Franchising of Retail Operations: The Case of the United States Postal Service Building a Retail Network for the 21st Century

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ABSTRACT

This thesis is about the effects of changing customer preferences on the United States Postal Service's retail network and offers a process for wider adoption of its current retail partnership program. The Contract Postal Unit (CPU) program represents 10 percent of the Postal Service's current outlets. This is a form of franchising. This thesis reviews franchising theory and highlights key research in the area to develop a business framework. Since many of the foreign posts have also been experimenting with operations similar to the CPU program, the franchising programs of four European posts are reviewed. I conclude by offering an approach that the Postal Service may use to look at how and when its customers use its products and services at their retail outlets and provide several recommendations that the Postal Service might consider if and when the Contract Postal Unit program is expanded.

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Erwin H. Schell Professor of Organization Studies
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Disclaimer

The views expressed in this thesis are those of the author and do not reflect the official views, policies, or position of the United States Postal Service.

No official United States Postal Service approval is expressed or implied.
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Chapter 1  Introduction

The United States Postal Service (USPS) is in a period of unprecedented time of change. With the recent economic crisis and the advent of the internet, the volume of the United States Postal Service has declined at an unparalleled amount in the last year, 12.7 percent from 2008 to 2009 (USPS 2010j). The first class mail has been particularly affected by these events. As the market moves towards on-line bill pay and on-line advertising, this volume will continue to erode. Under its current business model, the Postal Service cannot expand its services beyond the mail-related product and services, largely in part due to the current law which governs its public charter (USPS 2010c).

Looking to the future of the Postal Service, adjustments to the existing business model must be made in order for the Postal Service to continue its existing mission to deliver universal service to the American people. The Postal Service has already begun to look forward to a new business model with its announcement on March 2, 2010 (USPS 2010h). This press release states that the Postal Service has developed new strategies which include modifying its delivery network from six-days a week to five, expanding its products and services, and redefining its retail model.

Since 1970, with the passing of the Post Office Act, the Postal Service has been a self-supporting independent agency of the executive branch, relying only on the revenue it generates through the sale of its products and services (USPS 2010c). To deliver these products and services, it has a vast infrastructure related to the processing, distribution, and delivery of the mail as well as the largest retail network in America. With over 36,000 retail outlets, it has a larger retail network than McDonalds (US stores), Walgreens, and Walmart combined (USPS 2010j; McKinsey and Company 2010). Its retail network serves an average of seven million customers each day (USPS 2010g). However, in recent years, the number of monthly visits that customers make to use the Postal Service has decreased from

In general, the age of the internet has had a huge impact on how consumers and businesses interact. The Postal Service is no exception. Its customers are changing the way in which they use its products and services. Simply put, the internet has changed customer preferences. This thesis is about the affects of changing customer preferences on the Postal Service’s retail network and offers a process for wider adoption of its current retail partnership program, Contract Postal Unit, based on franchising theory.

This thesis is based on research from three general sources, research papers and corporate websites, interview/discussion with knowledgeable employees of the United States Postal Service, and my personal knowledge of the Postal Service over the last twenty years. I conducted a series of interviews with six professors from Massachusetts Institute of Technology and Harvard Business School, twelve professionals within the Postal Service from the areas of retail and marketing, operations, and corporate strategy from the January to April period in 2009. The interviews were on fact finding discussions. I would normally explain my topic and ask for their insight. This thesis reflects the views of the author and not necessarily those of the individuals who assisted in this research. During the course of the research, the Postal Service announced its Future Business Plan (USPS 2010h). The information from this plan has been used and incorporated into this thesis. The Future Business Plan does include a plan to modify its existing retail network. This thesis offers a framework that could be used in the further development of this plan.

The next chapter focuses on the Postal Service in the age of the internet and the strategic focus of the organization as it adjusts to the affects of the internet on its core business and retail operations. The first section will reflect on the USPS’s demonstrated ability to use disruptive innovation in the past to reduce costs of operations and improve service to its customers. The second section looks at the
affects of the electronic diversion on the Postal Service’s mail base and retail footprint, and how the Postal Service must continue to adjust to these affects. This chapter will close by looking at one of Clayton Christensen’s framework and how this framework might be utilized by the Postal Service (Christensen et al. 2007).

The third chapter of this thesis is a review of franchising theory and highlights key research in the area. The Postal Service’s Contract Postal Unit program, which represents 10 percent of its current outlets, is a form of franchising. Since many of the foreign posts have been experimenting with a similar concept, the fourth chapter is a review of the franchising programs used by four European posts.

The fifth chapter has two major sections. The first section will analyze the Postal Service’s history of retail partnerships with private enterprise and review its current retail models. The second section is devoted to a business framework that the Postal Service could use that incorporates franchising theory and makes recommendations to the Postal Service for how it might spread the adoption of the Contract Postal Unit program more broadly across the organization. In the last chapter, Chapter 6, I discuss the application of the franchising theory to the Contract Postal Unit program and suggest areas for further research.
Chapter 2  The Postal Service in the Age of the Internet

2.1 History of Innovation in the Postal Service

In a publication produced by the Postal Service called The United States Postal Service: An American History 1775 – 2006 (United States Postal Service 2007), the Postal Service demonstrates that it can not only adjust but embrace disruptive technologies. Many Americans would be surprised to learn that the Post Service (referred to as the Post Office Department up to 1970) played an instrumental role in the development of the infrastructure of today’s business environment by embracing past disruptive innovations, such as the steamboat, the railway, and air transportation (United States Postal Service 2007).

Throughout its history, the Post Office Department began to experiment with new forms of transportation prior to the full development of the technology and prior to the development of an infrastructure to support them. Over time, experimentation helped promote the full development of each of these transportation innovations and the infrastructure to support them. Much of this was achieved by partnering with other government agencies and private contractors. This began the Postal Service’s tradition of using innovation as a way to lower costs, improve service, and increase revenue as well as establishing a tradition of partnering with private enterprise.

After World War II, the first mechanized equipment was deployed for parcel and letter sorting. Although the first automation equipment for letters was introduced in 1982, the research and development had begun shortly after the end of World War II with the U.S. Bureau of Standards and the Rabinow Engineering Company. By the 1990s, the Postal Service began to deploy a remote encoding system. Today, using this system, an image of each letter mail piece is captured and analyzed. From this analysis, a barcode is sprayed on the mail piece and the piece is sorted according to its destination (United States Postal Service 2007). If the computer is unable to read the address, the piece is placed in
a special handling container. The image, however, is sent to a second computer system called the remote computer reader (RCR) for additional analysis. If the RCR is unable to complete this, the image is sent through the Ethernet to a location called a remote encoding center (REC). There, the image is sent to a computer operator (who is located off-site) who enters the address information. The computer operator types in the correct information as they see it on their screen, and the information is then attached to the original mail piece via the Ethernet. This information is identified with the mail piece designated with an ID tag located on the back side of the letter. This mail is then processed back through the system and a barcode is then sprayed on the mail piece and sorted to its designated bin. The process takes about 15 to 20 minutes. This system has been deployed in about 260 sites. Originally, there were over thirty REC facilities in the nation, but as computers and technology improved, the need for these facilities significantly decreased. Currently there are two remaining sites nation-wide. As a result of this technology innovation over the past 30 years, about 95 percent of all letter volume is sorted to each carrier in the delivery sequence of their route each day. This has improved service to the customer because they receive earlier delivery and has reduced cost for the Postal Service.

This system has driven innovation not only for the Postal Service but also for the mailing community. Mailers who prepare large amounts of barcoded mail are able to take advantage of the Postal Service’s work share pricing, which provides price discounts by sorting the mail to a destination, thus reducing costs for the Postal Service.

Although these examples do not apply to retail operations directly, they serve to show that the Postal Service has used disruptive innovation in the past to reduce costs and improve service. They also demonstrate how this institution has been a key entity in the infrastructure development within the United States.
2.2 **Why Change Now?**

Today the Postal Service is faced with a much different disruptive technology, the internet. The internet has changed the face of virtually every business in the western world from agriculture to Wall Street. In light of the internet’s impact, many legacy industries, like banking, telecommunications and newspapers, are adjusting their business models as a way to survive.

The Pew Internet & American Life Project is a research center that tracks the percentage of Americans who use the internet and how often they use the internet. Since 1995, the usage of the internet has increased from about 10 percent to 78 percent as of November 2009 (Pew Internet & American Life Project 2009b). This research further highlights the increase of home usage by noting trend data on home broadband usage. This has increased from less than 5 percent in 2000 to 60 percent in 2009. See Figure 2.1 below:

*Figure 2.1 Home Broadband Adoption Since 2000*


(Pew Internet & American Life Project 2009a)
The Postal Service publishes the annual Household Diary Report which monitors changes in
customer preferences and uses of the mail. The Postal Service data from "The Household Diary Studies
Mail Use & Attitudes" (United States Postal Service et al. 2009) shows 78 percent of respondents to the
survey have internet access and 63 percent have broadband. The increase of broadband is relevant.
Broadband makes it easier to use the internet and could expedite the use of internet services in
replacement of first class services such as bill payment and receipt of statements by today's Postal
customers (United States Postal Service et al. 2009).

For the Postal Service, the advent of the internet is a disruptive technology. Unlike other
disruptive innovations such as the steamboat, railroad, and airplane, where the Postal Service was able
to use these technologies to decrease costs and improve service, the internet dramatically changes its
fundamental business model. Table 2.1 below highlights the change in the overall volume of the Postal
Service from 2000 to 2009.
### Table 2.1 Volume by Class of Mail For Fiscal Years 2000-2009

<table>
<thead>
<tr>
<th>Volume (000,000)</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Decline from '00 to '09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single-Piece</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Class</td>
<td>55,089</td>
<td>53,599</td>
<td>51,922</td>
<td>49,109</td>
<td>47,688</td>
<td>45,838</td>
<td>44,226</td>
<td>42,263</td>
<td>35,356</td>
<td>31,633</td>
<td>-42.6%</td>
</tr>
<tr>
<td>Presort Letters and Cards</td>
<td>48,437</td>
<td>50,056</td>
<td>50,456</td>
<td>49,949</td>
<td>50,239</td>
<td>52,173</td>
<td>53,249</td>
<td>53,635</td>
<td>51,936</td>
<td>47,934</td>
<td>-1.0%</td>
</tr>
<tr>
<td>Total First-Class Mail</td>
<td>103,526</td>
<td>103,656</td>
<td>102,379</td>
<td>99,059</td>
<td>97,926</td>
<td>98,071</td>
<td>97,475</td>
<td>95,898</td>
<td>91,897</td>
<td>89,770</td>
<td>-19.1%</td>
</tr>
<tr>
<td>Total Standard</td>
<td>90,057</td>
<td>89,938</td>
<td>87,231</td>
<td>90,359</td>
<td>95,964</td>
<td>100,942</td>
<td>102,460</td>
<td>103,516</td>
<td>99,084</td>
<td>82,706</td>
<td>-8.2%</td>
</tr>
<tr>
<td>Total Mailing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Services Volume</td>
<td>205,076</td>
<td>204,764</td>
<td>200,374</td>
<td>199,866</td>
<td>203,757</td>
<td>209,249</td>
<td>210,132</td>
<td>209,373</td>
<td>201,128</td>
<td>175,677</td>
<td>-14.3%</td>
</tr>
<tr>
<td>Express Mail</td>
<td>75</td>
<td>73</td>
<td>64</td>
<td>59</td>
<td>54</td>
<td>55</td>
<td>56</td>
<td>55</td>
<td>48</td>
<td>47</td>
<td>-37.0%</td>
</tr>
<tr>
<td>Priority Mail</td>
<td>1,222</td>
<td>1,118</td>
<td>998</td>
<td>860</td>
<td>849</td>
<td>887</td>
<td>927</td>
<td>897</td>
<td>852</td>
<td>790</td>
<td>-35.4%</td>
</tr>
<tr>
<td>Total Shipping</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Services Mail</td>
<td>2,404</td>
<td>2,280</td>
<td>1,972</td>
<td>1,863</td>
<td>1,752</td>
<td>1,800</td>
<td>1,780</td>
<td>1,788</td>
<td>1,575</td>
<td>1,381</td>
<td>-42.6%</td>
</tr>
<tr>
<td>Total All Volume</td>
<td>207,480</td>
<td>207,044</td>
<td>202,346</td>
<td>201,229</td>
<td>205,509</td>
<td>211,049</td>
<td>211,913</td>
<td>211,161</td>
<td>202,703</td>
<td>177,058</td>
<td>-14.7%</td>
</tr>
</tbody>
</table>

Data from Revenue, Pieces and Weight by class of mail and special service from FY2000-2009
Available at the [http://www.usps.com/financials/rpw/welcome.htm](http://www.usps.com/financials/rpw/welcome.htm)

1 Single-Piece First Class in Letters, cards, Flats, and Parcels
2 Change in reporting of volumes Single-Pieces on Flats and Parcels in FY2008. Flats and Parcels in the Single-Piece could contain some Presort for FY08 and FY09
3 Total Mailing Services volumes includes FCM, Standard Mail, Package Service (Parcel Post), and Periodicals
4 Express Mail includes Mailgram volumes for FY2000-2006
5 Total Shipping Services Mail includes Express, Priority, Parcel Select, Parcel Return Service and International Mail (USPS 2000-2010)

Although the change in volume is dramatic within each category, the single piece data is the most significant. Between 2008 and 2009, there was a drop of 12 percent in this category. When the internet graph and the First Class Mail volume are contrast, the differences are striking. Figure 2.2 displays the trends.
There are two reasons that this data is problematic for the Postal Service. The first is based on the revenue structure of the Postal Service. According to the Household Report (2008), the Postal Service makes $0.20 more revenue on First Class Mail (FCM) than on Standard Mail. Therefore, the decline of FCM volume has a considerable impact on the financial situation of the Postal Service. The second is based on customer visits to their local Post Office. Although many Americans still continue to purchase most of their mailing services at a Post Office, visits to the Post Office are quite likely to decline as First Class volume continues to decline.

2.3 What Does This Mean?

The data in the previous section indicates that overall volumes have significantly declined over the last three years. Some of this decline is due to internet diversion and some is due to the overall state of the economy in 2008 and 2009.

In the Household Diary Studies from 2006 through 2008, customer visits to the Post Office remained fairly consistent. The surveys revealed that between 83 to 85 percent of the respondents visited their local Post Office at least once a month. In 2009, only 61 percent of respondents stated that
they had visited their local Post Office at least once a month. But, in 2009, information may be misleading since it does not indicate how much of this decline is due to the internet, private service providers of Postal Services or private service providers such as the FedEx store and UPS store.

The Postal Service recently hired three consulting firms to forecast volume changes during the next ten years. As a result, the Postal Service now projects that the volume will continue to decline in the future but not at the same rate experienced in the last three years. The Postal Service is projecting that in 2020 mail volume will be 150 Billion pieces per year, approximately a 15.2 percent decline from 2009. This figure assumes a consistent rate of broadband adoption. If broadband adoption increases at a faster rate, the pessimistic volume projection is 118 Billion pieces per year (McKinsey and Company 2010; Boston Consulting Group 2010).

These trends suggest that Americans plan to continue to use the Postal Service products and services over the next ten years but at a lower rate. It also indicates that customers will most likely purchase less products and fewer sales will result when they do visit Postal Service outlets. Together, this indicates that the revenue per transaction will decline causing the cost per transaction to rise in the future. When placed in the context that the Postal Service, by law, is unable to expand or offer non-mail related products and services, the current model of stand-alone Postal-operated outlets does not appear sustainable. Yet, the Postal Service does offer other retail outlets a unique value proposition. For the right type of business, offering Postal products and services, could increase the services they offer to their customers, increase the foot traffic in their outlets, and increase the revenue of their business. This is the premise behind the Contract Postal Unit model. In this model, the Postal Service partners with an existing retail outlet. The retailer places a Postal Service provided module in their outlet and sells Postal Service products and services. This concept is a form of franchising which will be discussed in Chapter Five.
To be successful in light of declining volumes, the Postal Service must recognize that customers will have more choices during the next ten years to move many of their Postal transactions to other channels. Although the surveys conducted by McKinsey & Company (2010) suggest that they do not plan to move all their transactions, their experience with Postal Service outlets in the future will be consequential. This holds true for postal-operated units and for contract postal unit outlets alike. For this reason, it is critical for the Postal Service to define how it will meet the needs of its customers who utilize retail outlets, both now and in the future. The next section outlines a framework that the Postal Service could use to address the needs of its customers. The framework was developed by Christensen et al. (2007).

### 2.4 What is the Job to Be Done?

Christensen develops a hypothetical example he calls the “The Milkshake” to demonstrate his framework. It begins with a restaurant that wishes to improve their sales of milkshakes (Christensen 2010). The restaurant first studied focus groups to learn how they might improve their product. After enhancing their milkshake, they found that sales of milkshakes in their stores had not improved. Then, someone from their staff went into the field to research what went wrong. They found that most people were purchasing their milkshakes in the morning. After interviewing a few customers, the analyst learned that customers were purchasing their milkshakes not because they tasted good but, instead because they wanted to drink something while sitting in traffic on their way to work and as a way of filling them up until lunch. Christensen points out that the company thought initially that their customers “hired” their milkshake for the taste but learned they had really “hired” the milkshake to fight the boredom of driving to work in traffic and to fill up until lunch. The value of knowing one’s customers is the heart of the story.
Why do customers hire the Post Office? Customers “hire” a retail outlet of the Postal Service to enable them to get some type of item from their location to another. They also hire the Postal Service to provide other services for them, such as ordering a passport, having a picture taken for passports, getting a money order, or purchasing stamps for future mailing needs. Based on the Household Diary Study (United States Postal Service et al. 2009), sixty-one percent of them hire the traditional post office outlet at least once a month. But, why do these customers select this outlet? What situation are they trying to address by using this outlet? By concentrating on the “situation” instead of the “need”, the Postal Service will gain the insight to why customers hire them. In addition, such data might provide insights on how to find customers who may be underserved and using different outlets.

Doing the job of “finding the job”: Once the Postal Service has determined why customers have hired them, it needs to determine the job to be done. For example, the USPS learned that consumers wanted an easy way to send packages without having to worry about weight. The situation required the Postal Service to send a package without having to weigh the package. The job to be done was mailing at a flat rate that did not vary based on weight.

“Finding the job” requires close observation of customer practices before, during and after a transaction. It also requires surveys on customer preferences and usage as well as reviewing existing data such as customer feedback and inquiry records. Although customer complaints can be emotional responses, they may reveal trends that indicate “the job” they are looking “to hire” the organization to do.

Synthesizing insights – From the research, “the job” that customers are “hiring” the outlet to fulfill will be revealed. In the hypothetical case of the milkshake, the data indicated that customers were looking for a fast way to fight the boredom of driving and to fill-up. With this information, the restaurant created a milkshake with bits of fruit that made the milkshake a little bit more difficult to
drink through a straw and added variety to the taste. Since it was a little more difficult to drink, it lasted longer and the small bits of fruit filled them up more.

For a postal service outlet, customer feedback may reveal the need for expanded hours or self-service units. The “job to be done” would be to make automated units more available to customers who may be underserviced since they need to complete their transactions after traditional business hours. For the selection of franchise partners, one key factor to derive from the data would be to determine “when” customers are hiring the Postal Service (Christensen 2010). For example, if the data reveals that customers use the Postal Service when they are running errands, such as going to the grocery store or filling up their gas tanks, partnering with outlets in these businesses would enable customers to minimize the number of stops they make. By selecting a partner who aligns with this situation, the Postal Service could fulfill the “job to be done” when the “job needs to be performed”. This would lead to increased sales for the franchisee and for the Postal Service.

2.5 Conclusion

This chapter looked at how the Postal Service has used disruptive innovation in the past to improve service and reduce costs. It suggested how the Postal Service has a long history of partnering with private enterprise to deliver its products and services. Today, the USPS is affected by a new disruptive technology, the internet. Based on changing customer preferences and decreasing volumes, the Postal Service has to adjust its current retail model. Although the existing retail model is not sustainable, the USPS still offers value both to its customers and its potential retail partners. In light of these changes, the USPS needs to look at how they can continue to deliver value in their retail channels. Christensen’s framework offers one way for the Postal Service to determine how to better service their customers and retail partners. One of the key insights to this framework is to identify the situation in which the customer uses a retail outlet and when that situation arises.
Chapter 3  Overview of Franchising

3.1  Introduction

The previous chapter discussed how the Postal Service has demonstrated experience partnering with private enterprise in the areas of transportation through subcontracting. It also has experience with partnering with private enterprise to provide more convenient access to its customers. The current Contract Postal Unit program, which will be discussed further in Chapter Five, is a form of franchising. But before thoroughly introducing this model, this chapter will provide an overview of franchising and outline those key areas that should be considered when a franchisor is developing a business model. To elaborate on franchising as a business model, a series of interviews was conducted with two franchisees who own and operate a successful 7-Eleven store.

3.2  Overview

Franchising is a business model of licensing the rights of one firm (franchisor) to another firm (franchisee) to operate on the franchisor’s behalf by selling the franchisor’s goods and/or services (Gillis and Combs 2009b). In return, the franchisee agrees to pay a fee and royalties on the products sold. This business model provides companies with the ability to expand its business at a lower cost of capital and facilitates a way for a firm to expand to more geographic areas. But with expansion, the business gives up partial control and their brand may be placed at risk (Gillis and Combs 2009a; Combs, Michael, and Castrogiovanni 2009). Another concern is “free-riding” of the franchisee, which also can place a brand at risk (Michael 2000). “Free riding” occurs when the franchise delivers a lower quality product or service.

Yet, despite the risks, many firms have embraced this business model. Franchising has become an important part of the American economy. There are over 900,000 franchised establishments. In
2005, they generated over $880 billion in annual sales and employed over 11 million individuals in the United States (Combs, Michael, and Castrogiovanni 2009; IFA Educational Foundation 2005). There are many types of franchises from car dealerships to fast food restaurants. The International Franchise Association has split franchising into two categories, business format and product distribution (Combs, Michael, and Castrogiovanni 2009; IFA Educational Foundation 2005). Business format includes retail products and services, quick service restaurants, and business services. Product distribution includes car dealerships and bottling. Although there are similarities in both categories, this chapter will look at franchising in the retail trade, a part of the business format category.

There are two different ways that firms develop their franchising business model. Some firms choose to franchise all of their units, which are referred to as “turnkeys” (Gillis and Combs 2009b). In this model, the firm does not have any corporate-owned units and relies completely on franchisees. In the second type, “chain-builders”, the firm manages a mix of corporate-owned and franchised units (Gillis and Combs 2009b).

The franchisor provides the franchisee with brand recognition, training, and marketing of the product and services. The franchisee manages the day-to-day operation of the business and brings an element of tailoring of the product or services to the local needs of the region. Because of their knowledge of the local needs, the franchisee often brings an element of innovation to the business since they have the incentive to sell more of the product and services to increase their profits (Gillis and Combs 2009b).

3.3 Organizational Design

There has been considerable research completed on organizational design in the last 20 years. In determining the organizational design of its retail network, each firm has to determine key factors for
their business. In looking at the business landscape that exists today, there are three structures being used: 1. Corporate only owned; 2. Franchised only; and 3. Mix of franchise and corporate owned.

In regards to franchising, there are three strategic advantages. First, as mentioned above, franchising enables the firm to grow without the cost of capital. Second, franchising allows the firm to grow geographically while reducing the cost of monitoring. Third, franchising lets the firm concentrate on marketing its products and services, developing brand recognition and training for the franchisee.

A fourth significant advantage is the innovation a franchisee may bring to the firm. One example is the creation of the McDonald’s McMuffin. The Harvard Business School case on McDonald’s (Upton and Margolis 2002) notes that it was a franchisee who invented the Egg McMuffin. Franchisees were looking for ways to generate new revenues. Herb Peterson, a franchisee owner in Santa Barbara, CA, wanted to develop a morning food that complemented the McDonald’s regular menu. He experimented with a few ideas in which customer’s could eat their food with their fingers and eventually came up with the breakfast sandwich. The corporation then took the idea and, with a few modifications, the Egg McMuffin was created.

There are disadvantages of the business model as well. Using the franchising model, the firm has less control of their products and services. Since the franchisees do not work directly for the firm, they have a tendency not to invest in new technologies and/or renovations (Gillis and Combs 2009b). In addition, as the franchisee adjusts to local market conditions, the firm could find there is a high variability in the products and services between outlets.

In fact, in a comparison of firms with the franchising only vs. only corporate-owned units of the restaurant and hotel industries, the firms that utilized franchising had lower ratings of quality (Michael 2000). It was also found that these franchise only firms could provide the “right type” of incentives for the franchisees and thus mitigate the lower quality risk. One example is rewarding only those franchisees with high quality rating with the opportunity to obtain more franchises. Michael (2000) also
found that franchisors with high growth potential were likely to have higher quality than those with lower growth (Michael 2000).

3.4 Organizational Design- Corporate owned only

Firms that have selected the corporate-owned organizational design are concerned with control and standardization. Some of the examples of firms with this model are FedEx Office, Red Lobster and Chipotle. These types of firms emphasize standardization and use extensive management information and monitoring systems. They build incentives for their managers based on sets of standardized metrics (Gillis and Combs 2009a).

This type of design gives the firm “strategic flexibility” (Michael 2000) and offers a way for experimentation with new corporate products, promotions and facility modernization (Gillis and Combs 2009b; Bradach 1997). These firms typically have structured, monitoring systems in place to drive standardization and include such practices as site visits, the use of mystery shops, and extensive ongoing communication with managers (Bradach 1997). This higher level of monitoring across geographic regions usually means a rather bureaucratic and hierarchical organizational form (Yin and Zajac 2004) with multiple levels.

Although the emphasis of standardization and compliance can result in high brand reputation, it may create disincentives for an innovative culture as well as adaptation to the needs of the local markets (Yin and Zajac 2004; Ketchen, Combs, and Upson 2006). These firms do not always receive accurate feedback on products and services since local managers have an incentive to state what they believe the firm wants to hear (Bradach 1997).
3.5 Organizational Design- Franchise only

There are many well known companies using the franchising-only model, such as Subway, Mailbox Etc./UPS Store, and Moe’s Southwestern Grill. With this model, firms build strong, refined processes that the franchisee purchases from the franchisor (Gillis and Combs 2009b). The franchisor concentrates on marketing its brand, improving its business processes, and training the franchisees. In general, the franchisor makes money through selling the franchise outlets via a franchising fee and collecting royalties from the sales.

Because the franchisee has incentives that encourage sales and high performance, this model, typically, requires less monitoring, than the corporate-owned model. Thus, it enables the firm to have a wider geographical dispersion (Combs, Ketchen, and Ireland 2006). It also creates incentives for the franchisee to address local market needs (Combs, Michael, and Castrogiovanni 2009). The model also encourages innovation in response to the needs of customers. (Combs, Michael, and Castrogiovanni 2009).

Franchise-only organizations are, however, at risk of variability between outlets which can lead to lower quality than found in the corporate-owned model (Combs, Michael, and Castrogiovanni 2009; Michael 2000). Variability is also of particular concern in the area of market promotions and new investments such as unit remodeling. In this model, the firm has to convince the franchisee through persuasion (Gillis and Combs 2009b) since it is likely to not be a part of the original contract.

3.6 Organizational Design- Mix of Corporate owned and Franchises

In this model, the firm has both corporate owned and franchised outlets. Some examples are McDonalds, 7-Eleven, and Hilton. The strategic advantage of this model is the ability for a firm to gain the geographic dispersion and “entrepreneurial spirit of innovation from their franchisees as well as standardization from the corporate owned outlets” (Gillis and Combs 2009b; Combs, Ketchen, and
Ireland 2006). This is the strategy of many firms seeking strong brand reputation (Combs, Michael, and Castrogiovanni 2009; IFA Educational Foundation 2005). In many cases, the corporately owned units are located in the same market as the franchised units.

Bradach (1997) studied five major restaurant chains that each had a mix of corporate and franchisee units. He found that companies using this structure gained both uniformity and system-wide adaptation. Corporate units developed standardization and information through management information systems where the franchisees brought a local element and served as “devil advocates” for new adaptations. The companies found that each of the unit types influenced one another creating “friendly competition” thus encouraging improvements in both types.

Franchisees within this structure provide a way for the company as a whole to generate feedback on new product proposals (Bradach 1997). Since the livelihood of each franchisee is dependent on the success of the franchise, their feedback is, typically, honest and direct (Bradach 1997; Combs, Ketchen, and Ireland 2006).

The firm, however, is at risk for inconsistency between outlets. This is particularly of concern when promotional offerings are made (Gillis and Combs 2009b). The firm is unable to offer regional exclusivity to franchises, which has been found to be a factor of franchisee success (Michael and Combs 2008). This structure can be more costly than the other organization designs since the firm has to create both a corporate infrastructure as well as a franchisee infrastructure (Bradach 1997).

3.7 Operating Model

Beyond the organizational design, a number of additional factors need to be addressed when developing a franchising business model. Of particular importance is the operating model of the organization. The operating model is defined by the relationship between standardization and integration (Ross, Weill, and Robertson 2006).
In franchising, the franchisor is selling the franchisee a proven system that helps the franchisee’s business grow and thrive. Within this system, each firm has to define their need for integration and standardization. Ross, Weill and Robertson (2006) define standardization and integration as follows:

“Standardization of business processes and related systems means defining exactly how a process will be executed regardless of who is performing the process or where it is completed. Process standardization delivers efficiency and predictability across the company.” (page 27)

“Integration links the efforts of organizational units through shared data. This sharing of data can be between processes to enable end-to-end transaction processing, or across processes to allow the company to present a single face to customers.” (pages 27-28)

In general, the retail store channel does not have much integration between the outlets. Each customer transaction is a unique event at each individual store and does not affect another outlet. On the other hand, the need for standardization is high. With a high level of standardization, the business processes have been clearly defined to create a system. This system provides consistency for the customers, the employees, and the suppliers.

For example, if Sally purchases milk and bread from “ConvenienceStore #1”, this information is not relevant to “ConvenienceStore Store #2” located across town. To the “ConvenienceStore” Corporate Office, however, there is a concern that Sally gets the same shopping experience whether she stops at store #1 or store #2. In fact, it is likely that her experience at store #1 could influence her decision to return #1 or visit store #2 in the future. For this reason, the ConvenienceStore Corporate Office would want to have standardized business processes to provide Sally with a consistent experience at each of the “ConvenienceStore” stores.

Ross, Weill and Robertson (2006) outline four operating models. Each of the models is defined by the level of standardization and integration needed for the company to accomplish their mission. There are four models which include: Coordination, Unification, Diversification, and Replication. Coordination and Unification are highly integrated, whereas, the Unification and Replication are highly
standardized models. In general, most retail franchised firms would select a Replication model. Figure 3.1 displays and describes the four models.

**Figure 3.1 Ross Weil and Robertson Operating Models**

<table>
<thead>
<tr>
<th>Business Process Integration</th>
<th>Coordination</th>
<th>Unification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High</strong></td>
<td>- Shared customers, products or suppliers&lt;br&gt;- Impact on other business unit transactions&lt;br&gt;- Operationally unique business units or functions&lt;br&gt;- Autonomous business management&lt;br&gt;- Business unit control over business process design&lt;br&gt;- Shared customer/supplier/product data&lt;br&gt;- Consensus processes for designing IT infrastructure services; IT application decisions are made in business units</td>
<td>- Customers and suppliers may be local or global&lt;br&gt;- Globally integrated business processes often with support of enterprise systems&lt;br&gt;- Business units with similar or overlapping operations&lt;br&gt;- Centralized management often applying functional/process/business unit matrices&lt;br&gt;- High-level process owners design standardized process&lt;br&gt;- Centrally mandated databases&lt;br&gt;- IT decisions made centrally</td>
</tr>
</tbody>
</table>

| **Low**                     | - Few, if any, shared customers or suppliers<br>- Independent transactions<br>- Operationally unique business units<br>- Autonomous business management<br>- Business unit control over business process design<br>- Few data standards across business units<br>- Most IT decisions made within business units | - Few, if any, shared customers<br>- Independent transactions aggregated at a high level<br>- Operationally similar business units<br>- Autonomous business unit leaders with limited discretion over processes<br>- Centralized (or federal) control over business process design<br>- Standardized data definitions but data locally owned with some aggregation at corporate<br>- Centrally mandated IT services |

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Drawing on the “ConvenienceStore” example, the Corporate Office would want high standardization and low integration since each of the individual stores do not need to have information beyond their store but need high standardization since the business processes of each “ConvenienceStore” should be the same. They would want the “Replication” model. Standardization would create the same customer experience across stores as well as create efficiencies across stores.

The Replication model also provides the franchisee and franchisor with additional benefits beyond customer consistency. It also serves as a tool for the franchisee to become more efficient in their processes through information sharing, to drive profits through information gained about customers, and reduce operating expenses through the coordination.
Based on this foundation, other factors such as branding, communication vehicles, compliance and monitoring, regulation and business entities, pricing, contracting, and the information technology infrastructure can be defined. Each of these factors is dependent on the other factors but they are addressed separately below to highlight some of the unique characteristics of each factor.

3.8 Branding

When an entrepreneur makes the decision to purchase a franchise, Michael and Combs (2008) found that there are three factors that increase the likelihood for success: brand reputation, training, and the franchise relationship (Michael and Combs 2008). Branding is a significant part of the franchising model. When using a franchising model, the firm has to define its brand and decide on how to preserve it. With the retail franchising model, brand equity and quality work hand-in-hand. Quality is defined not only in terms of cleanliness and level of service (Michael 2000) but also in the consistency and the uniformity between the outlets (Blair and Lafontaine 2005). It is this standardization that builds the brand equity of the company, creating an environment in which each customer can depend on certain levels of quality and service no matter what retail outlet they visit.

Protecting the quality of the brand is an important part of developing the contract between the franchisor and franchisee. Many franchisors develop contracts that create incentives to protect the brand. These incentives include monitoring and compliance, quality standards, and adherence to standardize business processes.

Ultimately, it is consistency that drives customer loyalty to a brand (Blair and Lafontaine 2005), which in turn promotes growth of the company. In the case of a franchise model, growth adds monetary value, which in turn, creates wealth for both the company and the franchisee.
3.9 Communication Vehicles

Communication between the franchisor and franchisee is a key success factor as well as communication between franchisees. Many franchisors have set-up franchisee associations or franchise advisory councils as a vehicle to facilitate communication and collaboration between franchisees (Gillis and Combs 2009b). In addition, successful firms set-up local, regional and national meetings where franchisees can share and collaborate on ideas to drive business and spread an entrepreneurial spirit throughout the organization (Gillis and Combs 2009b). The monitoring structure of the firm is also another way to communicate and encourage standardization, innovation, and collaboration with one-on-one feedback between the field representative and the franchisee (Gillis and Combs 2009b).

3.10 Compliance and Monitoring

As mentioned in the previous section, franchisors use their contracts with franchisees as one way to gain compliance from its franchisee. The other way is through monitoring. Upton and Margolis (2002) note that McDonald’s has over 221 field consultants who each visit over 20 restaurants in the United States several times each year. 7-Eleven has a structure in which every field representatives is assigned eight to ten stores (7-Eleven Franchisee Owner Interview 2010). These field representatives visit each of their stores once to twice a week. During these visits, they monitor quality and process adoption. These field representatives also share innovations from other stores to help individual stores increase their profits.

Across companies, the level of monitoring varies greatly. Some firms use mystery shops, others use field representatives, and some use a combination of both (Gillis and Combs 2009b; Bradach 1997). Ultimately, the franchisor has to return to the question of brand equity. When a firm wants high brand equity and reduced “free-riding” or non-compliance with standardization practices, they will want to build an infrastructure that has consistent monitoring and contractual incentives.
3.11 Regulation and Business Entities

Franchising raises a number of legal issues. Franchising is a licensing agreement between two firms, the franchisor and the franchisee. This relationship is regulated through the Federal Trade Commission. The trade regulation is referred to as Rule 436 and sets forth the minimum amount of disclosure required by the franchisor to enter into a franchise agreement. In addition to the federal regulation, there are a number of states that have additional regulations pertaining to disclosures (Sherman 2005). Within the regulation, there are two types of business format franchises, 1. package and product, and 2. business opportunity ventures. Andrew Sherman’s (2005) work is summarized in Table 3.1 and 3.2.

Table 3.1 Sherman’s Summary of Legal Requirements for Package and Product Characteristics

<table>
<thead>
<tr>
<th>Package and Product Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The franchisee sells meet the franchisor’s quality standards (in cases where the franchisee operates under the franchisor’s trademark, service mark, trade name advertising, or other commercial symbol designating the franchisor).</td>
</tr>
<tr>
<td>2. The franchisor exercises significant assistance in the franchisee’s method of operations.</td>
</tr>
</tbody>
</table>
| 3. The franchisee is required to make payment of $500 or more to the franchisor or a person affiliated with the franchisor either before or within six months after the business opens. (Pages 266-267) 

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1 RAISING CAPITAL by Sherman. Copyright 2004 by AMACOM BOOKS. Reproduced with permission of AMA BOOKS in the format of Dissertation via Copyright Clearance Center
Table 3.2 Sherman's Summary of Legal Requirements Business Opportunity Ventures

<table>
<thead>
<tr>
<th>Business Opportunity Ventures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The franchisee sells goods and service that are supplied by the franchisor or a person affiliated with the franchisor.</td>
</tr>
<tr>
<td>2. The franchisor assists the franchisee in any way with respect to securing accounts for the franchisee, or securing location or sites for vending machines or racks displays, or providing the services of a person able to do either.</td>
</tr>
<tr>
<td>3. The franchisee is required to make payment of $500 or more to franchisor or a person affiliated with the franchisor whether before or within six months after the business opens.</td>
</tr>
</tbody>
</table>

(Pages 267)²

There are a number of caveats that apply to these regulations. Fractional franchises, leased-department arrangements, and purely verbal agreements are exempted from the regulation (Sherman 2005). Clearly, this is an area that a firm needs to carefully research to ensure they are working within the regulations. Fractional or partial franchises are business agreements where the franchisor finances more of the franchise investment (Azevedo and Silva 2007). One example is the 7-Eleven Convenience stores franchise model (7-Eleven Franchisee Owner Interview 2010). In a fractional franchise, the corporation actually owns or leases the retail space. In return for the reduced investment by the franchisee, the franchisee pays a rental fee in addition to the traditional royalty and advertising fees. The franchisee is also responsible for all the furniture and equipment in the unit.

There is one more type of franchising called a “management contract”. In this type of franchise, the franchisor takes care of everything but the management of the unit. In exchange, the franchisee pays an additional administration fee, which is based on the sales as well as the rental fee and the royalty fee. In some cases, there is not a franchise fee (Azevedo and Silva 2007).

² RAISING CAPITAL by Sherman. Copyright 2004 by AMACOM BOOKS. Reproduced with permission of AMA BOOKS in the format of Dissertation via Copyright Clearance Center
It is worth noting that joint ventures, strategic alliances and co-branding are other business structures that can be used by firms that are thinking about franchising. In a joint venture, the firm would partner with another a firm. In a joint venture, two firms come together in a medium to long-term agreement. Both firms make an investment and joint ventures are considered a legal entity (Sherman 2005). A strategic alliance is short term in nature and is more flexible than a joint venture. A strategic alliance is not a legal entity (Sherman 2005).

Another option many firms have pursued is “co-branding”, which is also termed “multi-brand”. In this option, two businesses come together in an informal business relationship together to add value. In retail, one example of co-branding is Taco Bell and Pizza Hut, when they offer customers the option of products. In some cases, the businesses pool their resources and, in other cases, each of the businesses co-exists in one location and do not share resources, only a location. Another method of co-branding is for the retail outlet to buy another franchise to place in the retail outlet. In 2000, Subway had the most co-branded locations in convenience stores (Traczek 2000). Firms that pursue this option need, of course, to find brands that are complementary.

3.12 **Pricing**

In terms of pricing the franchise, there are many different approaches that franchisors have adopted. Contracting and pricing are two instruments that franchisors use to drive franchise growth, process compliance and customer satisfaction. Most franchise contracts include both a franchise fee and royalty fee. The franchise fee is a one-time fee that the franchisee pays at the beginning of the franchise contract. The royalty fee is a recurring payment that is based on the sales of the franchisee. This payment could be based on the net profits, gross revenue or some combination thereof.

The *2006 Profile of Franchising (2007)* notes that franchise fees range from $4,331 for the Sports and Recreation industry to $6,485,250 in the hotel industry. This large range is based on the scale of
the franchise and what is included in the franchise fee. In a survey of 1,125 business format franchisors, Blair and Lafontaine (2005) found that the median franchise fee was $20,000 with a range between $5,000 and $30,000. This survey also found that only 20 out of the 1,125 did not charge a franchise fee and 20 charged more than $50,000. The survey also showed a large variation between the sectors.

Royalty fees also vary greatly. The 2006 Profile of Franchising (2007) showed a median rate of 6.7 percent with a range from 4.6 percent for Restaurants and Lodging to 12.5 percent for Personnel Services. The survey by Blair and Lafontaine (2005) showed a median rate of 5 percent. In this survey, 8 percent of the franchisors did not charge a royalty fee. In most cases, these franchises charged a fixed rate per week or month. In addition, some of the franchises charged rates based on a decreasing scale as sales went up. There were a few cases where fees went up as sales went up but this was rare (Blair and Lafontaine 2005).

In addition, many firms charge an advertising fee. The 2006 Profile of Franchising (2007) report showed that an average of 79 percent of firms charged a national advertising fee and 41 percent charged a local advertising fee. The range for national advertising fees was 0.08 percent in the personnel services sector to 3 percent in the automotive sector. The average was 2.0 percent. The local advertising percentage also had an average of 2.0 percent but the range was from 1.0 percent in the travel sector to 2.2 percent in the maintenance services sector. The survey results by Blair and Lafontaine (2005) found that many franchisors do not make a clear distinction between the royalty fee and the advertising fee. This survey showed that many franchisors who had a large royalty fee did not charge an advertising fee. The combined advertising and royalty fees were 7 percent of sales.

It is worth pointing out that some franchisors do not charge any fees since they sell their product to franchisees for resale and, thus, are able to profit from this transaction. Some franchisors pay the franchisee based on the percentage of products/services sold as an incentive. And, some
franchisors charge much higher fees based on the services they provide the franchisee as is the case in the partial franchise and management contract organizational design.

For the franchisor, the franchise fee and royalty/advertising fee is a classic economics transfer pricing problem. The higher the percentage the more difficult it is for the franchisee to profit on their investment. This could lead to a high franchisee failure rate (Michael and Combs 2008). Conversely, the franchisor must profit as well and still cover the costs of training, advertising, and brand development.

3.13 **Contracting**

Contracting is one of the most complex components of any business but, in franchising, it is even more complex. It is through contracting that the franchisor is able to exert control over its franchisee owners. Franchisors use contracting to "incentivize" the franchisee to meet the overall strategic goals of the organization. For example, to protect quality and reduce non-compliance of business processes, a firm may have a clause in the contract that enables the franchisee to purchase multiple units within an exclusive territory based on some type of monitoring (Michael 2000; Combs, Ketchen, and Ireland 2006). Highlighted below are some of the clauses that franchisors utilize. The first two, "contract duration" and "contract uniformity" are found in the majority of contracts.

*Contract duration* - Franchising contracts range from 5 years to 20 years in length. The mean contract length was 10.7 years in 2001 (Blair and Lafontaine 2005). There is high variation in the length of contracts across industries. The data also showed that 91 percent of all the contracts were done in 5 year increments (Blair and Lafontaine 2005). Franchisors with more experience had a tendency to use longer contracts (Blair and Lafontaine 2005; Brickley, Misra, and Horn 2006).

For the franchisee, one of the key elements of the contract duration is return on investment. The longer the contract, the more opportunity the franchisee has to profit on their initial investment. For the franchisor, there are concerns of "free-riding" or non-compliance with longer contracts (Michael...
since it is difficult to terminate contracts. In addition, it is difficult for the franchisor to change the terms of the contract in regards to such matters as royalty and advertising fees as well as remodeling costs (Brickley, Misra, and Horn 2006).

**Contract Uniformity** – Based on economic theory, franchisors could profit from modifying their contracts based on market factors. Yet Blair and Lafontaine (2005) found that over 42 percent of franchisors do not negotiate with franchisees on the rates. Furthermore, the same study found that 38% of the remaining respondents only discuss modifying non-monetary factors when negotiating with potential franchisees.

**Other Factors** – A summary of additional clauses that firms have included in their contracts follows. These are typically used less often that those mentioned above.

1. **Prior industry experience** – To increase the likelihood of success, many firms will include in a clause requiring that the franchisee has to have a certain amount of industry experience (Combs, Ketchen, and Ireland 2006; Michael and Combs 2008).

2. **Active franchisee management** – This requires the franchisee owner to be actively involved in the daily operation of the franchisee (Combs, Ketchen, and Ireland 2006; Michael and Combs 2008). Normally this is specified in terms of average number of hours per day that the owner must be involved. It does not mean that the franchise owner is necessarily physically present in the unit (Brickley 1999).

3. **Exclusive territories and/or Multi-unit and/or area development agreements** – This clause gives the franchisee the right to own more than one unit in a certain area. It is called an “area development agreement”. The franchisor, therefore, has to deal with only one franchisee across multiple units.

4. **Product updating** – Some franchisors in the contract include clauses related to the quality and product updating (Blair and Lafontaine 2005).
5. Training – Some franchisors require a set amount of training time for all franchisees (Gillis and Combs 2009b; Michael and Combs 2008).

3.14 Information Technology Platform

In the age of the internet, franchisors are able to create information technology platforms that create value for both the franchisor and the franchisee. These systems address not only the back office functions for the franchisee but also how the front line can maximize sales. If properly designed, these systems drive innovation within the individual outlets as well as system-wide.

Bradach (1997) claims that one of the major differences between corporate-owned and franchised outlets is the management information system deployed. These systems can summarize costs, provide information about consistency of the customer experience to the front office, and assist the franchisee with information on how to maximize the profits. These systems can be off-the-shelf or customized systems developed in-house by the franchisor.

In making the determination of in-house development vs. off-the-shelf purchases, many firms outsource those functions that are not proprietary. They develop in-house systems for those functions that are considered a competitive advantage. Information technology can also be used to optimize supply chain management.

Many franchisors have increased their use of information technology. 7-Eleven Japan is one such firm (Nagayama and Weill 2004). 7-Eleven has built a full service suite of information technology programs to maximize profits in their units. For example, their systems include the ability to track sales of products by location in the store, track inventory, and monitor the profitability of individual sales. This information enables its franchisees to experiment with products to maximize their sales. With this information, the franchisee can predict sales by time of day and day of the week for labor scheduling.
The 7-Eleven America website highlights some of the features of their proprietary Retail Information System (RIS) (7-Eleven 2010).

**Table 3.3 Retail Information System for 7-Eleven America Website (2010)**

<table>
<thead>
<tr>
<th>Highlighted Features of 7-Elevens Retail Information System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Touch-screen point-of-sale (POS) cash registers with scanners</td>
</tr>
<tr>
<td>The integration of credit-card authorization and gasoline sales into the POS register</td>
</tr>
<tr>
<td>Item-level information to assist in making product-ordering decisions</td>
</tr>
<tr>
<td>Hand-held Mobile Ordering Terminals to facilitate ordering</td>
</tr>
<tr>
<td>Tools to help store personnel determine appropriate product assortment and slow-moving items</td>
</tr>
<tr>
<td>Daily weather reports and merchandising information and updates</td>
</tr>
<tr>
<td>The automation of some daily reporting requirements, such as merchandise and gasoline sales, and a payroll time-keeping mechanism</td>
</tr>
</tbody>
</table>

(7-Eleven 2010)

One of the reasons that business entrepreneurs look to purchase a franchise is to gain access to a standardized operation, operating manuals, training, and brand equity. An information technology platform is a way for firms to facilitate this knowledge sharing. Many firms have gone to online manuals and online training as a way to keep their franchisee’s updated on the latest trends and facilitate standardized training. It also gives firms an opportunity to tailor training to the demographics of the local communities, especially those firms that serve multi-language areas.

### 3.15 Summary

Many businesses have incorporated franchising into their business models. Franchising offers these enterprises a means to incorporate an entrepreneurial spirit of innovation to grow and improve its business while establishing some controls of standardization to maintain and even enhance its brand. The role of this chapter was to demonstrate that the franchising is a business model that can be tailored to support an operating model of a firm. In developing a successful franchising business model, the firm...
must address each of these components in their model to ensure each component complements and supports other components if desired results are to be obtained.

A summary of this chapter is provided in Figure 3.2 with each of the components. This framework provides a way of thinking about franchising comprehensively and, with a modest addition described in the last chapter, offers a way for the Postal Service to think about completing successfully in today’s franchising environment. Before examining the franchising framework further, I will review the franchising systems adopted by four foreign posts.
Figure 3.2 Franchising Framework
Chapter 4  Franchising in Four European Posts

The European posts have moved, by and large, towards privatization. Postal reform in Europe began in the 1960's with the reform of the British Post, Royal Mail (Crew et al. 2008). The largest reform took place in 2008 in the European Union with the passing of the Third European Postal Directive (Crew et al. 2008). This will end Postal monopolies in Europe by 2011 for most countries and, by 2013, for the remaining countries in the European Union. Most of the European posts have been either completely privatized with private investors or commercialized, with the government as the primary owner.

In a report by Accenture (2008) produced for the Postal Service, the structure of foreign posts is organized into four groups: State Enterprise, Government Corporations, Government Departments, and Privatized Corporations. Of the twenty-three posts studied by Accenture, only one is a government department, nine are state enterprises, ten are government corporations, and three are privatized corporations. The definition of each grouping is listed in Table 4.1:

<table>
<thead>
<tr>
<th>Grouping</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Department</td>
<td>Administered by a political appointee or part of a ministry</td>
</tr>
<tr>
<td>State Enterprise</td>
<td>Commercial flexibility, independent from direct administrative authority</td>
</tr>
<tr>
<td>Government Corporation</td>
<td>Organized under private corporate laws, but government as sole or majority shareholder</td>
</tr>
<tr>
<td>Privatized Corporation</td>
<td>Private Corporation with minority government shareholders</td>
</tr>
</tbody>
</table>

Postal reform raises the question of what is the value to society of universal service and access. As a post moves toward a profit or even a non-profit based structure, the cost of providing service to rural areas is highlighted. To resolve this issue, many foreign posts have looked for creative solutions, particularly in the area of retail access. For many of these posts, franchising or partnering with an existing retail business has been a solution. Partnering enables the post to provide access, reduce costs
and hopefully, provide convenience to their customers. Many European posts have applied franchising not only to rural areas but also to urban and suburban areas (Crew et al. 2008). This chapter will discuss briefly the retail franchise models of four foreign posts: La Poste, Australia Post, Deutsche Post, and Royal Mail. These posts were selected for two reasons: 1. They franchise, and 2. They have readily available information (in English) about their franchise model.

Each of these four foreign posts offers a wide range of products and services well beyond providing mailing products and services. These include some type of banking services. There is a mix of postal-owned and franchise outlets. In most cases, retail partners offered a reduced variety of the products and services offered in a postal-owned unit. All have utilized franchising as a way to provide their products and services to those customers in rural areas. Some of the posts have mobile post offices for remote areas. The majority have adopted a remuneration payment system. Following this system, the franchisee is paid a flat fee plus a commission based on their sales of postal related products and services. At least one of the posts charges the franchisee a technology fee. Two of the Posts have created “traditional” franchise models but there is limited information on their success. In contrast, one of the posts will not allow a stand-alone outlet.

4.1.1 Groupe La Poste

Groupe La Poste is a one hundred percent state owned enterprise (Accenture 2010). It has 17,082 public outlets. Of those outlets, 5,632 are retail partnerships ((Groupe La Poste Website 2010). It began the retail partnership in 2003 (La Poste Press Group 2006).

**Types of Outlets:**

**Corporate outlets** – These outlets offer mail services, banking, insurance, and miscellaneous products

**Relais Poste** (postal intermediaries) – Retail partnership that is conjunct with another retail outlet. They offer mailing services as well as some banking services

**Agences Postales** (Community Postal Agencies) – Mailing and some banking services
**Payment:** Remuneration – Flat Fee and Commission. In 2006, flat fee was 250 euros/month (300 euros in priority areas) for Relais Poste (La Poste Press Group 2006). The commission was based on mailing services (Groupe La Poste Website 2010).

**Geography:** 90% of French people are no less than 5 kilometers from a public outlet (Groupe La Poste Website 2010)

### 4.1.2 Australia Post

The Australia Post is a state owned enterprise (Accenture 2010). It offers a wide range of mailing products and services as well as services, such as bill payment, for more than 750 Australian businesses and government bodies in their outlets (Australia Post 2010). More than half of their customers utilize these services.

**Types of Outlets:**

- Corporate offices: 827 outlets which offer all available types of transactions.
- Licensed Post Offices (LPOs): 2969 outlets. It has both stand-alone outlets and outlets that are conjunct with another business. LPOs offer a mandatory range of Australia Post products and services. Some of the services conducted for other bodies are in all locations. Some LPOs complete mail processing and delivery duties.
- Community Postal Agents (CPA): 890 outlets. 90 percent are conjunct with another business. CPAs conduct mailing services as well as counter delivery services.
- Franchise: 3 to 28 outlets. The product and services offerings are unknown. Franchisee attends four to five months (unpaid) training.

**Payment:**

Licensed Post Offices, Community Postal Agents and Franchises have different structures.

- Licensed Post Offices (LPOs): Remuneration – Fees and commissions are based on performed work. LPOs can purchase Australian Post at a discounted rate. The LPOs pay a technology fee.
- Community Postal Agents (CPA): Flat rate based on the specific duties of the CPA and a representation allowance. CPAs receive a ten percent discount on sale of postage stamps. They also receive additional payments for counter delivery service.
- Franchise: Franchisee pays a franchise fee at the beginning of the contract. The Franchisee also pays a service fee and technology fee as well as all the labor, cleaning, shrinkage and business services costs. Australia Post pays for the rent, property management and maintenance, advertising and promotional materials, build-out and equipment, and electronic point-of-sale
technology costs.

**Access:**
93.4 percent of residences in metropolitan areas are within 2.5 kilometers of an outlet.
87.5 percent of residences in non-metropolitan areas are within 7.5 kilometers of an outlet.

**Contract:**
Licensed Post Offices (LPOs): no term
Community Postal Agents (CPA): 2 year term
Franchise: 10 year term
(Australia Post 2010; Australia Post Website 2010)

4.1.3 **Deutsche Post**

The Deutsche Post is a publicly traded corporation (Accenture 2010). Deutsche Post has a total of 17,000 retail outlets, which include corporate and retail partner outlets. The Post began retail partnering in 1993. In its 2009 Annual Report, the Post mentioned that it used mystery shoppers as a monitoring tool for its retail outlets. About 57% are partner operated ((Accenture 2010).

**Types of Outlets:**
- Postbank: 855 branches; offer all Deutsche Post mail and parcel products and services.
- Corporate outlets: Deutsche Post mail and parcel products and services as well as additional products such as Packsets. It also offers basic Postbank services.
- Retail partner: Retail partners operate in conjunction with a partner business. It offers a range of services based on size, location and demand of the outlet. Some of the locations offer basic Postbank services. Retail partners have a Deutsche Post module placed in their outlet.
- Point of Sale: These are retail outlets that sell only stamps with no additional services.

**Payment:**
- Retail partner: Remuneration – Flat Fee and Commission based on sales
- Point of Sale: Commission based on sales.
(Deutsche Post Corporation 2010a; Deutsche Post Corporation 2010b)
4.1.4 Royal Mail Group

The Royal Mail is the English post. It is has about 12,000 Post Offices branches. The majority (97 percent) are franchise or subpostmaster partners (explained below). They offer more than 170 different products and services (Royal Mail website 2010). The Royal Mail has three general outlet types. They have a special feature for very small communities called outreach services.

Types of Outlets: Corporate owned: 337

Franchise partners: These units can be conjunct with the existing retail outlet of the owner. These are large locations that offer a full range of products and services. This type of location has a “combi-store format” which means that the postal products and services do not need to be in a separate location within the outlet. This reduces the staffing requirements of the retailer.

Subpostmaster: There are three different types of subpostmaster categories. The subpostmaster can either purchase an existing site from an existing subpostmaster. The applicant is responsible for the build-out as well as developing a business plan for review.

Rural: These outlets have one to two counters and serve small communities. It can be conjunct with another retail business.

Suburban: These are mid-size outlets with up to five counters. This unit can be in conjunct with another business. It offers the majority of products and services.

High Street: This is a large outlet with over six counters, which offers a full range of products and services.

Outreach services: Provides services to customers in communities that cannot support a post office outlet. These offerings are performed by an established subpostmaster. There are four different types of offerings with this program:

Mobile post office: Customers receive post office services via a mobile unit that visits communities at set times and days each week. Mobile units offer the majority of products and services.

Hosted service: This service operates in a local community building at set times and days each week. The majority of products and services of the Royal Mail are offered.

Partner service: This exists in conjunction with another business. About 80 percent of products and services are offered.

Home delivery service: Available to very small communities. Customers place orders by telephone and products are delivered by core subpostmasters.
Payment: Subpostmaster: Remuneration – Flat Fee and Commission. Subpostmaster is responsible for build-out of the location. Franchise: One-off (custom made) franchise fee paid by the franchisee. Franchisee does not pay ongoing royalties but is paid through remuneration.

Access: 93 percent of the population lives within one mile of a branch

Contract: Franchise: 7 year

(Royal Mail website 2010; Royal Mail - Post Office Ltd 2010)

4.2 Summary

There is a good deal of variability in the franchising structure of the studied foreign post. This variability may be driven by the newness of the model since, in most cases, franchising is less than ten years old with the exception of the Deutsche Post. Over time, wider adaptation of one particular structure may become the standard as more is learned. Yet, this brief overview of the different systems does serve as something of a benchmark. But, caution is necessary since there is limited public data available on whether franchising has, in fact, reduced costs or increased profitability for either the post or the retailer. Customer satisfaction with the model remains an open question. Only one post, La Poste, published customer, shopkeepers, and local elected official satisfaction information. In a press release, La Poste indicated that a survey indicated a “high level of general satisfaction” with the country’s post (Groupe La Poste Website 2010). The survey indicated that 90 percent of the public, 87 percent of the town halls, and 95 percent of the shopkeepers were “satisfied” or “very satisfied” with Relais Poste and/or the Community Postal Agency (APC). The report indicated that 82 percent of the public believe that partnerships strengthen communities by helping to keep the shops open and attracting new residents.

In March 2009, the National Federation of SubPostmasters, an employee association of the Royal Mail, surveyed their membership of subpostmasters (National Federation of SubPostmasters 2009). Of the 775 respondents, 80 percent indicated that their post office existed in conjunction with another business. The report also indicated that the majority (66%) of those offices with a conjunct
business would “probably” or “definitely close” without the post office. Although this does not measure the level of satisfaction of the subpostmasters, it does indicate that the retail partnership is adding value to these outlets.

Most of the public information on each of these posts indicates that the emergence of franchising has been a fluid process. The Duestche Post released two different press reports that each noted modifications to the retail model (Deutsche Post Corporation 2005; Deutsche Post Corporation 2004). With the possible (and likely) changes in customer preferences and decline of mailing transactions in the future, the franchise and retail partnership model of these posts will continue to evolve.

This brief overview of the franchising concepts utilized by the foreign posts offers insight on how the Postal Service may want to modify its Contract Postal Unit program for expansion. It also indicates that most foreign posts have created systems tailored to the particular needs of their respective countries. The next chapter will briefly review the retail history and current design of the USPS with particular attention directed to the Contract Postal Units. In addition, it takes up the application of the franchising model to the Contract Postal Unit program in the USPS.
Chapter 5  Application of Franchising Framework to the Postal Service

By partnering with private enterprise through the use of franchising, the Postal Service can offer an opportunity to retailers to increase their revenue, their foot traffic, and service offerings and enhance their overall customer relationship. This is the basis of the Contract Postal Unit program. In 2009, Contract Postal Units accounted for 10.5% percent of the Postal Service’s retail network (USPS 2010j). This chapter is divided in two sections, the history of retail operations and its current structure, and the application of the application of the franchising framework outlined in Chapter 3. The application will pertain to the expansion of the Contract Postal Unit program.

5.1 History of United States Postal Service Retail Operations

From its beginnings in 1775 when it was first established to carry communications between the Continental Congress to the Revolutionary armies, the Postal Service and its Post Offices have been an integral part of the history of the United States. In 1789, Samuel Osgood became the first Postmaster General. At that time, there were 75 Post Offices (United States Postal Service 2007). Today, the Postal Service has over 36,000 post offices, classified stations, branches and carrier annexes, contract postal units and community post offices (USPS 2010j). Both in years past and present, the local Post Office has served as a central point of a community and means for customers to have access to secure means of communication throughout America. This chapter will highlight the history of the Post Office retail outlets and review the history of the USPS’s use of contracting with private enterprise to serve its customers’ retail needs.
5.2 **Brief Historical Overview of Retail Access**

In its Annual Report of 2009, the Postal Service denotes four types of retail outlets: Post Offices, Classified Stations and Branches, Contract Postal Units, and Community Post Offices. Post Offices are postal-owned units that are broken up into three additional categories: main Post Office, Classified Stations and Branches. The main Post Office is the central office of a community. Stations are sub-units that report to the Main Post Office within the city limits of the main Post Office. This structure was first created around 1863 as a means to offer free city delivery to the most populated areas of the United States ([USPS Historian 2006](#)). A branch functions like a station but it is outside of the city limits of the main Post Office. There are a number of historical reasons for these distinctions.

In the late 1890s, the Postal Service began to experiment with increasing access to its customers through the use of contracting with private enterprise with the introduction of contract stations ([USPS Historian 2006](#)) pg. 3. These contract stations were located in drugstores or businesses convenient to the customer. According to the USPS Historian (2006), “Storekeepers bid for an annual contract, whereby they received a lump sum to provide space in their stores.” Payment to the offices was done via a flat fee. This arrangement benefited the customer with increased access, the storekeeper with increased foot traffic and the Postal Service with a decreased need for hiring and for new post offices. By the 1960s, these contract stations were referred to as “unit” ([USPS Historian 2006](#)).

In 1973, another type of contract unit was created to serve small rural communities called the Community Post Office. These units include the rural stations and rural branches that were created in the late 1890s when rural free delivery was established. There are 797 Community Post Offices in existence today ([USPS 2010](#)).
5.2.1 Partnering with Private Enterprise – 1980s to Present Day

Since the 1980s, the Postal Service has been experimenting with several types of partnerships with private enterprise as a way to increase customer access, increase revenue, and reduce costs while allowing customers the added convenience at purchasing postal services at a venue where they regularly visit such as supermarkets and gas stations. As these programs matured, the USPS has refined their processes and service offerings based on knowledge gained from experience. Some of the historical programs have recently been revisited with a plan to retire them over time. When reporting the performance and revenue of these programs, the Postal Service does not report the data of each individual program, but instead, reports the sum of these programs as “Alternate Access” (USPS 2010j).

Today, there are four types of retail access where the Postal Service partner’s with private enterprise: USPS Approved Shippers, Contract Postal Units (includes Community Post Office), Post Office Express, and Stamps on Consignment (USPS 2010f). In addition to these four programs, the Postal Service offers additional “alternate access” programs through online and Postal-owned channels. These programs include USPS.com, Automated Postal Center (APCs), and Stamps by Mail/Fax. Below is a description of programs in which the Postal Service partners with private enterprise (USPS 2010f).

The Approved Shippers is a program in which a commercial enterprise, such as an office supply store or an independent shipping and mailing retailer, can offer USPS products and services. The retailer does not receive compensation for selling postal shipping services but can charge the customer a service fee. These vendors can also sell products and services that compete with the Postal Service like FedEx, UPS and DHL. The retailer is provided USPS branding rights and signage (USPS 2010j). In June 2008, there were over 2,000 participating retail locations (USPS 2008).

A Contract Postal Unit (CPU) exists within another company’s retail outlet and is operated by its own employees. Although the contract unit has been in existence since the 1890s, the Contract Postal Unit actually represents a relatively new program. In 2003, the USPS announced that they would begin
testing the Contract Postal Unit in the southeast part of the United States (USPS 2004)(USPS 2005). It differs from the traditional Contract Unit concept in two ways. First, Contract Postal Units have incentive based payments. Their payment is based on the postal services sold by the retailer. Second, the Postal Service provides a module to be placed in the outlet. The module has a similar look as Postal-owned retail outlets. As part of the agreement, the partner cannot sell other competing brands. In 2006, the Postal Service reported that 28.7% of its 4,200 CPUs (note: this number includes Community Post Offices) were performance based (USPS 2007). Many of the contract units prior to that time have been on a flat payment system. In 2009, the USPS reported that there were approximately 3,037 CPUs (USPS 2010)).

The first Post Office Express (POE) unit was opened in 1995. This unit is similar to a CPU in that it located in a partner’s facility but it is operated by Postal employees. The partner must sell US Postal products exclusively. All USPS products and services are offered in these units. There is a monetary exchange for lease of the space in the outlet. Like the CPU, there is a module. In June 2008, the Postal Service reported that there were 16 location nation-wide (USPS 2008).

The last program is Stamps on Consignment (SOC). The vendor must sell the stamps at or below postal prices. There is no compensation for selling stamps but it is a service that banks, drugstores, convenience stores or similar venues use to help increase their sales and serve their customers (USPS 2010f).

In 2009, the Postal Service reported that alternate access represented 29% of its total retail sales (USPS 2010b). The Postal Service has seen a steady increase of customers using alternate access channels. It is expected that each of these channels will continue to increase, especially the sales on USPS.com. This increase translates to an anticipated decline in customer visits to local Postal-owned outlets and drive the cost per transaction higher in the Postal-owned retail network upward.
It is for these reasons that franchising offers the Postal Service a lower cost alternative if it is to continue to serve its customers in a manner that is both convenient and customer-centric. For retailers, it offers the opportunity to increase foot traffic, make additional revenue, and offer a convenient service to their customers. With a daily average of seven million customer visits in 2009, the Postal Service has the potential to generate value for its customers and business partners (USPS 2010g).

5.3 Application of the Framework

The original framework outlined in Chapter 3 needs one additional component, Partner Selection. This component addresses one of the distinct differences of the USPS program and what is thought of as the “traditional” franchising. In a study published by International Franchising Foundation (2002) on multi-unit franchises, it was found that 16% of the total franchised-owned units are actually multi-brand or co-located outlets. Some examples of multi-brand outlets are Dunkin-Donuts with a Baskin-Robbins or a Subway in a franchised gas station or convenience store. As I have noted, many of the European posts have adopted a multi-brand franchising model. This type of franchising addresses the fact that a stand-alone unit based solely on mailing transactions may not be sustainable in the future. But, when offered as an additional service, it can add value and convenience for customers and generate additional sales in the current established business. The Contract Postal Unit program is essentially a co-location or multi-brand outlet. This incorporates the “When” factor from Chapter 2 of the Christensen’s framework. The Contract Postal Service Framework is displayed in Figure 5.1.
5.3.1 Organizational Design

The organization design of the current Postal Service is largely postal-owned units. In 2009, the Postal Service reported 27,161 Post Offices, 5,501 Classified Stations, branches and Carrier Annexes, 3,031 Contract Postal Units, and 797 Community Post Offices (USPS 2010j). As highlighted in the franchising chapter, there are three different options, corporate owned, franchise only, or a mix of franchise and corporate owned outlets. There is not a formula for determining the "correct number" of
corporate owned vs. franchise outlets. Most firms experiment to find the right mix for their organization. For the Postal Service, there are two key aspects to address in this regard: 1. the geographic access of its customers and 2. the products and services offered at each outlet.

Some of the foreign posts have used a combination of access per percentages of the population. For example, the Canadian Post operates with the retail access expectations for the country such that 98 percent of the populations will have a postal outlet within 15 km; 88 percent within 5 km; and 78 percent within 2.5 km (Government of Canadian - Minister of Transport 2009). The USPS could develop its own formula to measure retail access, an “access factor”. This factor could take into account both geographic access and outlet type. Below is an illustrative way to develop and apply an “access factor” approach.

**Geographic access:** The development of a geographic access aspect of the “access factor” could be accomplished by dividing outlets into three categories: rural, suburban, and urban. This would be similar to the Royal Mail (Royal Mail website 2010). The Postal Service could then measure access within the different categories by the percentage of outlets per population percentage. This would also serve as a measure of underserved areas as well as saturated areas.

**Outlet type:** The mix of postal owned and contract postal units could be based on the products and services offered and the employee skill set needed to service these transactions. Customers using the brick-and-mortar channel are in large part, individual customers and small businesses. Internal data shows that many of the consumer and small business transactions performed at retail outlets could be performed at a CPU (Postal official interview, 2010). There is a portion of retail consumers that use the Postal Service for more complex transactions such as direct mail. This type of transaction requires more skill and, thus, would be more suited for a postal-owned outlet. Using this information, the Postal Service could develop three categories of outlet types: full complement (postal-owned), partial complement (CPU) and general products (Stamps On Consignment).
The two aspects of “geographic access” and “outlet type” are not mutually exclusive. Within each geographic category, there would be an outlet type defined. For example, within the rural category, there would be three different types of outlets, full complement, partial complement, and general products.

Based on this framework, the USPS could then measure the “access factor” of the organizational design. In addition, by applying a revenue factor, the organization could measure the “access factor efficiency”. This efficiency factor could be tracked over time to determine when different areas should change an outlet type from full complement to partial complement or partial complement to general products. This process would both track the changing customer’s preferences and adjust to these changes.

To summarize in steps, in developing an organization design for the retail network, the USPS would:

1. Clearly define “geographic access” and the “outlet type”.
2. Divide the outlets into geographic categories, such as rural, suburban, and urban, and experiment with access levels to determine the geographic areas that may be underserved or saturated for each of the different categories.
3. Divide retail access in different outlet types, such as full complement, partial complement and general products.
4. Combine the two aspects to create categories. In the example, there would be nine categories – Rural-full complement, rural-partial complement, rural-SOC, and so forth.
5. The organization would then experiment with the “access factor” and “access efficiency” for the different geographic and outlet types to determine the optimal mix.
5.3.2 **Operating Model**

The operating model defines the level of integration and standardization of the business. In general, a firm with retail outlets needs an operating model with a higher degree of standardization to ensure the retail experience of each customer is the same across outlets and a lower degree of integration since the success of each outlet is not dependent on other outlets. For example, a Postal Office in Cambridge, MA does not need the unit-specific information such as the revenue or customer data for the Post Office in Hartford, CT to promote its own goals.

In managing retail outlets, the Postal Service would want to adopt a Replication operating model. This emphasizes a high degree of standardization and a low degree of integration.

5.3.3 **Training**

The training package is one of the key factors used by potential franchisees in their evaluation of the franchise model (Gillis and Combs 2009b). By developing a comprehensive training package, the Postal Service would hope to achieve standardization and thus improve customer service and revenues. There are several franchising leaders that the Postal Service could look to for help in developing their training program. One example is the Hamburger University run by McDonalds (McDonalds 2010). McDonalds franchisees have to complete a skill based training program that can take from nine months to twenty-four months to complete. Another example is 7-Eleven. It has its franchisee’s complete three weeks of classroom training followed by ten days in a training store to demonstrate the classroom application (7-Eleven (America) 2010). A third example is the Australian Post. It has its potential franchisee complete a six week, unpaid training course (Australia Post Website 2010).

Training is also a tool that the franchisor can use to determine the franchisee’s level of commitment. It also gives the franchisor an opportunity to emphasize the company culture, the value of
its business processes, its desire to enhance customer service, and the role that innovation and customization can play in the organization.

The Postal Service would need to design a course that covers not only how to conduct a sales transaction but also a course that covers the importance of standardization for customer service, a course that teaches the monitoring and compliance expectations, and a course that spells out the Contract Postal Unit's role in customer service and innovation in the retail network.

5.4 **Compliance and Monitoring**

Compliance and monitoring reinforce training. Lack of compliance would place the Postal Services’ brand at risk. Most companies that utilize franchising create a structured approach to compliance and monitoring through the use of field representatives who visit the franchisee and check for compliance (Upton and Margolis 2002; 7-Eleven Franchisee Owner Interview 2010). For example, the Royal Mail created a structure where the subpostmaster from larger Post Offices have the responsibility of monitoring these contract offices (Royal Mail website 2010).

The Postal Service currently utilizes a number of compliance and monitoring methods for its postal-owned outlets, some of which include on-site visits, email exchanges, telephone calls, and mystery shops. USPS adopted a new program, Customer Experience Measurement, (CEM), administered by an independent market research firm that provides survey data feedback to the organization (USPS 2010e). In March, the Postal Service released CEM results for Quarter 1 of Fiscal Year 2010. One of the indicators measures its customer’s experience when visiting a Post Office. 81.8 percent of residential and 76.6 percent of small and medium business customer rated their “Post Office experience” as “very satisfied” or “mostly satisfied”. Following these measures over time as the Contract Postal Unit program is expanded will be quite helpful.
In developing the monitoring and compliance system, the Postal Service needs to first determine key indicators such as wait time-in-line, adherence to business processes, and overall customer experience. Second, USPS would establish a method(s) for measuring these indicators. Third, USPS must develop the infrastructure to support the measurement of each indicator.

### 5.4.1 Communication Vehicles

Communication is the means to share information and create an environment of trust between the franchisee and franchisor. Gillis and Combs (2009) found that firms that had established high levels of communication had a high level of trust. This, in turn, led to higher revenue and performance than firms that had low levels of communication. They also found that communication between the franchisees leads to the emergence of a culture of innovation. Some of the tools used by franchises are advisory councils, newsletters, on-site visits, email exchanges, and phone calls (Gillis and Combs 2009b; Bradach 1997).

One example of the Advisory Council is the Australian Post which has a license advisory council. The franchisee members are elected by licensees and, then, appointed by Australian Post management. There are six state councils and one national council. They meet up to six times a year. These councils assist with product development, advertising and marketing (Australia Post Website 2010).

Another tool for enhancing communication is a newsletter. Some of the uses of a newsletter are to connect franchisees through sharing success stories, to communicate upcoming changes in the organization, for example, a software update, and share information on how franchisees have increased revenue and reduced costs.

The Postal Service already has two existing organizations to promote communication: the Mailers’ Technical Advisory Committee (MTAC) and the Postal Customer Council (USPS 2010d). The Mailers’ Technical Advisory Committee (MTAC) is made up of Postal management and members of
different mailer associations on a national level. The committee has a number of permanent and ad-
hoc sub-committees that work with Postal management on tactical technology and strategic issues
related to direct marketing mail preparation. The second example is the Postal Customer Council (PCC),
which operates mainly at the local level. The PCCs include local Postal management and local mailers. It
is a networking tool for local mailers and enables the Postal Service to communicate pertinent issues
that may affect them in the future. It also serves as a vehicle for these customers to provide feedback
on customer related service issues. The Postal Service also has an example of a newsletter for direct
marketing mail professionals called MailPro. This is published bimonthly (USPS 2010a). It covers future
changes to regulations and industry news.

5.4.2 Pricing

The Postal Service has a number of options on pricing its franchise model. The current system
pays the Contract Postal Unit a commission on the products and services sold. The level of payment for
the different services has incentives built into the model (Interview with Postal official, 2010) that ideally
promotes alignment with the strategic goals of the USPS. The model is based on the Postal Service
products and services as a supplemental offering to existing services of an existing retail outlet. The
Postal Service provides the Contract Postal Unit with a module that becomes the location in the retail
outlet where the postal transactions will occur. The Contract Postal Unit is responsible for the labor
costs associated with sales and the space for the module.

The current pricing model creates incentives to promote the sale of postal products and services
both for overall sales and by product line. The disadvantage of the current system is that it may not be
attractive to small rural outlets where the potential sales are smaller. Another pricing plan is the
remuneration model. This pricing plan has been adopted by several of the foreign posts who offer
programs that are similar CPU program. The remuneration model pays both a flat rate and a commission for the products sold.

The Postal Service might be able to better attract small retail outlet owners in rural areas by using the remuneration model. This would guarantee a small fixed income to the retailer in return for offering the postal products and service while maintaining sales.

In sum, one way the Postal Service could redesign its current CPU pricing structure is by varying the payment structure by the "geographic access" categories that were suggested in section 5.3.1. For example, for the rural category, the Postal Service could offer a remuneration plan. For the other categories, it would continue with the existing commission based pricing.

5.4.3 Contracting

Contracting is the means that firms use to create legal incentives and controls that create alignment between its franchisees and the corporation's strategic goals. The factors of the Postal Contract Unit contract would differ from outlined in Chapter 2 since the business model for the CPU builds on a multi-brand location and is not the sole revenue of the retail outlet. The emphasis of the contract would be on duration, adherence to business processes, security of the mail, and training based on the operational strategy of USPS.

5.5 Information Technology Platform

The information technology platform for the franchising model should facilitate the ability of the firm to reinforce standardization, compliance, monitoring, customer satisfaction and payment. It should also serve to give the franchisor knowledge of the transactions that are generating revenue and those that are not. It should enhance the profitability of both the franchisee and franchisor.
Information technology systems are costly but the information gained from a well designed system can pay dividends in the long term as well as the short term. Both the English and Australian posts highlight their information technology platforms as strategic benefits to potential franchisees (Australia Post Website 2010; Royal Mail website 2010). The Australian post levies a technology fee on its franchisee units. This could be an option for the USPS. The information technology system has the ability of not only delivering value to both the Postal Service and its retail partner but also strategic advantage to its brand.

5.5.1 Partner Selection

The selection of the retail partner is critical if the Contract Postal Unit program is to grow and be successful. The postal products and services need to complement the existing business partner. Using “geographic access” categories for outlets could prove useful in developing criteria for partner selection. In urban and suburban areas, it may be useful, for example, to partner with supermarket chains. This may not be so useful in rural areas that do not have chain outlets. In rural areas, it may be possible to partner with general stores or local gas stations. To thoroughly develop this concept, the buying patterns of consumers would need to be studied and knowledge gained on how and when customers purchase Postal products and services. Since the Postal Service has been experimenting with this retail partner concept since 2005, an analysis of the success rates of the units and type of businesses would also be useful. In addition, it would be useful to obtain customer satisfaction information for the different types of businesses to understand if some business types have delivered services better than others.
Chapter 6  Conclusion

This thesis reviewed the United States Postal Service’s retail network, and how the Postal Service might expand the use of its Contract Postal Unit program. To understand the changing retail environment and whether the USPS could adopt to such a change, I reviewed the history of the Postal Service and demonstrated their ability to not only embrace innovation in the past, but use it to better service their customers. The Postal Service has a long tradition of partnering with private enterprise. Moving towards an expanded CPU program could be regarded as a natural progression as a means to deliver better service to customers. To enhance the customer experience, in light of their changing preferences, I outlined a process to define not only “how” and “why” the customer uses the USPS retail network but “when” a customer visits an outlet. In terms of expanding the CPU program, I argued that the “when” is critical. Careful consideration and research into the “when” may well help in the selection of retail partners to ensure that the retail expansion provides added convenience to customers.

Since the Contract Postal Unit program is a form of franchising, I have also has looked at how the Postal Service might build a stronger expansion program. I demonstrated that most key franchising elements apply to the CPU program. In the areas of organizational design, training, compliance and monitoring, communication, and information technology, I developed and recommended a planning process for the Postal Service to consider. These recommendations are based on a review of the literature on franchising practices, the innovation of foreign posts, and postal knowledge gained from both Postal officials and my own experience. I close this thesis with general broad suggestions for the Postal Service to consider for future research.

I believe that the expansion of the Contract Postal Unit offers the Postal Service a way to increase its retail access to customers. It, also, offers a way for the Postal Service to significantly decrease transactional retail costs by 33-41% (USPS 2010c). A recently published USPS report notes that
the average cost at a Postal owned outlet is $0.31-$0.39 per dollar of retail revenue whereas the cost of a Contract Postal Unit is $0.13 (USPS 2010c). This indicates the economic advantage Contract Postal Units represent compared to the traditional Postal owned outlets.

One area for further research is, though, the overall cost impact of increasing retail access to the overall retail network and the consequence(s) of moving these transactions from a Postal owned outlet to a retail partner. Campbell and Frei (2010) found in a three year study on the affects of online services, in one bank, that the use of one service delivery technology may affect service consumption and costs across all delivery channels. In fact, they found that the service consumption increased, presumably due to the added convenience, thus, increasing the overall delivery costs. The USPS may find that the added convenience of additional outlets may simply move its transactions from one outlet to another. If the Postal Service is not able to adjust to the decrease in transactions at Postal owned units by reducing its labor costs and/or reducing its Postal owned outlets, it may find that the average cost per dollar of retail revenue for the entire retail network will increase, at least in the short term.

However, the authors of the same banking study found that during the same period, there was an increase in customer retention and satisfaction, thus, suggesting the true value of the additional delivery channel is the ability to increase customer retention and satisfaction and the ability to attract new customers (Campbell and Frei 2010). If research within the Postal Service replicated this finding, the Postal Service may find that the customer retention and satisfaction is of higher value for survival in the market place than the differences in the costs of the retail network.

Finally, I suggest that considerably more research on USPS stakeholders is required. I have relied mainly on publicly available information. Many more interviews with customers, employees, additional postal service officials, representatives of foreign posts, and existing Contract Postal Unit partners would provide much needed information which would be extremely useful in determining the future vision of the retail network.
In conclusion, the United States Postal Service has a long tradition of serving the American people. In the past, the Postal Service has been the mainstay of each community throughout the United States, a meeting place where family and friends could visit while conducting their business needs. In the age of the internet, these physical meeting places have given way to virtual ones. To continue to connect with the American people, the Postal Service must evolve to serve to their customers at their meeting places of today. By doing so, it will build a retail network for the 21st century.
References


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Christensen, Clayton M. 2010. Lecture series and meeting - attended four part lecture series in February 2010 at MIT Sloan by professor christensen. one of the lectures was about the "job to be done" framework. the milkshake example is from this lecture. in a discussion in April 2010, professor christensen shared the concept of determining "when" is the job done and under what circumstances. (Feb - Apr).


