

**BOOKSPAN-T-2**

**BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001**

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**RATE AND SERVICE CHANGES TO  
IMPLEMENT BASELINE NEGOTIATED  
SERVICE AGREEMENT WITH BOOKSPAN**

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**DIRECT TESTIMONY  
OF  
MATTHIAS EPP  
ON BEHALF OF  
BOOKSPAN**

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## Direct Testimony

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### 4 **1. Autobiographical Sketch**

5 My name is Matthias Epp. I am Senior Vice President Media & Internet at  
6 BOOKSPAN. I have been with BOOKSPAN since 2000. Prior to working for  
7 BOOKSPAN, I was the Chief Marketing Officer at DealPilot.com and held senior  
8 positions in catalog management and new member acquisition marketing at BMG  
9 Direct. I started my career in corporate development functions at Bertelsmann  
10 AG. I graduated from The Koblenz School of Corporate Management (Koblenz,  
11 Germany) with a degree in management, and from the Graduate School of  
12 Business at the University of Texas at Austin with a Master's Degree in Business  
13 Administration.

### 14 **2. Purpose of Testimony**

15 The purpose of this testimony is as follows. First, I describe the history of  
16 BOOKSPAN, and place BOOKSPAN in its industry context. Second, I describe  
17 BOOKSPAN's approach to marketing, and how mailing decisions are made in the  
18 context of its marketing plans. Finally, my testimony briefly reviews  
19 BOOKSPAN's volume history and volume forecasts, including the before-NSA  
20 and after-NSA forecasts, and places those projections in context for  
21 BOOKSPAN.

1 **3. Background on BOOKSPAN and its Industry Context**

2 BOOKSPAN's primary mission is to provide the public with a superior  
3 book buying and reading experience through targeted editorial selection, great  
4 savings, and exemplary customer service. We are achieving this mission by  
5 operating various book clubs that are either general interest clubs, or designed to  
6 serve specific groups of consumers with common reading interests. General  
7 interest clubs encompass a variety of fiction and non-fiction topics, such as diet  
8 and exercise, reference, biography, cooking, history, and children's books.  
9 Specialty clubs offer books and related merchandise that are specific to certain  
10 genres, such as mystery, science fiction, religion, hunting and fishing, gardening,  
11 romance, and particular professional interests (e.g. nursing). We offer titles that  
12 have been editorially selected at competitive, discount prices.

13 Although there are a few other companies offering book clubs, our  
14 greatest competition is from retail establishments and on-line sales. Our book  
15 club offerings compete directly for sales with the many other shopping venues  
16 open to our customers which offer discounted books. Our most formidable  
17 competition is from large discount chains (such as Walmart, Target, and other  
18 discount general merchandise and drugstore chains that sell inexpensive books),  
19 large buying club stores (such as Costco, BG's and Sam's Club), and on-line  
20 shopping sites (such as Amazon, Borders, and Barnes & Noble). Large retail  
21 booksellers such as Borders and Barnes & Noble are also competitors.  
22 Scholastic and TrollCarnival have competitive children's book clubs.

1           While it is difficult to generalize on book sales trends industry-wide, book  
2 publishing is popularly described as a mature industry. Industry statistics  
3 suggest that the overall rate of growth in the book publishing industry is relatively  
4 flat.<sup>1</sup> These same statistics indicate that a combined category of book club and  
5 mail order sales is declining at a rate of roughly nine percent per year since  
6 2002. There are, however, a lot of shifts in sales among categories of books.  
7 For example, we can generally observe that while sales of many categories of  
8 books have been declining overall over the past few years, sales of children's  
9 books and religious books have increased over the same period.

10           Despite broad competition in a relatively flat market, BOOKSPAN  
11 attributes its continued success to its editorial expertise, its constant  
12 experimentation with new marketing and business development ideas, its  
13 understanding of and ability to respond to its customers' preferences, and its  
14 success in managing operational costs and achieving economies of scale.  
15 BOOKSPAN's members value three essential characteristics of BOOKSPAN's  
16 clubs: the convenience of at-home delivery, editorial pre-selection of titles, and  
17 price advantage.

18           Since BOOKSPAN uses the mail both to serve existing customers and  
19 reach new customers, postage costs are obviously a major factor influencing  
20 BOOKSPAN's business. Other factors which have influenced BOOKSPAN's  
21 ability to grow its business – not necessarily in order of importance – are:

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<sup>1</sup> Management Practice Inc., *Estimated Book Publishing Industry Net Sales*,  
<http://www.publishers.org/industry/index.cfm> (Association of American Publishers 2004).

- 1 • the general state of the economy (the disposable income of our target  
2 markets, and their expectation of future disposable income);
- 3 • BOOKSPAN's success in the selection and offering of popular books (our  
4 ability to pick best sellers in advance);
- 5 • the cost and price of the books (both our ability to negotiate a good price  
6 on our bulk purchases, and the discounted price we charge our  
7 customers);
- 8 • the perceived value of our enrollment offers (e.g., number of free books,  
9 introductory charges, additional premiums, and purchase commitment);
- 10 • the regulatory climate (e.g., which has moderated our use of  
11 telemarketing); and
- 12 • the availability and pricing of good mailing lists (a factor we further  
13 address below).

14 As with any direct mail marketer, the availability and pricing of good lists is  
15 a critical success factor. A good list of rental names can provide us with our  
16 most valuable members – those demonstrating both good credit and purchasing  
17 behavior. BOOKSPAN spends a significant amount of financial and other  
18 resources up front on acquiring each new member, with the hope that this  
19 member will buy not only the few books that they agree to buy to allow us to  
20 break even, but additional monthly or catalog selections. Generally speaking, it  
21 is these purchases beyond the required commitments that provide the return on  
22 our investment. Using a weak list can result in a low response rate, or a  
23 disproportionate number of new members who purchase only the minimum

1 quantity of books or (even worse) who fraudulently break their membership  
2 agreement, or it can result in members where – due to high costs – the cost of  
3 acquiring each member is less than the expected future contribution from such  
4 member. So BOOKSPAN recognizes that the health of the list industry – the  
5 availability and pricing of good direct marketing lists – is essential to our ability to  
6 replenish our membership base each year and eventually grow our book club  
7 business.

#### 8 **4. Marketing at BOOKSPAN**

9 BOOKSPAN invests a lot of money in advertising and marketing to  
10 acquire new members. Potential customers receive highly attractive introductory  
11 offers at our risk. Basically, in exchange for receiving several books at a nominal  
12 price plus shipping and handling, new members agree to a minimum purchase  
13 commitment (typically four books over two years). Members have the option to  
14 purchase our monthly selections at our discounted prices for the duration of their  
15 membership. They are obligated to let BOOKSPAN know, approximately every  
16 three to four weeks, in response to our mailed catalogs and notices, whether they  
17 intend to decline the monthly selection (e.g., by returning a negative option card).  
18 Members typically receive our current book catalog seventeen times per year.

19 BOOKSPAN grows its membership through direct marketing. As a direct  
20 marketer, BOOKSPAN manages a portfolio of marketing channels and programs  
21 to promote its clubs. Of course, we use direct mail: primarily Standard Mail  
22 letters and flats. We use print advertising, which would consist of on-page  
23 advertising in various magazines such as *Ladies' Home Journal* or *Good*

1 *Housekeeping*, and other publications such as *The New York Times Book*  
2 *Review*. We market through inserts into newspapers and enclosures in third-  
3 party mailings and shipments, through telemarketing and through the Internet.

4       The percentage that each media represents in our overall marketing  
5 portfolio shifts, largely depending on price and relative effectiveness. These  
6 media are priced very differently, and there are vast differences in the  
7 effectiveness of the various channels. On average, the cost to reach one  
8 consumer is much lower in print advertising, inserts and enclosures, and Internet  
9 advertising, relative to the costs of a typical Standard Mail piece. However, our  
10 ability to target customers with a common set of characteristics is generally  
11 superior through the mail than through print ads. For this reason, we find that  
12 direct mail, while more costly on average, is frequently more effective in terms of  
13 response than print advertising. As to telemarketing, relatively recent changes in  
14 the regulatory climate have tended to limit our telemarketing activity.  
15 Nonetheless, we use all available media to reach potential customers.

16       Our marketing plan is developed through a complex and circular process.  
17 We begin with annual growth, revenue, cost and profitability goals that are set by  
18 our corporate owners. Based on various business metrics such as historic  
19 revenues, costs, and profitability, our existing club membership figures, how  
20 many books an average club member will purchase, and the duration of a typical  
21 club membership, we develop an overall marketing budget that we expect would  
22 enable us to meet our owners' goals.

1           Also, BOOKSPAN is constantly designing new potential marketing  
2 campaigns for each of its forty existing clubs, and for its prospective new clubs.  
3 Our media managers and their teams – print, mail, telemarketing and Internet –  
4 are responsible for the campaigns specific to their particular marketing medium.  
5 Our marketing managers are responsible for the marketing success of specific  
6 club brands. Together they develop a set of marketing campaigns for each club  
7 brand. We plan hundreds of campaigns per year.

8           Determining which marketing campaigns actually get executed requires  
9 complex, multi-factor decision analysis. Each campaign (and in direct mail, each  
10 list for each campaign) is evaluated by applying a common set of business  
11 metrics, such as expected cost per mailing, response rate, and average revenue  
12 contribution. These metrics are used to determine the expected profitability for  
13 the campaign or list in question. The campaigns (and lists) are then ranked, and  
14 those campaigns and lists that are high enough in rank so that they meet our  
15 internal profitability thresholds are ultimately the campaigns that are executed.  
16 When the campaigns above the threshold exceed the available marketing budget  
17 then the most highly ranked campaigns only are selected. Thus, individual  
18 marketing campaigns form the details of the overall promotional budget. Even  
19 small differences between the campaigns (such as differences in postage, cost of  
20 paper, list costs and rental terms, as well as expected response rates) can  
21 change the ranking of a campaign, or the ranking of particular lists within a  
22 campaign. Postage typically constitutes a significant percentage of the costs of  
23 our direct mail campaigns – roughly half of the cost per thousand customers

1 reached in a typical campaign. Thus, when postage rates go up or down only a  
2 few percentage points, particular direct mail campaigns (or specific lists within  
3 campaigns) go off or on our list of executable campaigns.

4 Each month, BOOKSPAN management reevaluates actual results with  
5 respect to meeting our annual financial goals. While we establish marketing  
6 budgets at the beginning of a year, variances in the actual results compared to  
7 the financial goals can trigger a re-evaluation and re-allocation of the marketing  
8 budget. In general, campaign plans are reviewed and re-planned on a monthly  
9 basis, with adjustments occurring both on the overall and at detailed levels.  
10 Marketing campaigns and lists may go on or off our list of active campaigns  
11 depending upon actual financial and marketing performance. Campaign  
12 rankings can even suggest the value of accelerating a club's growth by allocating  
13 more marketing resources to it or closing a particular book club and removing  
14 marketing resources. Another way of saying this is that with each monthly  
15 financial forecast, our forward-looking marketing budget for operational purposes  
16 is subject to adjustment.

17 We rely on our latest marketing budget to determine order volumes for  
18 paper, print production, books, envelopes, catalogs, and staffing levels in  
19 customer service and transaction processing. In short, we operate on the basis  
20 of our marketing budget. Our marketing budget thus determines a significant  
21 percentage of our costs, which affects our cash flow projections, and overall  
22 financial management at BOOKSPAN. This, in turn, factors in to the financial  
23 management of our owners, one of which is subject to SEC reporting

1 requirements, and both of which report quarterly on their revenue and profit  
2 projections. Thus, our budget and volume forecasts are determined analytically,  
3 and subject to considerable internal scrutiny.

4 Postage constitutes such a significant percentage of the costs of a typical  
5 campaign that it is arguably the single most influential factor dictating which  
6 direct mail campaigns get executed. The larger a potential price incentive, the  
7 more direct mail campaigns wind up on our execution list, and more of our  
8 budget is thus moved to mail. For example, consider a direct mail campaign that  
9 costs approximately \$400 per thousand mailpieces. If postage costs roughly  
10 \$.20/piece, postage costs are roughly half the costs of the campaign. As little as  
11 a \$.01 change in postage rates is \$10 per thousand pieces, or 5% of the  
12 campaign's postage costs. A \$.02 change in rates is \$20 per thousand pieces,  
13 10% of the campaign's postage costs, and 5% of total campaign costs per  
14 thousand mailpieces. Considering that BOOKSPAN ranks hundreds of  
15 campaigns, and each campaign has the option of purchasing as many as 150  
16 different lists, each of which are also ranked, even small changes in postage can  
17 have significant effects on BOOKSPAN's mail volume. Simply, the greater the  
18 price incentive, the more BOOKSPAN would mail.

## 19 **5. BOOKSPAN's Volume History and Volume Forecasts**

20 BOOKSPAN's three years of historic volumes (see Table 1) are based on  
21 data drawn from its own postal systems, adjusted to correspond with Postal  
22 Service fiscal years, and then verified against Postal Service permit data.  
23 BOOKSPAN's general trends suggest declining solicitation mail volume.

1 BOOKSPAN attributes the uncharacteristic increase shown in the most recent  
 2 complete Postal Service fiscal year to one-time factors that do not suggest future  
 3 growth in mail volumes. For example, among these factors are BOOKSPAN's  
 4 decision to severely limit our telemarketing during our last fiscal year. The  
 5 portion of our marketing budget that had been previously dedicated to  
 6 telemarketing campaigns was applied to our direct mail campaigns. Also, this  
 7 past year was an election year. This circumstance enhanced BOOKSPAN's  
 8 expectations regarding the popularity of certain of our special interest clubs.

9 Table 1 Bookspan's Historic Solicitation Volumes

10 (Past Three Postal Service Fiscal Years)

	FY 2002	FY 2003	FY 2004
New Membership Std letter-size	84,694,802	82,991,923	94,014,756
New Membership Std Flat-size	215,324,921	196,631,597	164,378,427
<b>Total</b>	<b>300,019,723</b>	<b>279,623,520</b>	<b>258,393,183</b>

11

12 BOOKSPAN also provides its current best estimate of its three-year  
 13 volume forecasts (see Table 2). While the Postal Service may project its future  
 14 mail volumes based on its historic experience, BOOKSPAN cannot forecast total  
 15 numbers of mailpieces independently from its planning of other direct marketing  
 16 campaigns. Its decision process with respect to the operation of its campaigns  
 17 dictates that it cannot offer a mail volume forecast with great precision more than  
 18 a few months in advance. Nevertheless, I have developed the best possible  
 19 three-year before-rate and after-rate mail volume forecasts based on information  
 20 BOOKSPAN possesses at the present time.

1 Table 2 Bookspan's Forecasted Solicitation Volumes

2 (Next Three Postal Service Fiscal Years)

	<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>
Before Rate			
New Membership Std letter-size	78,000,000	75,000,000	75,000,000
New Membership Std Flat -size	137,000,000	129,000,000	130,000,000
<b>Total</b>	<b>215,000,000</b>	<b>204,000,000</b>	<b>205,000,000</b>
After Rate			
New Membership Std letter-size	105,000,000	105,000,000	107,000,000
New Membership Std Flat -size	120,000,000	110,000,000	110,000,000
<b>Total</b>	<b>225,000,000</b>	<b>215,000,000</b>	<b>217,000,000</b>

3

4 Since we have obviously not planned all our potential campaigns for the

5 prospective three-year period, I have used our marketing budgets for current and

6 previous years and applied our best estimate of future cost increases as well as

7 our expected growth in profitability over the next few years to arrive at our best

8 estimate of mail volumes. The before-rate forecasts reflect BOOKSPAN's

9 expectation that there will be a significant drop in new member Standard Mail

10 letter and flat solicitations beginning in the first year of the agreement, a modest

11 further drop in volume in the second year, and relatively level volumes in the third

12 year. We anticipate the significant drop in the first year projection primarily due

13 to the anticipated 5.4% increase in postage rates. This is the single most

14 predictable event that is certain to affect mail volumes by reducing the number of

15 lists that qualify in each planned campaign. The further drop is projected

16 primarily because we anticipate a further postage rate increase.

1           After-rate volume forecasts (see Table 2) demonstrate significant  
2 increases in Standard Mail letter volumes, but deeper cuts in Standard Mail flat  
3 volumes. This is because BOOKSPAN anticipates that providing BOOKSPAN  
4 with a discount on Standard Mail letters will cause a modest migration of mail  
5 from flats to letters. Postal Service testimony demonstrates that despite this  
6 expected migration, the NSA is favorable to the Postal Service.

7           I do not expect an incentive that is provided only for letter solicitations to  
8 result in shifting all or most of BOOKSPAN's mail from flats to letters. As my  
9 forecast suggests, an incentive provided to letter solicitations may result in the  
10 selection of some additional letter mail campaigns over some flats campaigns.  
11 However, there is a limit to how much flat mail can be converted to letter mail.  
12 BOOKSPAN uses lists of both internal and external names to market to  
13 prospective club members. External name lists are lists we rent from other  
14 companies. Experience has shown response rates in most clubs are higher  
15 using a flat mailpiece format when marketing to external lists, perhaps because  
16 the mailpiece draws more attention and has a greater impact, or because it  
17 resembles a typical catalog mail piece. Internal name lists are either lists of  
18 former members, or lists of members of one club being solicited to join another  
19 club. Experience has shown in most cases our response rates are higher using  
20 a letter format when marketing to internal lists. Our hypothesis is that existing or  
21 former members of another club respond better to letters than flats because they  
22 are already accustomed to receiving letter mailings from BOOKSPAN. Going  
23 back to our method of ranking lists and campaigns by expected profitability, it

1 becomes evident that changes in mailing costs for one format will offset some or  
2 all of the lower response rate, allowing us to shift the corresponding volume to  
3 letter format. At the same time, BOOKSPAN must continue to maintain an  
4 effective mix between marketing to internal and external names. We need to  
5 continue to add new members, and to do so, we need to continuously market to  
6 new names. Since in the aggregate flats are more effective when marketing to  
7 external lists, we simply cannot shift all of our flats to letters and still hope to grow  
8 our business effectively.

## 9 **6. Conclusion**

10 This NSA offers tremendous potential to increase BOOKSPAN's direct  
11 mail solicitation letter volume. BOOKSPAN's solicitation letter mail contributes to  
12 institutional costs at a greater rate than solicitation flat mail. The promotional  
13 mail discounts will encourage BOOKSPAN's ability to test new lists that are  
14 currently on the margins, and will undoubtedly encourage BOOKSPAN to shift  
15 our new member solicitation from other media to direct mail.

16 Also, as my colleague Robert Posch further describes in his testimony, we  
17 expect this NSA to have other favorable effects on Postal Service volumes.  
18 BOOKSPAN conducts its relationship with its members through the mails, so  
19 adding new members contributes in predictable ways to the mailstream.

20 Furthermore, BOOKSPAN rents our own growing lists to carefully  
21 screened marketers that are launching promotions likely to appeal to a particular  
22 book club demographic. Our membership growth enhances these list rentals,  
23 and these rentals contribute to further growth of direct mail. To the Postal

- 1 Service, this means even higher mail volumes, with no additional investment in
- 2 incentives.