	■	■

[1] Total costs of e-commerce merchants, both insourced and outsourced.
Source: Industry experts; McKinsey analysis

incumbents need to step up their game by further optimizing their current operations, boosting operational excellence in sorting, transport, pickup, delivery, and (often neglected) business support functions. We propose seven key initiatives that can reduce total costs by up to 20 percent (Exhibit 4). The levers with the greatest impact for many players are advanced ways of production integration, analytics-supported flexible resource planning, and an automation opportunity of up to 50 percent for operational planning and support activities, that are today often too manual and inefficient.

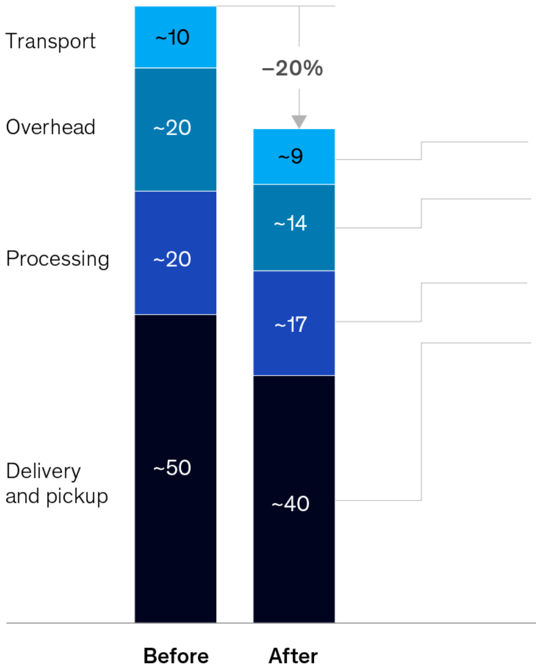
Build the right capacity. Building on a solid operational foundation, incumbents need a long-term plan to establish the additional capacity required to participate in continuous parcel growth. The long-term plan needs to answer three key questions: How much capacity is needed (and where) in line with evolving e-tailer fulfillment strategies and service expectations? What's the right kind of automation technology in line with product mix and local factor costs? How can additional capacity be integrated in the best way to protect joint network economics? With about 75 percent of delivery speed issues in today's postal networks being "structural," strategic investments into the network offer a unique opportunity to not just create capacity for growth and improve the operating cost base, but also for a real step change in service offerings.
As such, leading players are already and continuously investing billions of dollars into their networks.

Create an innovation engine. Incumbents should follow a structured approach if they are to innovate both their products and production systems. With both quality enhancements and cost reductions in mind, they should first create a consumer-centric product strategy. Next is developing a digital and data strategy. This should set critical foundations in place via a two-speed IT approach and address innovation for the customer experience (think personalized delivery notification and rerouting) and value-chain design (think underlying enablers for track and trace, for instance). The strategy should also consider attaining new frontiers in the production system or product portfolio (for example, with drones and robotics or artificial intelligence). Two "must have" priorities should currently be at the top of any postal executive's agenda: The first is raising end-to-end transparency along the production chain via both advanced software and new, increasingly economical hardware like smart sensors. The second is enhancing dynamic delivery-route planning capabilities, as this is the door opener to the biggest potential step changes in cost and customer experience.

Exhibit 4

Key initiatives in operational excellence can enable up to 20 percent in cost reduction.

Total costs of direct levers, indexed to 100



Direct levers

Transport. Use smart planning and asset ownership

Overhead. Revamp and digitize support and planning processes rigorously

Processing. Continue to drive automation and standardization

Delivery and pickup. Drive synergies and excellence in delivery and pickup economics

Overarching levers

Footprint. Drive rigorous network redesign

Labor model. Overhaul wages and flexibility

New operating models. Use radical operating-model changes

Get into action mode

So how can postal players get started? Most importantly, they need to get into action mode and execute. Of course, major transformations touching on the operational core of the business are not easy to get underway with so many options to consider. A few elements can help:

Plan each move with care. Incumbents should create a shared vision and gain alignment throughout the company. And they should understand customer needs in as much detail as possible in order for those needs to be translated into action.

Build momentum with early wins. To implement successfully, companies should take one step at a time, create momentum, and realize quick, early wins. Top priority should be given to crucial initiatives that promise immediate payoff—without hindering bolder moves or investments in cutting-edge technologies.

Know the players. Managing both internal and external stakeholders is crucial. Everyone from staff to leadership to regulators must understand the vision and the road map, as well as the benefits the transformation will bring, if they are to understand why change is necessary. Incumbents need to become competitive parcel players if they are to sustain the core business and deliver universal services in the most economical way.

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