Chapter 2

Will Entrants into a Liberalized Delivery Market Attract Investors*

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1. INTRODUCTION

The purpose of this paper is to examine the question of whether entry into a liberalized letter delivery market would be attractive to venture capital investors. At the outset it should be recognized that such an enterprise would be quite risky. Competition by a startup against an established incumbent who enjoys significant scale economies could be quite difficult. For example, CityMail, an entrant against the incumbent Sweden Post, began operations in 1991 and has twice gone into bankruptcy. It has had several primary shareholders including most recently Norway Post and prior to that Royal Mail. While CityMail is currently profitable, we can say with perfect hindsight that it would not have attracted investors if its original business plan had been analyzed correctly by them.[1,2]

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* The views expressed in this paper are those of the authors and do not necessarily represent the opinions of the Postal Rate Commission.

1 Publishers Express in the United States is another delivery startup. It had an all star lineup of investors (including Time, Inc., Meredith Corp. American Express and R.R. Donnelly). Publishers Express delivered mail excluded from the letter monopoly for a couple of years before it folded in the mid-nineties.

2 An investment in a business like CityMail might be more attractive after bankruptcy than as a startup. This could happen if at time of bankruptcy the business had built significant scale or the startup losses were wiped off the books.

In this paper we develop a financial model of an entrant into the U.S. letter mail delivery market in order to evaluate the economic feasibility of the required investment. The cream-skimming model from our graveyard spiral paper (Cohen et al. 2004) provides inputs to the financial model. We conduct sensitivity analysis on the variables used in both models to determine their relative importance. We then calculate the internal rate of return (IRR)[3] for specific values of the most important variables. This provides insight into the likely success of an entrant in attracting adequate startup capital, which is a precondition for successful entry.

2. THE SWEDISH EXPERIENCE

Sweden has the only liberalized letter mail market with an entrant that has garnered significant portions of the market. It thus provides the only source of information for a financial analysis of entry into a newly liberalized market. CityMail reports that it was in the black for the first quarter of this year and for the first time it is heading for a positive result for a full calendar year (2004).[4]

Table 1: CityMail Volume and Shares (1992-2003)

Year	Volume (Millions)	Share of Total Swedish Mail Volume	Year	Volume (Millions)	Share of Total Swedish Mail Volume
1992	18	1%	**1998**	152	4%
1993	19	1	**1999**	167	5
1994	29	1	**2000**	148	4
1995	36	1	**2001**	174	5
1996	54	2	**2002**	192	6
1997	116	3	**2003**	216	7

Average Annual Volume Growth	
1992-2003	**25.6%**

Table 1 displays CityMail's growth and market share. Delivery operations began in 1991 with 1992 being the first complete year of operations. CityMail targeted bulk computer-generated mailings destined for the city of Stockholm. In 1996 service expanded to the areas

[3] IRR is a standard financial measure used to evaluate investment opportunities. See Section 3.2 for a definition of IRR and Section 5.3 for a discussion of minimum values considered necessary to justify investments.

[4] Email from CityMail, May 12, 2004.