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Report to the Chairman, Subcommittee on Federal Services, Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate

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U.S. POSTAL SERVICE

Proposed Policy to Accept Credit and Debit Cards Makes Sense Conceptually

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The Honorable David H. Pryor
Chairman, Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report responds to your September 27, 1993, request regarding the U.S. Postal Service's proposed policy of accepting credit and debit cards at post offices nationwide. You were concerned that the Postal Service might proceed too hastily, without adequate consideration of costs and benefits, in implementing the policy nationwide.

In the summer of 1993, the Service began extensive pilot tests of card acceptance at post offices in the metropolitan areas of Washington, D.C.; Dallas-Fort Worth, TX; and Orlando, FL. We informed the Subcommittee of the status of the Service's proposed policy and plans to accept credit and debit cards in December 1993. At that time, the Subcommittee asked us to determine whether the Postal Service has a sound business basis for its proposed policy of accepting credit and debit cards. Also, as requested by the Subcommittee, we will track the Service's ongoing efforts to reach decisions on matters regarding implementation of a card acceptance policy and provide you with additional information on whether and how those matters were resolved.

Results in Brief

The Service's proposal to accept credit and debit cards conceptually makes business sense on the basis of the (1) potential for improved convenience to postal customers from optional payment methods, (2) potential cash management benefits to the Service, and (3) acceptance of these cards by businesses, particularly those that compete with the Service, and government agencies. Essentially, the proposal is grounded in the Service's efforts to improve customer satisfaction and thereby help ensure the long-run sustainability of the postal system. However, before the Service can implement a card acceptance policy nationwide, a number of issues relating to the detailed costs and benefits of the policy and various options, such as whether to accept cards at just larger post offices and whether to accept them just at windows or both windows and vending machines, need to be resolved. To resolve these issues, the Service is pilot testing card use at windows at selected post offices in Florida; Texas;

Washington, D.C., and its Maryland and Virginia suburbs; and in vending machines at selected post offices in California. The tests are scheduled to be completed by the end of 1994. The test results are needed before the Service makes any recommendation to the Postal Board of Governors on nationwide card acceptance. Service officials said that they do not intend to expand card acceptance beyond current card accepting locations until this decision is made.

Background

The Service has accepted credit cards at some post offices since 1981. According to Postal Service officials, these were local initiatives by Service officials in the field, and management of the initiatives was often fragmented and not coordinated. In April 1991, then Postmaster General Anthony Frank established a task force to make recommendations on the future direction of credit card acceptance. The task force concluded that additional testing was needed and established a pilot test at 10 sites.

The 1991 task force arranged for a feasibility study by Arthur D. Little to determine the extent of market demand for credit and debit cards at postal retail windows and vending machines. The study included an assessment of the card industry, surveys of household and business customer interest in using cards, and program cost estimates. Arthur D. Little recommended, among other things, that the Service offer the card payment option at windows and vending machines.

In 1992, using the data the task force provided, Postmaster General Marvin Runyon decided that the Service should begin accepting credit and debit cards as soon as possible. He believed that this policy would (1) increase convenience to customers, (2) support the Service's competitiveness, and (3) improve cash management. He viewed this program as one of a number of initiatives needed to respond to an increasingly competitive postal market. The program is to be accomplished in three phases. In phase one, which started in June 1993, the number of participating pilot test sites was expanded from 10 to about 550 postal locations in Washington, D.C.; Orlando, FL; and Dallas-Fort Worth, TX, to collect implementation cost and window operations data. At pilot test sites, card transactions are to be conducted at post office retail windows equipped with stand-alone electronic card authorization terminals that accept VISA, MasterCard, and Discover credit cards and many local and national debit cards, such as Pulse, Honor, Most, Maestro, and Interlink.

Credit and debit cards can be used at the pilot test sites for most products and services offered by the Service, including bulk mail payments, Express and Priority mail, and stamps. The only restriction is that money orders and collect-on-delivery services cannot be purchased with a credit card. The Service has set no minimum or maximum limits on transaction amounts.

Phase two is to entail submitting a proposal to the Postal Board of Governors on acceptance of credit and debit cards and then nationwide implementation of card acceptance, if the Board approves such a policy. Postal Service policies require that the Board review and approve or disapprove all proposed corporate initiatives or major operational changes that are to include expenditures in excess of $7.5 million over program life. The Service expects to submit a card acceptance proposal to the Board during the summer of 1994. The results of the test, including site preparation costs, card fees, and cash and check handling costs, are to be included in any recommendation to the Postal Board of Governors.

Assuming Board approval, phase three will focus on integrating the card equipment with the Service's integrated retail terminals (IRT), which are automated cash registers. The Service plans to replace its out-dated IRTs. New IRTs are expected to make card transaction processing more efficient and collect better sales information for analytical purposes. Off-the-shelf IRTs with built-in card processing functions are to be procured in 1995.

Service officials expect that, after initial national implementation, about 1 percent of its transactions (valued at $474 million) would involve cards. About 1 year after national implementation, they expect card transactions would reach 15 percent (or $7.1 billion).

Objective, Scope, and Methodology

Our objective was to determine if the Postal Service's proposed policy of accepting credit and debit cards makes business sense in light of customer service, cash management, and competitiveness considerations. At Service headquarters, we reviewed planning and budget documents on card acceptance. We also reviewed the results of (1) earlier tests, (2) progress reports on the current test, (3) reports prepared for the Service on the use of cards and the cost-benefit aspects of card acceptance. Our review also included a feasibility study prepared by Arthur D. Little, a survey by Market Facts, and a survey by MasterCard. We interviewed members of the Service's task force and other officials responsible for planning and coordinating the program. We also interviewed Service officials

responsible for retail and vending machine operations to discuss the California card acceptance program. We did not verify test data or studies that we obtained from the Service; however, we did discuss data collection and study methodology with officials who sponsored the work.

At the Postal Service Southwest Area Office in Dallas, TX, we interviewed officials involved with the pilot test. We discussed the pilot test with Postal Inspection Service officials in Fort Worth, TX. At the Postal Service's Dallas and Fort Worth districts, we interviewed officials responsible for coordinating the card acceptance tests. We reviewed district documents on cost-benefit aspects of the program and progress reports on the tests. At the Postal Service Santa Ana district in southern California, we interviewed the official responsible for debit card acceptance at vending machines and obtained sales data. We also interviewed VISA and MasterCard officials.

On April 22, 1994, we provided draft copies of this report to the Postal Service Treasurer and the Manager of Retail Support, program managers responsible for card tests at post office pilot sites and vending machines. We obtained their oral comments on April 26, 1994.

We did our work from October 1993 to March 1994 in accordance with generally accepted government auditing standards.

Postal Service Can Potentially Benefit From Accepting Credit and Debit Cards

Accepting credit and debit cards at post offices could benefit both the Postal Service and its customers through improved convenience of paying for postage and purchasing services. Studies by the Postal Service showed that the policy could help improve cash management. Since accepting cards is becoming common in government and is commonplace in the private sector, the Service believes, and we agree, that it needs to keep up with the times to remain competitive.

Improved Convenience to Customers Expected

By using cards at post offices, customers could potentially benefit through improved convenience of their transactions with the Service. Service in-house studies, the 1991 Arthur D. Little study, and other data showed that cards save time for postal customers, and many prefer to use them instead of cash or checks.

Time-and-motion studies at some of the pilot test sites showed that card transactions were processed more quickly than cash or check transactions, thus saving customers time. For example, these studies

showed that at post office windows, a credit card transaction was processed in an average time of 52 seconds compared to an average of 80 seconds for a check. The average time for debit card transactions was 32 seconds compared to an average of 43 seconds for processing cash. Reducing customer transaction time at windows could help the Service achieve its national standard of "service in 5 minutes or less." This standard, announced in July 1993, was endorsed in Vice President Gore's National Performance Review report,[1] which advocated providing federal services in a more timely and businesslike manner.

In addition, the Arthur D. Little study found that card users purchased more per visit, thereby reducing the number of post office window visits that they needed to make. Service officials believed that this finding was consistent with the early results from the pilot sites, which showed that the average cash transaction was between $7 and $8, the average check transaction was about $45, and the average card transaction was $47 for credit cards and $44 for debit cards. However, Service officials said, and we agree, that these data did not show whether card acceptance would result in increased sales revenue overall.

A survey related to a limited promotion of credit cards at pilot test sites, conducted by MasterCard in cooperation with the Postal Service, indicated favorable public reaction to the card payment option. For the last 2 weeks of November 1993, MasterCard offered a $5 mail-in rebate to postal customers using cards to make purchases in the pilot test areas. As part of the rebate application, customers were asked to complete a brief questionnaire. The responses from about 4,000 respondents provided the following insights into customer buying characteristics and opinions:

- Ninety-two percent reported that they were either satisfied or very satisfied with the speed and ease of card acceptance.
- In describing their feelings about the Service's accepting cards, 64 percent reported that it makes the post office more like a retail establishment. Thirty percent said it provided added convenience, and 5 percent said it provided for better customer service.
- Eighty percent reported that the promotion encouraged them to use cards for the first time at post offices.
- Seventy-nine percent said they used cards to purchase stamps. Other major products or services purchased with the cards were weighed mail (10 percent) and Priority or Express Mail (5 percent).

[1]From Red Tape to Results: Creating a Government That Works Better & Costs Less, Report of the National Performance Review, Sept. 7, 1993.

Customer convenience is expected by the Service to be further enhanced by introduction of card acceptance at postal product vending machines. The Arthur D. Little study concluded that this feature in vending machines would be welcomed by customers because it would offer an alternative to waiting at post office windows and would be cost effective because of minimized labor costs.

The Service plans nationwide introduction of card acceptance in vending machines. In addition to the 550-site pilot test at windows, the Service is exploring the development and deployment of card acceptance through vending equipment. For example, this payment option has been used on a limited basis in one district in California. In 1991, the Service retrofitted 11 machines to accept debit cards. Local Postal Service officials said that vending sales in those machines increased 55 percent after the card payment feature was introduced.

About 5,000 new stamp vending machines are scheduled to replace obsolete equipment nationwide. The new machines are to include a feature for card acceptance as a payment option. Although they are scheduled to be deployed in late 1994, they are not to have the card acceptance feature turned on until it is approved as a national policy. Future vending equipment is to include card acceptance as a payment feature and be deployed as existing vending equipment is replaced.

Improved Cash Management and Efficiency Anticipated

Postal Service officials said that the use of cards could improve cash management, reduce bad check handling expenses, and reduce opportunities for employee fraud. Service officials told us that, compared to checks and cash, accepting cards would improve cash management because funds could be made available faster for Service use, thereby reducing interest costs. The officials stated that local checks are credited to Service accounts 1 or 2 days after deposit; out-of-town checks usually take 3 days. VISA and MasterCard credit and debit transactions processed by 7 p.m. Eastern time are credited to Postal Service accounts the next day. Currently, Discover card credit transactions take a little longer to credit to Postal Service accounts, but Discover has made a commitment to credit transactions the next day.

The Service incurs substantial cash handling and bad check costs that could be reduced under a credit and debit card acceptance policy. For example, Service officials said that during fiscal year 1993 they submitted

about 49,000 bad checks, valued at $5.1 million, for collection with the General Services Administration contract collection agency. In conjunction with the current card pilot test, the Service contracted with Coopers and Lybrand to study and report on the cost of handling cash and checks. Their methodology included an examination of the cash, check, and card transaction costs at a sampling of pilot test sites and estimated that the Service incurs nationwide cash handling costs of about $1 billion annually. The study also showed that initially card acceptance costs would be more costly than that of cash or checks because of start-up costs and small usage volumes. However, at full implementation, the cost to process card transactions would be about one half the cost of processing cash or checks.

A VISA official told us that cards could also help reduce employee fraud because sales transactions do not involve cash and because card use is controlled by the customer. We noted that the Postal Inspection Service, in its semiannual report ending September 1993, reported that 200 employees were identified for embezzlement of postal funds, including cash and money orders, totaling $1.9 million. Although credit cards are not to be used at post offices for money orders, the acceptance of the cards could reduce the risk of cash losses.

Card Acceptance Is Widespread

A Service policy of accepting cards would be consistent with current practices of other public and private organizations. Credit and debit cards are widely accepted at retail establishments throughout the country. Cards give consumers convenience and flexibility, reduce banks' costs of processing checks, reduce merchants' costs of handling checks, and increase the level of convenience and service offered to customers. Banks like debit cards because the average cost per debit card transaction is lower than the average transaction cost for checks. An automatic teller machine transaction costs about 40 percent of the cost to process a check, and a debit card transaction at a store counter costs about 21 percent of a check's processing cost.

The phenomenal growth of the credit card market confirms the public's growing preference for the card form of payment. According to Department of Commerce reports, the number of credit card holders increased from 86 million in 1980 to 111.3 million in 1991. The number of cards increased 95 percent in that period to 1.027 billion and was projected to increase to 1.319 billion by the year 2000. Credit card spending more than doubled in the past decade from $200 billion in 1980

to about $481 billion in 1991 and is expected to double again to $882 billion by the end of the century, according to Commerce reports.

The Arthur D. Little study, mentioned earlier, noted that credit cards are a well-accepted form of payment. Cards are increasingly being accepted, even by traditionally cash-only retailers. Debit cards are increasingly used at the point of sale. The study concluded that there is a market demand for accepting cards at postal retail windows and vending machines. The consultants found that 27 percent of households and 15 percent of small businesses surveyed expressed an interest in using cards at post offices. The potential market could be as high as 200 million transactions per year, according to the study.

In addition, to measure the potential success of accepting credit and debit cards at vending machines, in February 1992, the Service arranged for a nationwide consumer survey by an independent contractor, Market Facts, Inc. The study involved a total of 1,007 in-home interviews, and the respondents generally supported card acceptance for postal products and services at postal windows and vending machines.

Some federal agencies—the U.S. Government Printing Office, the U.S. Customs Service, the U.S. Mint, and the Army and Air Force Exchange Service—accept credit cards. Credit cards are also accepted by some state and local government units for the payment of taxes and other fees. In addition, the Service's mail service competitors—Federal Express, United Parcel Service, and Mail Boxes, Etc.—accept credit cards. Finally, the Canadian postal service—Canada Post Corporation—is considering acceptance of credit and debit cards for its products and services. A July 1993 feasibility study recommended that Canada Post Corporation accept both debit and credit cards and offer this payment option at both urban and rural postal facilities.

Implementation Issues Are Being Addressed

As previously indicated, the Postal Service has recognized that it needs more data, such as the expected volume of credit and debit transactions and the estimated costs it will incur in accepting the cards, before implementing a card acceptance policy nationwide. Data are needed to make implementation decisions such as (1) which cards to accept; (2) what equipment to use; (3) where cards should be accepted (windows, vending equipment, and large and small retail facilities); (4) whether card use should be limited to certain products or services; (5) if and how cards should be promoted; and (6) what related training employees might need.

Of particular importance, in our view, is the need to gather adequate data on the expected use rate of cards at post office windows compared to the total number and dollar value of window transactions. Data on card use and associated costs, including fees charged by credit card companies,[2] are needed to determine the extent that investment in card processing equipment and clerk training can be justified. The decision to make these investments and incur these costs will have to consider customer convenience, savings of cash and check handling costs, and other benefits related to the approximately 40,000 post offices, branches, and stations nationwide. For example, the Service knows that the 2,500 largest post offices handle about 75 percent of its walk-in business. But if it elects to offer card acceptance at all 40,000 post offices, its estimated up-front costs could rise from $7 million, covering the 2,500 facilities, to $45 million for all post offices. Further, data on the anticipated volume of card transactions nationwide could prove useful in negotiating fees to be paid by the Service to card companies.[3]

To address implementation issues, the Service is collecting data at the 550 test sites. The Service has also contracted with Coopers and Lybrand to collect and analyze pilot test cost data and to assist in future decisions and related events, such as the presentation to the Postal Board of Governors and contract negotiations for card processing services.

Conclusions

If the Service is to adapt to an increasingly competitive environment and operate in a businesslike fashion, we believe that its proposed policy to accept credit and debit cards conceptually makes sense. Such a policy could help the Service make its services more convenient to customers and potentially reduce its cash and check handling costs. However, before adopting and proceeding with large-scale implementation of a credit and debit card acceptance policy, the Service needs to complete and analyze the results of pilot test efforts, including the costs and benefits of various options. This information is needed for making a recommendation to the Postal Board of Governors, implementing any final decision, and negotiating fees to be paid to card companies.

[2]Initially, the Service expected to pay 1.8 percent of credit transactions to participating card companies. However, during the 550-site test, a fee of about 1.3 percent was negotiated.

[3]On reviewing the draft of this report, Service officials said that they would probably limit initial nationwide deployment of card acceptance to the 2,500 busiest post offices. These facilities would get card acceptance capability at all service windows. Later in 1996, smaller post offices would get at least one, or possibly more, card accepting service windows depending on expected card sales activity.

Agency Comments

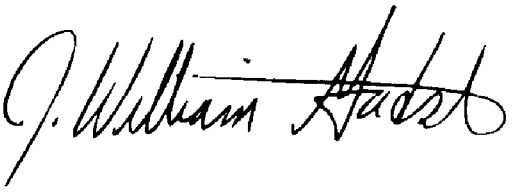
Service officials agreed with the facts and conclusions of our report. They made minor comments regarding plans for nationwide card acceptance, which we incorporated where appropriate.

As agreed with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the date of this letter. At that time we will send copies of this report to the Postmaster General and to other Postal oversight committees in Congress. Copies will also be made available to other interested parties upon request.

Also as agreed with the Subcommittee, because the pilot tests were still ongoing when we completed our work in March 1994, we will continue to monitor the tests and provide you with additional information when the pilot tests are completed.

Please call me on (202) 512-8387 if you have any questions about this report. The major contributors to this report are listed in the appendix.

Sincerely yours,



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