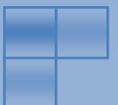


2009

UNITED STATES POSTAL SERVICE FUTURE BUSINESS MODEL

Analysis & Action Recommendations

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October 2009



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EXECUTIVE SUMMARY

I. Analysis of the Current Business Model

Six major issues most impact the current business model:

1. There is a secular, non-cyclical shift away from paper to electronic messaging.
2. The current recession increases the rate of mail volume loss.
3. Loss of volume starts a downward spiral that is difficult to correct.
4. Network fixed costs will not drop as fast as volume and revenue.
5. There is a cap on price increases, but not on cost increases.
6. Legacy and statutory costs associated with employment threaten viability of the USPS.

The issues above lead to the following conclusions:

1. The network is highly efficient and is most cost-effective when it is loaded.
2. The Postal Service should not be subjected to arbitrary assessments.
3. The current situation cannot continue like it is now; it is a non-sustainable condition.
4. It is not a performance problem. It is a fundamental business model problem.
5. The key stakeholder remains, first and foremost, the American public.

II. Analysis of Alternative Business and Regulatory Structures

The alternative Business Models and Regulatory Structures are identified and discussed, relying on the criteria set forth in the Postal Accountability and Enhancement Act, 2006, Public Law 109-435, Section 710 (a).

The Business Models identify the four fundamental approaches.

1. The Market Intensification Model operates within the current business model parameters, but increases both operational and marketing excellence, identifying niche markets and other sources of additional revenue.
2. The Global Market Expansion Model generates revenue by assisting other countries in building their domestic postal networks.
3. The Market Leverage Model utilizes the current postal networks (distribution, retail and delivery) to offer revenue-generating products and services offered under the USPS brand identity, and to offer "One-Stop Services" for other federal, state and local government entities at a convenient local post office.
4. The Innovation Model – also known as the Open Market Model – goes one step beyond the Market Leverage model, permitting the products and services of other organizations to be offered through the postal network.

The Regulatory Structures also recognize four fundamental forms of oversight.

1. Government Agency structure – like the Post Office Department prior to 1971.
2. Independent Establishment of the Executive Branch – the current structure, with governance by the Board of Governors, and pricing oversight by the Postal Regulatory Commission.

3. USPS Regulates Licensed Franchisees – Private businesses could purchase or lease ‘service areas’ in which they would have the exclusive right to conduct mail operations and use the USPS brand. Similar to what some contractors do now, on a building or route basis.
4. Oversight of Private Sector Operators. This is privatization in which the USPS or other entity provides regulatory oversight of private operators.

III. Recommendations

A. Focus on the Inevitability of Change and the Need for Action

There are what appear to be six “absolute truths” that can be succinctly summarized:

1. Traditional mail volume and revenue is declining at a rate in excess of ten percent annually and this will continue as technology and demographics drive a shift from paper-based transactions and communication to electronic alternatives.
2. The number of mail delivery points will continue to rise at a rate of 1.0 to 1.5 percent per year, raising network costs. This will occur no matter what happens to mail volume.
3. While variable costs have been reduced significantly, the fixed nature of network costs, coupled with the steady growth of delivery points, means that the system cost will remain relatively constant even as volume and revenue drops.
4. As a consequence, operating losses will grow under all scenarios.
5. To maintain accessible universal service under the current model, the Postal Service will have to raise prices on the remaining volume which will endanger the affordability of the mail and will in all likelihood hasten further reductions in volume.
6. The only way to achieve accessible universal service at an affordable price will be to either (a) rely on Congressional appropriation to cover the revenue-expense gap in mail operations, or (b) allow the Postal Service to generate revenue that utilizes the current network and assets so that the financial loss in mail service can be made up by non-mail related products and services.

These six unavoidable “truths” should be embraced by the Postal Service and form the basis of a national conversation that leads to a Congressional, stakeholder and public consensus for action.

B. Develop the Business Case for Combinations of Business Model Strategies

Before any business model is initiated, additional research and analysis will need to be done to develop the business case in terms of the markets to be served, the revenues expected, the costs incurred, the benefits and obstacles, and implementation plans. When the business case is more fully understood, pilot sites should be activated. At the outset, it appears that no one strategy can fully fill the revenue-expense gap that mailing operations will experience, so the solution will likely be a compatible combination of multiple strategies working in concert.

C. Test Various Business Models and Regulatory Structures in Pilot Projects

There is a sense of urgency for reaching this stage and these strategies should be tested soon in carefully selected settings. It is unlikely that Congress or any of the major stakeholders will embrace dramatic change without reasonable effort to first assess how the various alternatives might work and

how their impacts are felt. Without pilot sites, the discussion devolves into assertions and claims, doing no good.

Once there is at least a working level of agreement about the need for change, the Postal Service needs to be prepared to test each of the identified business models with the different regulatory structures in mind to best determine how those structures impact the strategies deployed. The test should be approached in the same project-managed professional manner that was used during the introduction of automation with objective assessment of the pilot activities based on agreed metrics and indicators.

D. Evaluate the Pilot Project Results and Proceed Expeditiously

The pilot projects should be evaluated to learn everything possible about what works and what does not work. The evaluation process should be transparent so that all stakeholders can develop informed understanding of the results. After that understanding is developed, the process can continue to evolve. This recommendation recognizes that there is merit in assessing the effectiveness of all the recognized alternatives and in following a repeatable sequence of plan, pilot, and assessment.

PART ONE: THE CURRENT SITUATION

I. Overview and Requirement for This Report

A. Overview of U.S. Postal Service

1. A Universal Service

The U.S. Postal Service (“Postal Service” or “USPS”) is a vast and complex system that links each household, business and other organization in the United States each delivery day. This is a fundamental characteristic of the USPS that cannot be emphasized too strongly. Note that while many people communicate via e-mail or telephone, by Instant Messenger or texting, or even Twitter, there are many Americans who do not have these services. No other entity in the nation performs this service or even has a near-term capability to do it. This is “universal service” – one system that connects everyone in the nation.

2. A Complex Nationwide System of Networks

This unique universal service capability is made possible by a three-layered network that includes:

- Almost 400 mail processing plants linked by contractor-operated multi-modal rail, highway and air transportation logistics;
- More than 36,000 Post Offices, Stations and Branches and contracted postal retail units, which provide Point-of-Service (POS) customer interaction;
- Nearly 150,000 delivery routes that deliver mail to every residential and business address in the U.S. every delivery day.¹

3. Financial and Operational Considerations

Several financial and operational issues are relevant when examining the current business model of the U.S. Postal Service. First, the price that the Postal Service can charge is subject to restrictions that create pricing “floors” on competitive products and pricing “ceilings” on non-competitive products. Second, the Postal Service is a highly automated, very complex fixed-cost network system. Because of this, volume increases can be handled without commensurate increases in cost, but for the same reasons, costs cannot drop commensurately when volume declines. This structural fixed cost is currently further limited by the requirement for six-day delivery. Third, mail volume and revenue have declined significantly as a result of the current recession, and also because of the shift of financial transactions, bill presentment and payment, and communications messaging from the U.S. Mail to electronic alternatives such as e-mails with attachments and the Internet. While improvement in the economy may mitigate some of the volume loss related to the recession, the volume loss due to electronic competition will likely not return for mail, any more than it will for newspapers, magazines, textbooks or other paper-based industries that are undergoing wrenching change. Finally, while the Postal Service has managed to keep cost increases at or below the general rate of inflation, there are now legacy costs for health care and retirement that are beyond the control of the Postal Service.

¹ USPS Quarterly Financial Report, Quarter 3, 2009 (10-Q), page 18

These legacy costs, coupled with volume and revenue declines, threaten the viability of the organization.

B. USPS Impact on U.S. Economy

1. Direct Impact of the Postal Service

The Postal Service has a direct financial impact in two fundamental ways. First, this year it will generate nearly \$70 billion in revenue and \$75 billion in expenditures. This translates into about \$55 billion in salary and benefits, and \$20 billion in other costs. That money will be paid to employees, contractors and vendors who will spend it in their home communities, creating more income for other businesses and jobs for other workers. Second, the Postal Service directly impacts the economy through the delivery of bills, packages and advertising that facilitates commerce, creating sales, income for businesses, and wages for employees. One measure of impact: one out of every 200 workers in the U.S. is a postal employee.²

2. Indirect Impact of the Postal Service

In addition to the direct impact of Postal Service expenditures on the U.S. economy, the Postal Service provides the infrastructure that enables such industries as direct mail advertising, magazines and newspapers delivered by mail, and package delivery. These huge industries are, in turn, supported by paper mills, transportation services, and other businesses that employ an estimated nine million U.S. workers who prepare the paper products that become the mailed items, write the content for those magazines, newspapers, and direct mail ads, and sell the products that are delivered by Priority Mail and Parcel Post. The Postal Service is the conduit for more than \$1 trillion in commerce, representing about 7.5 percent of the U.S. Gross Domestic Product (GDP).

C. Requirement for This Report in the 2006 Postal Law

The 2006 Postal Accountability and Enhancement Act establishes the obligation that is the basis of this analysis, and provides two distinct specifications related to (1) reformation of the Postal Service business model, and (2) maintenance of affordable universal postal services in the U.S.

1. Evaluating Options and Strategies for Reform

Section 710 (a) of the Act establishes the focus on alternative business models:

The Comptroller General of the United States shall prepare and submit to the President and Congress a report that builds upon the work of the 2002 President's Commission on the United States Postal Service by evaluating in-depth various options and strategies for the long-term structural and operational reforms of the United States Postal Service...³

2. Maintaining Affordable, Universal Postal Service in the U.S.

² Source: Department of Labor (2009) at www.dol.gov. 140 million workers in U.S. and 656,000 postal employees.

³ Postal Accountability and Enhancement Act, 2006. Public Law 109-435. Section 710 (a)

Section 710 (b) specifies the requirement regarding affordable, universal postal service.

The Government Accountability Office may include such recommendations as it considers appropriate with respect to how the Postal Service's business model can be maintained or transformed in an orderly manner that will minimize adverse effects on all interested parties and assure continued availability of affordable, universal postal service throughout the United States. The Government Accountability Office shall not consider any strategy or other course of action that would pose a significant risk to the continued availability of affordable, universal postal service throughout the United States.⁴

These two sections of the Act, taken together, require that the future business model for the U.S. Postal Service must not only be responsive to the economic and technology changes that have made the current model nonviable, but must also assure that affordable universal service is maintained.

II. The Current USPS Business Model

A. Financial and Operational Analysis

The current USPS Business Model is dealing with change at an unprecedented rate. The issues facing the present model can be characterized most accurately by considering the most recent financial and operational data.

1. Pricing, Volume, and Revenue

Pricing of postal products is highly regulated by law. Under the 2006 Postal Accountability and Enhancement Act⁵, the products offered by the U.S. Postal Service are categorized based on whether the Postal Service is dominant in the market that product serves.

Market dominant products include First-Class Mail, Periodicals (magazines and newspapers), Standard Mail (primarily advertising mail), and individual customer Package Services. These products are identified as "Mailing Services", and have historically provided about 90 percent of postal revenue. The competitive products (termed "Shipping Services") include Express and Priority Mail, Bulk Parcel Post, and Bulk International Mail. These contribute about 12 percent of revenue and one percent of total mail volume.⁶

There are substantial restrictions on pricing in both the Mailing Services and Shipping Services product lines. The price of postage for the market-dominant Mailing Services cannot rise at a rate greater than the Consumer Price Index – All Urban Consumers (CPI-U). Even if postal costs rise faster than CPI-U, postal prices and revenues cannot go beyond this 'ceiling' defined by CPI-U. This is the case for the nearly 90 percent of the revenue sources that are in non-competitive Mailing Services. The price of non-dominant products like Priority and Express Mail can be raised, but the price charged must cover the costs incurred for handling the volume of that class of mail. As a result, pricing is constrained with

⁴ Postal Accountability and Enhancement Act (PAEA), 2006. Public Law 109-435. Section 710 (b)

⁵ Postal Accountability and Enhancement Act of 2006, Public Law 109-435.

⁶ Data through June 30, 2009. Source: Quarterly Financial Report for Quarter 3, Fiscal Year 2009 (Form 10-Q), page 21.

a “pricing floor” for competitive Shipping Service products. With this pricing “ceiling” for mailing services, and pricing “floor” for shipping services understood, consider now the relationships and trends involving revenue and mail volume.

Table 1 presents financial and operating trends for the most recent reporting period, Fiscal Year 2009 through the end of Quarter 3, ending June 30, 2009.

Table 1: Selected Financial and Operations Data from 10-Q as of June 30, 2009

(All data in millions)	Nine Months Ended June 30,		Change from 2008-09	
	2009	2008	In Units	Percent
Revenue, Costs and Net Income(Loss)				
Operating Revenue	\$52,372	\$57,195	(\$4,823)	-8.4%
Operating Expenses	\$57,036	\$58,320	(\$1,284)	-2.2%
Compensation and Benefits	\$40,073	\$40,289	(\$216)	-0.5%
Non-personnel Expenses	\$16,963	\$18,031	(\$1,068)	-5.9%
Operating Profit (Loss)	(\$4,664)	(\$1,125)	(\$3,539)	
Volume and Workhour Data				
Total Mail Volume in Pieces	135,572	155,201	(19,629)	-12.6%
Employee Work Hours	955.3	1043.2	-87.8	-8.4%
Cost Sensitivity to Workload Changes				
Work Hours Decline as Percent of Workload (Volume) Decline				66.6%

As noted in Table 1, mail volume is down 12.4 percent in one year, for this most recent nine-month period ending June 30, 2009. Perhaps more significantly, for the most recent three-month period of April 1, 2009 through June 30, 2009, mail volume is down from the same period the prior year by 14.8 percent.⁷ Mail volume peaked in 2006, and since that time has been declining. That rate of decline has accelerated as follows:

- From 2006 to 2007, volume declined 00.5 percent.
- From 2007 to 2008, volume declined 04.5 percent.
- From 2008 to 2009, volume declined 12.6 percent, comparing the first three quarters of each year

If the year-to-date trend as of June 30 continues FY 2009 volume will be 177,162 million pieces of mail or a 14 percent drop from the average volume of the eight preceding years 2001-2008

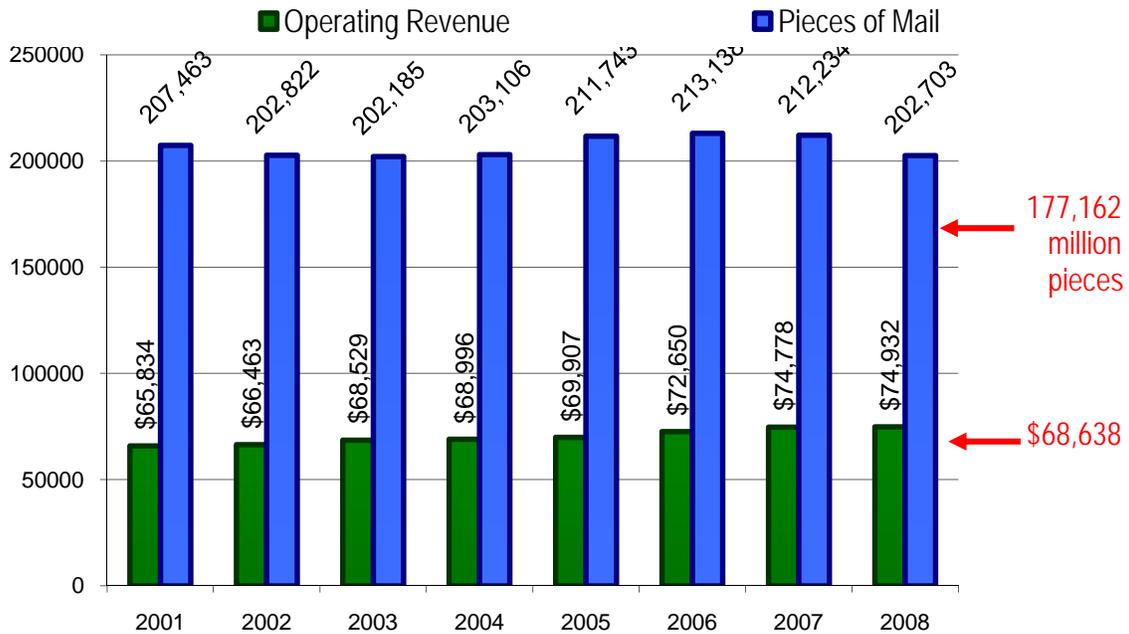
Revenue has declined, too. Table 1, above, demonstrates a revenue change from \$58,320 million for the first three quarters of Fiscal Year 2008 to \$52,372 million for the first three quarters of Fiscal Year 2009. This represents an 8.4 percent decline in revenue through June 30, 2009, the most recent data available.⁸ Note that a price increase averaging 3.8 percent became effective on May 11, 2009.⁹ If the revenue decline remains constant through the end of FY 2009, the annual revenue will be about \$68,638 million. **Graph 1** below depicts the volume trends for the last eight years as perspective.

⁷ United States Postal Service Quarterly Financial Report for the Quarter Ending June 30, 2009 (10-Q), pages 19-20

⁸ USPS Quarterly Financial Report, Ibid.

⁹ Average pricing increase was referenced in the USPS Quarterly Financial Report, Ibid. Page 20

Graph 1: USPS Volume-Revenue (In millions of dollars/pieces)



Source: USPS Annual Reports 2001-2008

Both volume and revenue are experiencing declines caused by diversion of postal business from hard-copy mail to electronic alternatives. This is a secular shift energized by technology and demographic changes and the volume and revenue lost will not likely return. The current recession is also contributing to the loss. Some mail volume will return, but how much and for how long is unclear.

2. Overview of Operating Costs and Workload

Table 2: Operating Revenue and Expense in Total and Per Delivery Unit

OPERATING REVENUE AND EXPENSE IN TOTAL AND PER DELIVERY POINT								
	2001	2002	2003	2004	2005	2006	2007	2008
Pieces of Mail (000)	207,463	202,822	202,185	203,106	211,743	213,138	212,234	202,703
Delivery Points (000)	137,682	139,452	141,361	142,320	144,326	146,174	147,993	149,192
Total Operating Revenue	\$65,834	\$66,463	\$68,529	\$68,996	\$69,907	\$72,650	\$74,778	\$74,932
Total Operating Expense	\$65,640	\$65,234	\$63,902	\$65,851	\$68,281	\$71,681	\$80,105	\$77,738
Compensation & Benefits	\$51,351	\$51,557	\$50,428	\$50,821	\$52,449	\$54,665	\$54,186	\$53,585
Other Expenses	\$14,289	\$13,677	\$13,474	\$15,030	\$15,832	\$17,016	\$25,919	\$24,153
Annual Revenue per Del Pt	\$478	\$477	\$485	\$485	\$484	\$497	\$505	\$502
Annual Expense per Del Pt	\$477	\$468	\$452	\$463	\$473	\$490	\$541	\$521
Annual Comp/Bene per Del Pt	\$373	\$370	\$357	\$357	\$363	\$374	\$366	\$359
Annual Other Expense per Del Pt	\$104	\$98	\$95	\$106	\$110	\$116	\$175	\$162
Annual Mailpieces per Del Pt	1,507	1,454	1,430	1,427	1,467	1,458	1,434	1,359

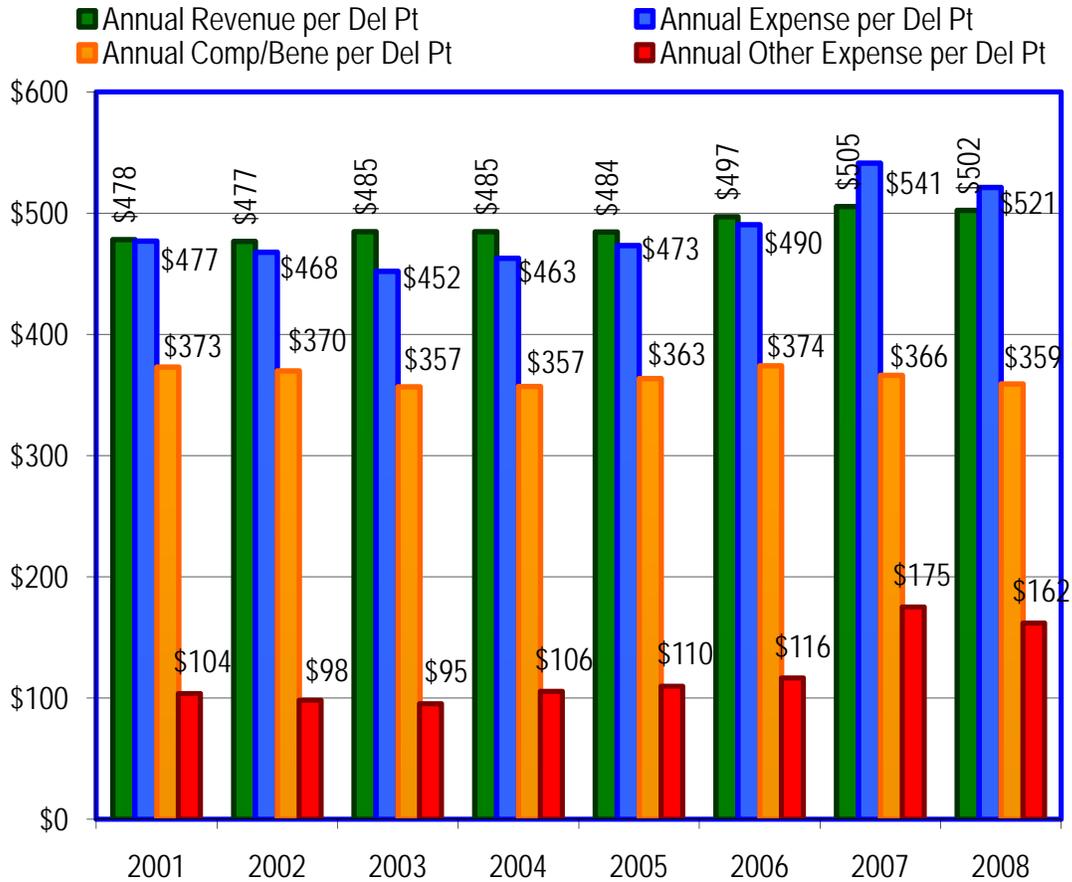
Source: Data extracted from USPS Annual Reports, and annual Comprehensive Statements, 2001-2008

U.S. Postal Service workload is primarily defined by two measures – the number of delivery points (mailboxes) that are served, and the amount of mail delivered to those boxes. Both measures of workload, along with revenue and expense data for the past eight years, are presented here. In the

seven years from 2001 through 2008, the number of delivery points served by the U.S. Postal Service increased by 8.4 percent, an average of 1.2 percent annual growth in workload as measured by delivery points.

Because the network is constantly expanding, it is useful to compare operating data on a per-delivery point basis. [Graph 2](#) illustrates those comparisons.

Graph 2: Operating Data per Delivery Point



Source: USPS Annual Reports and annual Comprehensive Statements, 2001-2008

The green bar in Graph 2 presents the USPS revenue per delivery point, calculated by dividing the total annual revenue by the number of delivery points – mailboxes – served by the U. S. Postal Service for the fiscal year indicated in the bar chart. Note also that Table 1 on page 7 shows that the revenue per DP continued to decline from FY 2008 to FY 2009.

The blue bar shows the total annual cost per delivery point for the years indicated. The total cost per delivery point for Fiscal Years 2007 and 2008 is substantially higher than prior years. To determine the source of the cost increase, note the yellow bar data which represents the annual compensation and benefits divided by the delivery points. That cost has dropped four percent since 2001, reflecting the business focus on cutting the controllable costs.

The red bar shows the non-personnel expenses divided by the delivery points. The average "other expense" cost per delivery point for 2007 and 2008 is \$169, which contrasts with the 2001-2006 average of \$104. This increase of 62 percent from the six-year base is heavily impacted by health care costs for employees in retirement. This legacy cost has added between \$7 and \$10 billion dollars per year since 2007, and continues in 2009. That increase alone amounts to a tax on mailboxes of more than \$60 per year or twenty cents per day times almost 150 million mailboxes.

These data introduce two characteristics that are fundamental in understanding the current financial and operational picture in the U.S. Postal Service. The first is the fixed-cost nature of a network operation such as the Postal Service. The second is the extent to which legacy costs beyond the control of the Postal Service are affecting the cost of operations.

3. Postal Operations: Three Networks in a Unified System

The U. S. Postal Service can be viewed as a three-layer network. A closer look at these three networks within the postal system is instructive.

a. Processing and Transportation Network

There are about 400 mail processing and distribution plants that sort mail that originates within the plant geographical service area, along with the mail that comes into that plant for ultimate delivery within the plant geographical service area. These plants operate as hubs, each sending out transportation "spokes" to an average of about 90 post offices, stations and branches that provide retail services and that house the carriers who deliver mail to the mailboxes on the routes. The 400 plants are linked by highway, rail and air transportation to exchange mail among these plants.

The number and location of mail processing plants, and the frequency and range of transportation linking those plants, is largely determined by two factors. First, workload factors influence how many plants there are and where they are located. Workload includes the number of pieces of mail that originate from or arrives for delivery within a geographic area such as the Washington D.C. metro area. The workload also includes the number of delivery routes to which the plant has to separate the mail to be delivered in the service area. For example, if there are 800 delivery routes served by the plant, the plant has to sort mail to each of these, and that takes time, workroom floor space, and other resources. If there are 2,000 routes to be served, then there might be a need for two plants rather than one. If mail volume drops, there is a reduction in the workload factors that relate to volume. However, there is still the workload associated with separating the mail into delivery sequence for the 800 delivery routes.

The other determinant of the processing and distribution network is the delivery standard expected for mail originating from each postal processing plant's service area – what delivery areas will be delivered overnight, which will require two days, and which three (for First Class Mail). For example, if mail originating in Washington, D.C. is expected to be delivered overnight in Washington, but can take two days to be delivered to Baltimore, then the processing plant will require a certain capability and capacity to achieve that. First-Class Mail in the U.S. Postal Service is targeted for delivery in one, two or three days after it enters the postal system.

This is useful to note when alternative business models are discussed. The service standards and the size of the delivery area served both impact the number of mail processing plants needed, and the cost of transportation between plants. The current configuration of how 'far out' a local city can expect mail to be delivered overnight was designed when it was essential to have mail delivered overnight within the local economy. Much of the infrastructure cost of the USPS was put in place to enable delivery of that mail overnight. One question for any discussion of the business model of the Postal Service is whether local-area mail still needs that overnight delivery, and if there could be substantial cost reductions from minimizing the overnight feature. The argument can be made that if something really needs to be delivered overnight, a customer can always use Priority or Express Mail, e-mail, or fax. The overnight service areas were defined decades ago, when these alternatives were not nearly as available or accessible.

The other key point is that the network of processing plants and transportation is largely a fixed-cost system. If volume drops twenty percent, the trucks transporting mail between Washington D.C. and Richmond, Virginia will still have to go all the way. There may not be as many truck trips needed, but that, too, is constrained by the reality that the receiving plant can't handle getting all its mail at once at the last minute.

Similarly, the number of plants and the cost to run them is also not very volume-sensitive. If a plant serves a half-million mailboxes on 700 delivery routes, the mail still has to be placed in delivery sequence for each of the 700 routes. If there is twenty percent less volume, the machine processes may take slightly less time, but that won't translate into substantial savings. The number of plants is dictated more by the considerations of overnight service and how many mail customers are served.

b. Retail Post Office Network

Within the national network of processing and transportation lies the retail network of post offices, classified stations and branches, and contractor-operated retail units that provide walk-in retail counter services to postal customers. There are about 36,000 of these retail facilities as of 2008. The 400 processing plants serve the 36,000 post offices, resulting in an average of 90 post offices served by each plant.

The location of retail post offices has been influenced to an extent by two factors: (1) the number of customers within the service area of a specific post office; and (2) the geographic distance that customers have to drive to get to a post office. There are many reasons why there are 36,000 post offices now, even after thousands have already been closed or merged into other service areas. While the widespread use of autos and other transportation meant that citizens didn't need a Post Office within walking distance, the mail volume and revenue growth of the last half of the twentieth century made consolidation of offices a low priority. In addition, the community concern that accompanies a Post Office closure or consolidation into another nearby office may have made closures more trouble than they were worth.

Now that overall mail volume and the resulting revenue is dropping, the cost of these retail facilities becomes more of an issue, and the declining use of the mail means that retail counter activity may not grow, or will even decline. There are other reasons to reconsider how many post offices are needed. Stamps and other postage now can often be purchased at supermarkets and other retail facilities, and

can always be purchased online through the Postal Service website. Packages can also be sent directly from the home or business, so that a trip to the Post Office is no longer necessary.

Note that most Post offices not only serve a retail and point-of-service function, but also perform as an operational facility for the delivery routes that serve the local area. That delivery function must be considered before deciding whether to close an office, but without question some can be closed.

In addition to workload and service considerations, there are other factors that must be weighed in evaluating the need for a post office.

Local Post Offices, stations and branches provide the Post Office Box service that many individuals and businesses use as a delivery point for their mail, preferring the security and anonymous location of the Post Office box rather than the convenience of delivery to the residence or business. Retail locations historically have also been influenced by community identity issues. For example, prior to 1970, there were more than 1,200 post offices in Kentucky. In many instances, the local Post Office served fewer than a hundred customers, and these offices were often the only public building in the community. Since that time, many offices have been closed because the retail revenue generated in the smallest post offices demonstrated that there was insufficient need for postal services to justify keeping the office open, and other Post Offices were nearby. Closing low-volume post offices is frequently operationally and financially advantageous, but it can cause considerable concern among the local citizens who are losing their post office, and that concern is often expressed to their Congressional representatives.

Finally, U.S. Post Offices have served a role linking the community to the government. The local Post Office is the designated federal location for draft registration. It often sells migratory bird stamps to fund federal conservation efforts. The Post Office may be the repository of information and brochures about military service, federal income tax, and social security. In smaller communities the local Post Office may also serve as the place where notice of various public meetings will be found, where local citizens can leave books to be returned to the county library's "bookmobile", and where someone can get directions to an address.

The more than 36,000 post offices, stations and branches serve as a second network within the postal system – a service and retail sales facility that serves every person in the U.S. This network presents both significant opportunities for cost reduction and significant opportunities for revenue generation.

c. Delivery Route Network

More than 150,000 delivery routes operate each day out of about 36,000 post offices, stations and branches. Each of these routes takes mail to anywhere from 200 to more than a thousand mailboxes (delivery points) each day. Each route delivers anywhere from several hundred to several thousand pieces of mail each day. There is also mail delivered via Post Office Boxes located in Post Offices, stations and branches.

Note that the number of residential and business mailboxes served by the USPS is not determined by the Postal Service. Generally, any new home or business can put up a mailbox and get delivery. Each new subdivision, shopping center and office building adds many delivery points that increase costs for the USPS, while these new boxes do not necessarily contribute any additional revenue. As of June 30,

2009, the number of mailboxes served had risen 0.8 percent from the same period last year.¹⁰ That does not sound like much, but for 150 million mailboxes served, this would amount to about 1.2 million additional mailboxes – or the equivalent of adding another Phoenix, Arizona to the network each year; and those extra mailboxes do not presume to add any new revenue...just extra cost. Note also that the most recent data about the rate that mailboxes were added occurred during the depth of a significant economic recession. In more economically vibrant times, the rate of growth is considerably higher, and the seven-year average from 2001 through 2008 is 1.2 percent annual growth, amounting to an average of more than 1.5 million new deliveries each year.¹¹

As a result of the dynamics described above, delivery costs steadily rise simply by the addition of new delivery points. Those delivery points are created by new homes built and businesses opened, so it is a customer-driven choice, not that of the Postal Service. It is also important to recognize that much of the cost of the delivery process is fixed – it will not vary substantially, whether there is an average of two pieces of mail per delivery, or eight pieces per delivery. The carrier still has to go to the end of the street, even if there is only half the mail volume.

Mail delivery is made to a mailbox. Mailboxes are legally restricted to only receive U.S. Mail on which postage has been paid. The mailbox belongs to the individual customer who placed it there, but the use of the box is restricted to U.S. Mail. The restriction to only put U.S. Mail in the delivery receptacle is based on the recognition that if other organizations have the freedom to place items in the box, then anyone could open anyone else's mailbox to put something in...and might take something out, too. Theft of mail from mailboxes is not common. One reason for that is because only the mail carrier and the person who receives mail at that box are authorized to open that box and in most instances the mailbox is in a visible location that would deter possible theft.

The frequency of delivery is a factor in both service and cost. The delivery network operates Monday through Saturday, but not on federal holidays. There is consideration given to reducing delivery to five days, by eliminating Saturday delivery. This will avoid some costs of that sixth day of going to each delivery point, but of course there will be some costs that don't drop – the cost of building and vehicle depreciation, for example. In addition, there is a consequence to revenue if mailers resort to alternative methods to advertise to households because there is no delivery on Saturday and Sunday.

The delivery network, finally, does present a very unique and valuable asset even beyond the feature of universal service. The delivery employee who serves that route has detailed knowledge of the neighborhood, and is in that neighborhood each delivery day. If the carrier is in the neighborhood already to deliver mail, the marginal cost of performing other services will be relatively low. This invites consideration of how the carrier could be employed to do other things, ranging from reading utility meters to checking on the elderly as a fee-for-service to them and their concerned children who do not live nearby. This matter will be considered further in Part II of this paper.

B. The Fixed-Cost Nature of the Networks

Cost reduction opportunities in the U. S. Postal Service are constrained by two operational and regulatory characteristics. The first is the inherently fixed nature of network costs. The three interlinked

¹⁰ Quarterly Financial Report for Quarter 3, 2009. (10-Q), page 27.

¹¹ USPS Annual Reports 2001-2008, Comprehensive Statements 2001-2008

postal networks in the United States -- processing, retail and delivery -- may well be the most complex tangible network anywhere in the world. Approximately 400 plants link with each other and with the 36,000 retail post offices, and through those with the more than 150,000 delivery routes that enable the Postal Service to reach each delivery destination every delivery day. That alone is a complexity that finds superlatives inadequate. However, even beyond that, these multi-networks operate so effectively and efficiently that a paper product – letter, larger flat envelope or package – can be delivered from one end of the nation to the other for an average cost of forty-two cents each by employees who earn an average of seventy cents per minute. Providing a service that is inexpensive with a geographical reach that broad through well compensated employees requires efficiencies that only complex networks can provide.

The Postal Service is not the only complex network, of course. Electric companies, water utilities, and the nationwide railway system are three examples of complex networks familiar to us all. These networks all have the ability to move units of electricity, water or rail engines and cars at a price that is much lower than if these networks were not in existence. A key characteristic for all these networks is that changes in the volume of what they distribute will not appreciably change the cost of the network. If network volume is rising, that's good. If it's declining, then it's not possible to cut the costs as fast as the volume drops.

For example, if electricity usage declines, it will certainly drop the costs associated with the electric generating plant that can be taken offline. The network cost – the high-tension lines, the residential wires, the meters, and other components – remains the same. Less electricity does not reduce the cost of establishing the lines. The water utility experiences a similar network effect. The amount of water flowing through the water supply lines or leaving via the sewer system can rise or fall, but the cost of the water lines and sewers is highly fixed. If people use less water the total costs will not drop much, so the attributed cost per gallon of water handled would rise.

Volume reductions might lead some to think that the answer is to “de-network” the processes to reduce the fixed costs in some way, but if that were to happen, the reality of a 42-cent price product being handled by a 70-cent per minute employee would cause postal costs to rise exponentially. That is likely not a solution.

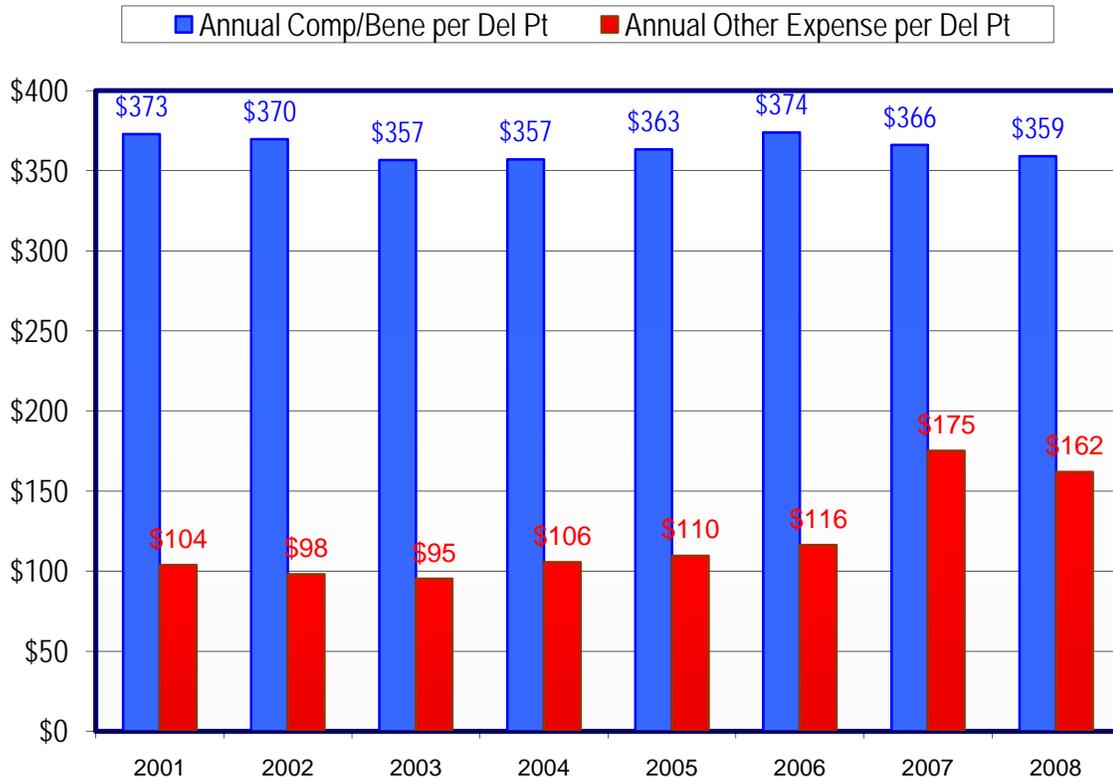
C. Costs of Human Capital and Legacy Labor Costs

The Postal Reorganization Act of 1970 mandated that postal employees should be paid wages comparable to those in similar private-sector jobs. The employment relationship is regulated by the federal statutes that govern private sector collective bargaining, and impasses in bargaining or in grievances arising out of the administration of the contract would be resolved, if necessary, by a final and binding arbitration process.

For the most recent Fiscal Year 2008, the U.S. Postal Service incurred operating expenses of \$74,932 million, including \$53,585 million in compensation and benefits of employees. Human capital consumes the majority of operating resources, and for that reason employment costs will be a significant part of any analysis of the condition of the U.S. Postal Service. While it would be simple to document the employment costs and the employee work hours for any period of time, it is most instructive to express employment costs as the number of work hours and dollars that are required annually to service each mailbox in the ever-expanding network.

Graph 3 displays that data for the years 2001-2008.

Graph 3: Employee Costs per Delivery Point



Source: USPS Annual Reports, 2001-2008

As illustrated by the blue bars on this graph, the total annual compensation and benefit cost, divided by the number of delivery points served, expresses the annual employee cost per delivery point. That value has declined from \$373 in 2001, to \$359 in 2008, a 3.7 percent decline over the seven year period, an average of about a half-percent decline per year. At the same time, the red bars depict the costs that are not direct compensation and benefits.

These non-personnel costs remained steady from 2001 through 2006, but rose dramatically in FY 2007 and remained there in 2008. This leap in cost is largely attributable to the payments required by the Postal Service to cover future retirement-related health care costs of current employees. [Table 3](#) presents the percent change in employment costs and non-personnel expenses, along with the changes in revenue, total expense and mail pieces delivered per delivery point.

Table 3: Employment Cost Trends

Employment data per Delivery Point	Chg 2001-2008
Revenue	5.0%
Total Expense	9.3%
Compensation & Benefits	-3.7%
Other (non-personnel) Expense	56.0%
Mail pieces delivered	-9.8%

Source: USPS Annual Reports and Comprehensive Statements 2001-08

A closer look at the 56 percent increase in non-personnel expense illustrates the impact of the pre-funding requirement for the health care costs of current employees when they retire. Before this cost was assessed against the Postal Service, the increase in costs was cumulatively 17 percent from 2001 through 2006. However, between 2006 and 2008, this rose from that 17 percent cumulative value to 56 percent, an additional 39 percent.

Beyond the trends shown here, finally, there is the question of whether labor costs are reasonable. The Postal Reorganization Act of 1970 stated that postal employees should earn compensation that is comparable to that of equivalent private-sector jobs. Some studies conducted by independent consultants have found that in many instances, the Postal Service pays more for a given job than would normally be paid in the private sector. For example, the Postal Service's *Strategic Operations Plan 2001-2005* analysis compiled data from negotiations with labor unions regarding pay comparability. The analysis demonstrated that in lower-skilled custodial and general clerical functions, the Postal Service pays nearly twice as much as the private sector.¹² This is relevant to the analysis of future business models because the labor cost of various revenue-generating strategies could be significant, and must be considered.

Despite the complexity of the employment relationship that involves thousands of facilities, hundreds of thousands of employees, and four major employee unions, the labor cost per mailbox served has actually declined. Despite this achievement, the assessment for payment of future retirement costs of current employees has created a legacy cost that threatens the viability of the Postal Service. It amounts to a "tax" of sorts, of about twenty cents per day per mailbox, paid for by postal customers.

D. Non-Operational and Legacy Cost Assessments

In addition to the operational issues facing the Postal Service and its current business model, there are non-operational matters that impact the financial viability of the Postal Service. One notable impact occurred in the Postal Service Retirement Health Benefit Fund ("PSRHBF"), which already has \$34 billion set aside for USPS retiree health care benefits for future retirees. The cost for current retirees was already being funded at about \$1.5 – 2.0 billion per year, but in 2007, the Postal Service was required to fund an additional \$7-10 billion per year.

¹² Operations Strategy, 2001-2005. U.S. Postal Service, 2000. At page 133.

These costs to pre-fund future benefits of current employees raise the costs of the Postal Service significantly. In Fiscal Year 2007, this charge amounted to 13 percent of revenues and in Fiscal Year 2008 it was 10 percent. The pre-funding requirement was established in the 2006 Postal Accountability and Enhancement Act, and as Postmaster General John E. Potter noted in his testimony to Congress, "... the primary genesis of the prefunding obligation was as a means to preserve the budget neutrality of the Postal Accountability and Enhancement Act."¹³ However valid that strategy was in 2005 and 2006, the years since then have presented an entirely different environment in which the Postal Service must operate. There is substantial evidence in the researched literature to suggest that pre-funding is not only actuarially unnecessary, but could even be endangering the interests of the mailing public.

On September 30, 2009, a continuing resolution passed the Senate to change the pre-funding of retiree health benefits by allowing USPS to pay only \$1.4 billion for FY2009 and to defer the remaining \$4 billion to FY2017. While this is helpful from a cash-flow basis, it is temporary relief and further illustrates that any permanent solution will require a fundamental change in business model.

E. Summary of Issues

1. There is a secular, non-cyclical shift away from paper to electronic messaging.

The Postal Service is faced with a loss of volume because of new technology capabilities and because a growing number of people prefer electronic means of communication. Bills are being e-mailed to customers, and are paid by those customers online. Communication occurs routinely via e-mail, often with attachments that would have previously been mailed. The Internet has captured much of the written media previously published in newspapers and magazines - publications that would have been mailed - and the Internet also gets an increasing share of advertising dollars. This problem is not unique to the Postal Service, but is being experienced by virtually every industry that deals in print media, transactions and messaging.

2. The current recession increases the rate of mail volume loss.

While the permanent shift from paper transmission to electronic transmission continues to occur, the loss of mail volume has been aggravated and accelerated by the current recession. The combination of the secular shift away from paper to electronic messaging and transactions has shocked the postal system with a dramatic volume drop of about 12 percent in the last year. While some of this volume may come back to the Postal Service when the current recession ends, it will be only a short-lived rise in mail volume.

3. There is a cap on price increases, but not on cost increases.

The Postal Service is subject to regulatory restrictions on how much it can raise prices. However, the cost of postal operations is not similarly capped. The regulatory freedoms provided in the 2006 Postal Accountability and Enhancement Act have been helpful, but do not address many of the operational and financial challenges facing the organization.

¹³ Statement of Postmaster General/CEO John E. Potter before the Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security of the Committee on Homeland Security and Governmental Affairs, U.S. Senate. August 6, 2009 at pages 15-16.

4. Network fixed costs will not drop as fast as volume and revenue

The Postal Service handles a product that costs 42 cents per piece using labor that costs 70 cents per minute. The efficiency required to break even on those terms necessitates an extremely efficient and complex network, and the Postal Service has three of those – processing and distribution, retail, and delivery. However, the same complex network that enables that efficiency is by its nature a very fixed, highly automated network. As a consequence when mail volume declines the cost of the network does not drop on a one-for-one basis.

5. Legacy and statutory costs associated with employment threaten viability of the USPS.

The employee compensation and benefit cost per delivery point has actually declined since 2001, reflecting aggressive and effective measures by the Postal Service. However, the Postal Service Retirement Health Benefits Fund requirements create an obligation that is beyond the control of the Postal Service and that cost is very large – more than ten percent of postal revenues. The deferral of \$4 billion is only a temporary help, and does not resolve the greater legacy issues.

6. Loss of volume starts a downward spiral.

As mail volume declines, the fixed network postal costs must be spread over declining mail volume, raising the total cost per piece and ultimately requiring a price increase. The price increase – along with secular loss of mail to electronic media – then prompts mailers to mail fewer pieces which means that fixed costs now must be borne by even fewer pieces...and the spiral continues.

F. Conclusions – The Inevitable Change

1. It cannot continue like it is now.

The problem today is a mail volume shift driven by recession and technology change and much of it won't come back to the USPS. The current situation has to change in fundamental ways.

2. It is not a performance problem. It is a business model problem.

The Postal Service has built an efficient and effective system for delivering mail, especially when mail volume continues to rise. It processes and delivers a product that carries very little revenue value throughout the U.S. and does it with labor costs that are comparatively high. The problems faced by the Postal Service were not caused by a performance deficiency, but by economic and technology changes that have shifted volume and revenue, constraining the current model with unsustainable revenue losses.

3. The network is highly efficient and is most cost-effective when it is loaded.

The complex Postal Service networks are essential to maximize efficiency. If volume drops, though, the same network characteristics make it difficult to reduce network costs. That suggests that the new business model must aim to load the system with revenue-generating workload that can be handled efficiently. The Postal Service cannot survive by disassembly of the network. That would only cause the loss of network operating efficiencies.

4. The Postal Service should not be subjected to arbitrary assessments

The Postal Service Retirement Health Benefits Fund pre-funding issue illustrates one example of how the Postal Service is subject to financial assessments that can be more stringent than applied to the private sector, and that appear to be arbitrary. An assessment of more than ten percent of annual revenue would devastate many private sector businesses, and the Postal Service is no different.

5. The key stakeholder is the American public.

There are many stakeholders in the Postal Service and the mailing industry. However, the key stakeholders are the American citizens, who ultimately use and pay for the postal system in the U.S. The ultimate question is "What do they need, and what business and regulatory model will best meet that need?"

PART TWO: POSSIBLE FUTURE BUSINESS AND REGULATORY MODELS

I. Alternative Business Models -- Strategic Choices

A significant strategic rethinking and expansion of the USPS business model is essential. A business model concerns how a business creates value for its customers through its operations, products and services and generates sustainable operating and financial performance. A business model is concerned with the products and services provided, their value relative to their cost, and how efficiently and effectively the business creates, produces, delivers and supports those products and services in chosen markets.

Analysis of possible business models considers such factors as markets, comparative and competitive advantages, and strategic issues related to specific opportunities and trends. That much is relevant to the analysis of business models for any enterprise. However, when the enterprise activities have historically been performed by the government, it's also necessary to consider the regulatory structure that will provide regulatory or oversight functions to assure protection of the public's interests.

A basic conclusion is that there is no single "solution" that in itself assures future Postal Service success. Multiple choices or "solutions" will be required, suggesting that the future business model will be much more complex and multi-faceted than anything seen to this point. There are several alternative business models and alternative regulatory schemes. Four archetypal models are offered here to frame all of these choices and their basic theme and focus. The alternative regulatory structures that would provide oversight of the four business models are examined in the next report section.

These four models define a whole set of unique strategic choices and product/service options designed to improve network operating and financial performance. Some of those choices have already been made by management and the goal here is to affirm these choices and direct even more attention to their execution. Other choices are more radical and will require a basic rethinking of the scale and scope of Postal Service products and services and how and where they are provided.

Some combination of these four will most likely be required to produce the magnitude of outcomes necessary to create sustainable financial performance. A very systematic approach is required when considering multiple strategic choices posed by the different models since some may conflict, all need to reinforce each other, and all pose significant resource and funding challenges that must be recognized and resolved early. Obviously, much more detailed analyses than possible in this report are required to understand the full potential benefits and liabilities of each model. The models presented next are offered as a way of framing that task.

A. Matrix Analysis of Possible Business Models

A relatively simple yet powerful model allows each of these to be first defined and evaluated separately and then the possible regulatory structures that best accommodate are considered. A strategy matrix first attributed to Igor Ansoff (Ansoff, 1957) produces four quadrants in which current and new products

and services are contrasted against current and new markets in which those products and services would be provided. A market can be defined by a new customer base or geographic service area. A completed matrix with the four possible models is illustrated in [Table 4](#).

Table 4 – Product/Service Delivery Matrix

	Current Markets	New Markets
Current Products/Services	<p>1. Market Intensification</p> <p>Theme: “Do what we do, always better.”</p> <p>Strategy: Further intensify efficiency improvement initiatives in all parts of the organization to boost operating performance (e.g., operating margins). Make targeted R&D investments to assure a dominant position as the high quality, high reliability and cost effective competitor. Seek market share expansion opportunities and new niches within existing markets. Engage in cost sharing with others to reduce operating costs.</p>	<p>3. Global Market Expansion</p> <p>Theme: “Leverage knowledge & operating competence abroad.”</p> <p>Strategy: Recognize and market domestically and internationally unique USPS knowledge capital and operating competencies in same or related industries. Produce at least 10 percent of total operating income from international sources by 2020 through advisory services, turnkey systems development and management of operations.</p>
New Products/Services	<p>2. Market Leveraging</p> <p>Theme: “Leverage the distribution/delivery network.”</p> <p>Strategy: Expand the “pipeline” of products/services provided. Seek both private and public partnering alliances to support diverse range of new products/services within the current USPS distribution & delivery network.</p>	<p>4. Innovation/Open Market</p> <p>Theme: “Open the market to creative competition.”</p> <p>Strategy: Open the current distribution/delivery network and network to new products/services developed internally and by others. Wherever possible do so beyond the US. Invest in and partner with others for R&D and new market entry. Control of the mailbox is retained.</p>

Note that this matrix displays four significant and distinct approaches to identifying possible business models. These are not mutually exclusive and some or all of these could be utilized in an appropriate future business model for the U.S. Postal Service.

B. Market Intensification Model – Current Products/Services in Current Markets

This first model does not imply “no change.” To the contrary, it would require: (a) very substantial additional investments in R&D and new technologies and processes that reduce costs and boost operating performance, (b) rethinking and restructuring workforce pay, benefits and work rules, (c) additional partnering with others to share network costs, and (d) development and marketing additional product/service features of existing offerings to increase revenue per customer. This model calls for “Doing what we do, always better.”

Ongoing process and operations improvements have been underway for some time and have yielded very significant results. This model calls for even more intensive and continuous improvement initiatives. The model calls for significantly intensifying the focus on enhancing business outcomes through current network operations and products and services offered in current postal industry markets by: (a) further increasing operating efficiency, (b) addressing labor costs and work rules, and (c) identifying additional underexploited niche market opportunities for additional revenue within the present network.

Primary emphasis with this model is upon cost reduction and operating margin improvement within the current distribution and delivery network. Additional revenues from product/service line extensions and add-ons are possible but may offer only marginal revenue improvement. The Market Intensification model does call for aggressive market pricing to be the dominant competitor in the larger domestic postal industry. Competition would be through both current and add-ons/extensions to products/services. Operating scope and processes with facility locations and operations would continue to be strictly determined by system-wide cost/benefit analyses of operating effectiveness and efficiency. Initiatives that enhance overall safety and security would also be made to minimize the financial consequences of lapses.

The universal service obligation would remain a core criterion in all these analyses and improvement efforts. Accessibility and affordability would remain important, as well, but may be diminished in some locations where higher cost/lower service density operations are eliminated. This may mean that differences in accessibility will likely increase between regions and locations to eliminate redundancies and infrastructure costs. Service standards would be evaluated and adjusted as appropriate.

The leadership team will need to judge how many and which initiatives are able to be launched in tight proximity. A more realistic approach is to assume a three to five years timeframe for seeing any significant return on the investments made.

This Market Intensification Model requires that legacy costs and statutory obligations such as pre-funding of retiree health care costs be satisfactorily addressed beyond simply deferring part of the current obligation. Without permanent resolution, all proposed business models will be in jeopardy.

C. Market Leveraging Model – New Products/Services in Current Markets

This model calls for “Leveraging the current distribution/delivery platform.” It recognizes the tremendous scale of the present distribution and delivery network and in-place infrastructure and asks how it might be used to deliver new products and services within it. These may be created and supported by the USPS or by others in partnering and synergistic alliances, all designed to reduce

operating costs and generate additional revenues. Current USPS products and services would continue to be offered but be supplemented by additional new products and services provided either by USPS or in partnership with other public providers such as state and local governments and other federal agencies or private providers.

One very significant such offering would be a “one-stop government services” concept that equips and staffs appropriately located local post offices to provide a broad spectrum of federal and perhaps state or local government services, such as for VA and Social Security, IRS services, vehicle and drivers licensing, etc. Such service centers could also offer such non-postal products as financial savings certificates or other forms of investment and other consumer services that use the highly-valued USPS brand to communicate security and trust. The postal function in Italy has explored this strategy, and appears to have at least some degree of success in the early stages.

This multiple-service strategy is practical because of ‘smart terminals’ and the availability of intra- and internet transmission of data. The local Post Office would not have to become expert at any of the services, but only be able to follow the on-screen prompts and escalate more complex issues to remote experts in a manner similar to what technical call centers do in many organizations now.

Another potentially significant revenue generating service would be to allow appropriate private sector commercial advertising in and on USPS equipment and facilities. A major advertising agency would be retained to administer all aspects of this venture on a nationwide basis. While advertising on USPS assets would require some evaluation of potential Commercial Free Speech and other First Amendment issues, it would be worth exploring.

It is also possible to share operating costs with private sector organizations co-locating within USPS facilities, although the local and state tax implications for USPS of doing so must be considered. The walk-in traffic in post offices is a major asset that itself can be leveraged to generate more revenue.

The Market Leverage Model means that market access and pricing would be more stable over time due to cost sharing. The primary emphasis of this model is to maximize the possible value contribution of every facility and vehicle. A greater variety of products and services would be provided at a single location, enhancing access and convenience. Larger numbers of people would visit postal facilities to utilize other services then being provided. Managing increased numbers of customers could, however, make safety and security bigger issues. Nonetheless, the universal service obligation would be met with this model and customer convenience enhanced.

The model could also present an opportunity for Postal Service employees to acquire new skills and perform additional new roles in supporting services delivered within existing facilities.

D. Global Expansion Model – Current Products/Services in New Markets

Because the current USPS market is every person, business and location in the United States, any new geographic markets would, by definition, be outside the U.S. Other national postal services such as those of Denmark, Norway, and Japan have created product/service models that allow them to generate one-fourth to one-third of their total revenues outside their national boundaries and traditional postal services. They recognize their substantial comparative skills and competencies – i.e., their intellectual or knowledge capital – and use it to support postal services and related activities for other

nations. The USPS has tremendous logistics and operating expertise that can be shared with others; it is a major asset that is presently not leveraged as fully as it could be.

As of September 28, 2009, the U.S. has 4.5 percent of the world population¹⁴, but currently transacts 46 percent of the world card and letter volume.¹⁵ The obvious growth is in foreign markets as their economies continue to develop. We believe that 5 percent to 10 percent or more of total USPS revenues could be generated from products and services provided outside the US by 2020. These would include: (a) advisory and consulting services to other national postal services and industries, (b) developing and supporting turnkey postal services in other nations such as Mexico, and (c) providing integrated global logistics and supply chain support services for domestic and international companies. This model calls for “Leveraging knowledge and operating competence abroad.”

This model does not affect existing domestic operations except in the processes that directly interface with international operations. It is the least disruptive business model for current operations in that sense. It is therefore an attractive model since it can complement all other models. Because this model would operate in other countries, it would be important to structure it organizationally so that it is not too closely identified with the U.S. Government.

There would be no impact on universal service obligation and domestic access. However, it is a dramatic shift in the mission, scale and scope of a historically domestic-only organization. The basic objective is to take expertise into international markets including paid advisory services, logistics and operations support, and potentially management assistance in setting up or improving foreign postal and related industry logistics and operations. The USPS becomes, in effect, a global consulting and out-sourcing provider.

Realistically, international initiatives would be organized and managed as a separate operating entity within the larger USPS structure. It would require sufficient staffing and access to USPS management and work force to perform projects lasting from weeks to years. This would require the selection, training and development of employees at multiple levels to participate in international assignments. Postal Service employees engaged in international projects may be exposed to potentially greater safety and security issues depending upon the international setting, their roles and duration of a project.

It is difficult to gauge the financial contribution of a global expansion initiative, but a large turn-key network development project could potentially generate several hundred million dollars over its duration. It would require a significant initial investment to build capabilities and market services, but marginal compared to the costs associated with other models.

E. Innovation or Open Market Model – New Products/Services in New Markets

This model calls for “Opening markets to creative competition.” It is the most radical in that it essentially opens the postal industry to further competition and use of the distribution and delivery network for additional products and services, both domestically and internationally. In all cases, the

¹⁴ U.S. Census Bureau Website, U.S. and World Population Clocks, retrieved on 9-28-09.

¹⁵ U.S. Postal Service Website at <http://www.usps.com/communications/newsroom/postalfacts.htm>, retrieved on 9-28-09.

USPS would retain control of the mailbox, and would handle additional products and services of third parties that would be delivered by USPS.

Delivery personnel could, for example, read meters electronically for public utilities, or facilitate updating of GPS-based digital imagery of neighborhoods for local governments and private enterprises such as Google's Street View™. USPS branded and supported products such as financial instruments (e.g., savings stamps) could be actively promoted, as well.

As an entry into Internet-based postal services, the general market trend toward digital communications could be facilitated by having some form of USPS validation and registration of electronically delivered legal or commercial documents on a fractional cost per transaction basis. The objective would be to bring USPS credibility to a market that is growing rapidly and fraught with privacy and identity validity issues.

The Open Market Model invites additional providers to participate in the distribution, operations and delivery network which enhances competition and price competitiveness. USPS would play the lead role in monitoring market access and assuring performance, safety and security standards, as well as maintain control of the individual mailbox. The universal service obligation mandate is maintained although USPS may act as "franchisor" and regulate access and affordability of products/services provided by "franchisees". This would compare to the Public Service Commission (PSC) model in the utilities markets. While access to a wider range of products and services enhances accessibility and convenience, the model could possibly "overload" the network with products/services, creating customer confusion and dissatisfaction.

This model requires very active product/service innovation and development by USPS to be an effective competitor. A significant commitment to on-going R&D and innovation is essential if market dominance is to be maintained in those areas it wishes to compete. The model assumes that USPS will generate fees for services from others for accessing the network and other providers retain USPS to support their products and services (e.g., utilities for meter reading).

The open market model requires considerably more flexibility in work rules and labor agreements and introduces other providers' workforces into the previously USPS marketplace. On the other hand USPS employees may gain access to new skills and develop new roles outside the traditional postal service.

Extensive planning and coordination will be required over a multi-year period to plan for the opening of the market and network. A staged process where experimentation occurs in a specific market or service area is recommended to test operating reliability, service quality, customer acceptance, and work force adjustments.

This model is the most radical in that it essentially opens the postal industry to further competition and use of the distribution and delivery network for additional products and services, both domestically and internationally. In all cases, the USPS maintains control of the mailbox but allows access to customers for additional products and services delivered by USPS. USPS delivery personnel could, for example, read meters electronically or facilitate updating GPS-based digital imagery of neighborhoods for local governments and private enterprises. USPS branded and supported products such as financial instruments (e.g., savings stamps) could be actively promoted, as well. The move toward electronic

communication could be facilitated by USPS validation and registration of electronically delivered legal or commercial documents on a per transaction basis. This model could also include offerings of some domestic new products in international markets where governments and private customers may want the reliability, neutrality and trust provided by the USPS.

II. Alternative Regulatory Structures

Whatever business model is employed will be regulated by a statutory and oversight framework. To help frame the choices possible in regulatory structures, imagine a continuum that runs from a traditional government agency on one extreme to a private sector enterprise on the other extreme which operates with minimal oversight and regulation. Along that continuum are a number of alternative regulatory scenarios that could be used with the possible business models.

The discussion that follows will consider four archetypal regulatory structures. [Table 5](#) displays the four possible regulatory structures contrasted against the four business models.

Table 5: Market and Regulatory Continuum Matrix

		Most Regulation <----- REGULATORY CONTINUUM -----> Least Regulation			
		(A) Government Agency	(B) Current Model	(C) Licensed Franchises	(D) Private-Sector Operations
Broad Range of Products <----- MARKET CONTINUUM -----> Traditional Mail	(1) Market Intensification Model	1A - Traditional Post Office. Congress directs. Improve processes Identify new business.	1B - Current USPS Model. PRC & Board direct. Improve processes Identify new business.	1C - "Postal Franchising" USPS regulate Franchisees innovate Like McDonalds	1D - "FAA Model" Gov't oversight Private sector owns Like public utilities
	(2) Global Market Expansion Model	2A - Post Office Dept with greater global reach. Significant issue with government identity	2B - USPS offers global services & consult without government "identity baggage"	2C - Domestic franchising operations, with global licensing of process but not "USPS" Identity	2D - Oversight of domestic mail operations, but no oversight internationally
	(3) Market Leverage Model	3A - Government postal operations plus "one-stop government services" offered.	3B - USPS postal operations plus "one-stop government services" offered.	3C - Licensed Franchisees operate mail plus "one-stop government services" offered.	3D - Oversight of private-sector operators offering traditional mail and "one-stop" serv.
	(4) Network and Platform Innovation Model	4A - Government postal operations with any compatible use of platforms & networks.	4B - USPS postal operations with any compatible use of platforms & networks.	4C - Franchise postal operations with any compatible use of platforms & networks.	4D - Privately owned postal operations with any compatible use of platforms & networks.

Perhaps the most important question is what regulatory and organizational processes and structures can best accommodate these models. The most appropriate business model or combinations of

models is one that addresses the shortcomings found in the current model while still always assuring universal, affordable service for the American public. As noted, there is no single choice among these models that can fully overcome the challenges noted in Part One. A combination of these four model choices offers the greatest prospects for success.

The four alternatives present the most fundamental choices: (a) going back to a government agency status, with Congressional funding and oversight; (b) retaining the current "Independent Establishment" status, and then in (c) defining a revocable license for a third party to operate as a franchise of the USPS, or (d) defining an irrevocable event that permanently removes the USPS from postal operations.

A. Government Agency – The Pre-1970 Post Office Department

The first regulatory structure considered exists on the "government" end of the regulatory spectrum, and basically resurrects the old Post Office Department that existed prior to 1970.

1. Description of the Regulatory Structure

Regulation of a Postal Service that operates under any mix of the possible business model scenarios could take the form of a government agency. Such an agency would be responsible to Congress and the White House, operating as a department within the Executive Branch of the federal government. The federal government, rather than an independent Postal Regulatory Commission, would decide what postage prices should be for various types of mail. It would define the scope and type of products and services offered, and it would fund any operating losses with Congressional appropriations.

2. Analysis of the Regulatory Structure

This regulatory model was the one in effect until 1970. Postage prices were set by Congress, and Congress was much more involved in the day-to-day events of the Postal Service than is the case today. Members of a state's congressional delegation were consulted about appointment of postmasters and other high-ranking local management and employees routinely sought the help of their Congressional representatives in work-related personnel matters.

This regulatory model is more hands-on for the government. Because the House of Representatives has an election cycle every two years, it does present issues with long-term planning for the Postal Service. This can be a problem because sophisticated network operations require substantial capital funding for automation design and deployment, and other cost-reduction measures. Such long-term investments become rational only when the organization is on a steady and relatively predictable course. This model would encourage various constituencies such as the mailing industry, postal unions, and others to contact Congress to lobby for the interests of that group. That would not likely be helpful in stemming labor cost increases or establishing long-term plans that enable capital investment in complex systems. This is significant because of the importance of maintaining an efficient network, and effectively managing labor costs.

B. Independent Establishment of Executive Branch

The current regulatory status of the Postal Service is that of an independent establishment of the Executive Branch of the U. S. Government. It's not a corporation, and it is not a government agency.

1. Description of the Regulatory Structure

The current regulatory model includes a key role for the Postal Regulatory Commission (PRC), which is an independent government commission tasked with the responsibility of assessing the need for price increases in the non-competitive mailing services group of products that includes First-Class Mail, Periodicals, and Standard Mail. In addition to the pricing oversight of the PRC, the Postal Service is directed by a Board of Governors. The governors are appointed by the President and serve 9-year terms with staggered expiration dates so that the top leadership of the organization does not change suddenly. The current model requires that the Postal Service cover the cost of operation with revenue alone, not receiving any general appropriations from Congress.

2. Analysis of the Regulatory Structure

This regulatory model places responsibility for USPS pricing and operations in the hands of the PRC and the Board of Governors and the Congress is removed from direct involvement. If a Congressional representative is approached by a mailer, union officer or other party, that Representative refers the issue to these oversight organizations, or directly to the Postal Service itself, because the Representative is not responsible for dealing with postal matters directly. Long-term planning for the Postal Service is facilitated by this model because of the 9-year term of Governors. This long-term view, along with the relatively "hands-off" position of Congress, does help control cost increases. However, the restrictions in the current model do not permit the Postal Service the range of operation needed to responsibly address the revenue declines caused by volume loss.

C. USPS as Franchisor or Licensor

One fundamental regulatory alternative is for the Postal Service to authorize private sector companies to provide the services currently offered by the Postal Service. This would generate two outcomes that are not available in the current "Independent Establishment" regulatory structure. The first is that the operators would have the opportunity to try different processes to meeting the universal service mandate. Each franchisor could approach the requirements based on the unique circumstance in that franchisor's service area. The second outcome is that franchises could be revoked if the affordability, accessibility and universal service requirements were not met. Much like the "Baby Bells" in the last half of the 20th Century, franchising would set up competition within the postal system that does not exist now and allow for various approaches to see what works best in this new century.

1. Description of the Regulatory Structure

If the decision is made to provide postal services through a regulatory structure other than that of a government department or an independent enterprise of the executive branch, there are two ways to do it. One is through a permissive relationship such as license or franchise, and the other is through outright sale of postal assets to one or more private companies that would provide postal services subject to some level of regulatory oversight. The key difference between a licensed franchise and an

outright sale is that a franchise would be revocable by the Postal Service or other regulator, if the franchisee did not satisfactorily meet the affordable, universal service or other requirements.

2. Analysis of the Regulatory Structure

While a government-run Post Office Department and the current regulatory model are both familiar, providing postal services through franchises or licenses would be a very substantial step away from past practice. A license is defined as a “permission granted by competent authority to engage in a business or occupation or in an activity otherwise unlawful.”¹⁶ A franchise is defined as “the right or license granted to an individual or group to market a company’s goods or services in a particular territory.”¹⁷ The difference between the two terms is found in the right granted to a franchisee to use the name of the franchisor. For example, a licensee may be permitted to provide postal services in general, while a franchisee would be allowed to use the name “U.S. Postal Service” when offering such services.

Within the United States, this structure would take the form of one or more franchises that would be entitled to use the identity of the U.S. Postal Service. Note that a national franchise could be established, or franchises could be awarded to specific geographic areas of the nation, while a government agency or government enterprise continued to operate the U.S. Postal Service in other areas of the country.

There are many businesses that operate “company stores” in some areas, and ‘franchise stores’ in others, with some of the most visible occurring in the fast-food industry. There are other examples of multiple regulatory structures operating side by side.

For example, in Northeast Florida, a government agency, Jacksonville Electric Authority (JEA), the eighth-largest community-owned electric utility service in the nation, provides electric service to three-quarters of a million accounts, while Florida Public Utilities, a publicly traded corporation not associated with any government, serves nearly 100,000 accounts that border the service area of JEA. The two utilities interact without disruption.

The singular advantage of regulating through the use of a franchise is that the franchise agreement would reserve to the U.S. Postal Service or to the federal government the right to end the franchise relationship if certain standards of operation, price and service are not maintained as required. This is a very important feature, given the responsibility that rests with the Postal Service and federal government to assure affordable, universal mail service. .

A franchise or license relationship would likely enable the franchisee to utilize current Postal Service assets, including facilities, networks and equipment. It might require the franchisee to provide necessary maintenance and repair to the equipment as part of the relationship, and the franchisee could purchase new equipment as needed. A franchise relationship would also reserve to the Postal Service an interest in maintaining the network, which would facilitate the necessary long-range planning and financing capability to upgrade the network as needed. Finally, a franchise operation would enable labor costs to be determined by the franchise award process and competition.

¹⁶ Retrieved online at www.Merriam-Webster.com/dictionary/license.

¹⁷ Retrieved online at www.Merriam-Webster.com/dictionary/franchise.

D. Regulatory Oversight to Private-Sector Owners (Privatization)

A sale of postal assets and/or market rights would create the least regulated oversight of postal services. One question that requires serious consideration is how the terms of the sale would allow the government to assure that universal, affordable service would be continued.

1. Description of the Regulatory Structure

The sale of Postal Service assets and the exclusive right to operate within the defined market would require consideration of many very fundamental issues. The first issue, of course, is how the government would assure that affordable, universal mail service is maintained and what powers the government would retain in the event that the universal service obligation was breached.

The sale could be of the entire national system of the Postal Service or it could be discrete parts of the system. For example, the processing and distribution, including inter-plant transportation, could be sold as a national network while retail and delivery services could be sold on a state-by-state basis or a larger or smaller geographic area. Regulation by the federal government would include third-party audit of at least three criteria – the maintenance of universal service, access to postal services, and the affordability of that service. What is not certain is what would happen if the private operator failed to meet standards established for these indicators.

2. Analysis of the Regulatory Structure

Note that the sale could be one that transferred ownership of fixed assets located within the market area that is sold to a private operator. If an operator purchased the exclusive right to conduct postal operations in Texas, for example, that sale would include a sale of all facilities, vehicles and equipment located within the geographic boundaries of the defined market. The private operators would be responsible for network operation and maintenance within their respective areas. They would also be responsible for compensation for their workers.

One of the issues to be considered is the ideal size and scope of the units to be sold. For example, if the entire U.S. Postal Service were sold as one entity, the cost and the required scope of operation would eliminate all but the largest operators from competing for the purchase. As an alternative, the Postal Service could be sold in some rational segments that would enable local operators to consider competing for their local postal operations. For example, offering the Memphis metro area as a specific operating unit for sale would enable competitive bids for an operation that might generate \$500 million per year in revenue.

This also raises the issue of how revenue generation and service provided would be attributed among various private operators or franchisees. In the example above, the Memphis operator may receive a half-billion dollars a year in revenue and generate mail that is to be delivered in the service area, plus other mail for the remainder of the nation. The Memphis operator would already be compensated for transportation, processing and delivery costs within the Memphis area, but there would have to be consideration of the value provided by other operators who incurred the processing and delivery expense to deliver the mail that created revenue in Memphis. A letter originating in Memphis and

delivered in Chicago would have to give some revenue credit to the Chicago operators for performing the delivery of that mail piece.

III. Responsiveness of Alternatives to PAEA Requirements

The analysis in Part Two, sections I and II, centered on four business models and four regulatory structures. The following analysis assesses the alternative business models and regulatory structures based on the criteria set forth in the Postal Accountability and Enhancement Act of 2006 (PAEA). The PAEA identified eight criteria to be considered for any proposed change to the current postal business model and regulatory structure. Each will be discussed with reference to the possible business models and the alternative regulatory structures.

A. Assumptions Underlying Analysis of Alternatives

Analysis of the alternative business models is made with these assumptions:

1. Mail volume will continue to decline because of a non-cyclical shift away from paper-based content. This assumption recognizes the forces that are changing not only mailing services, but also newspapers, magazines, textbooks, recreational reading and advertising.
2. Mail volume loss has been exacerbated by the current recession, and some volume may return when economic conditions improve; but may be again offset by other factors, such as the 'go green' movement.
3. It will become increasingly difficult to extract costs from postal operations as volume continues to drop, causing net increases in the operating cost per mail piece.
4. Labor cost may be managed well at the operating level, but legacy and statutory assessments can create uncontrollable and almost insurmountable costs.
5. Mail volume will continue to be at least as sensitive to price changes as it is now, and may become more sensitive, so that price increases may cause greater volume drops.
6. Contractors can continue to process, transport and deliver mail, as is done now with contractor-operated facilities, Highway Contract Route (HCR) transportation, HCR Box Delivery Routes, and Contract Post Offices and Stations.

B. Qualitative and Quantitative Effects on Universal Service

Each of the business models and regulatory structures considered has a provision for the maintenance of mail service that is universal, affordable, and accessible. There are two fundamental questions to be considered. The first is how these three terms are defined and measured, and the second is how they are financed.

Universal service generally recognizes that each person in the U.S. should be able to send mail to others in the U.S. and abroad and should be able to receive mail from both domestic and foreign mailers. While six-day per week mail delivery has been the standard for delivery frequency for many decades, the frequency required to achieve universal service is not fixed either. There were many "two-trip" and even "three-trip" routes in some urban areas of the U.S. as late as the 1980's, and those have been largely reduced to one delivery per day. Some of these 'downtown routes' do not deliver mail on Saturdays now, and have not for decades. All this is still universal service. These examples

illustrate the important point that while Universal Service includes consideration of delivery frequency, the specific number of deliveries per week, and number of days per week, has varied over the years.

Similarly, universal service does not define a location where the mail is available to the addressee. Some customers have mail receptacles mounted on the wall near the front door, while others use a door slot, and others have street boxes at the curb, or a box that is part of a free-standing cluster of boxes or a central mailroom in a building. Universal Service is the capability to send and receive mail to any address, but the frequency and location of the mail box is not uniform for all customers.

Accessible not only refers to the location of the customers' mail receptacles, but also to the capability to purchase stamps, mail packages, and pick up mail that can't be delivered for some reason – such as the requirement of a signature. Traditionally, post offices have served this function, selling stamps, accepting packages for mailing, and holding mail for pickup. However, this accessibility can also be achieved by reliance on business partners. Many supermarkets sell stamps, and there are locations that accept packages in a variety of retail establishments. The newest dimension of accessibility is the internet, which enables customers to be able to calculate postage, buy that postage online, arrange for pickup of packages by the delivery employee who services the mailer's business or residence, and order stamps and mailing supplies from the USPS website. In the past, the concept of accessible could be measured as the distance to the nearest post office, but there are now convenient alternatives that create accessibility in previously undreamed ways.

Finally, universal service must be affordable. Communication and commerce have historically been supported by the U.S. Mail, and implicit in that support is the affordability of the service. Affordability can be directly assessed by examining the price of postage, but in a greater sense, it is also evaluated by what subsidies must be in place. If it costs a customer fifty cents for the stamp to mail a letter, that is the cost evaluated to determine if it is 'affordable'. However, if there's also a taxpayer subsidy of twenty-five additional cents per letter, then the seventy-five cents is what is measured to determine affordability. Affordability is not just measured in terms of what the mailer pays, but also in terms of what the addressee or taxpayers may pay.

With these issues of universal service, accessibility, affordability and related matters in mind, there are a few things that become apparent. The affordability of mail is a function of both the system cost, plus the variable cost of each piece that utilizes that mail system. For example, if there are 100 billion pieces of mail in the system in a year, and the cost of that system is \$50 billion, then the cost per mail piece is fifty cents each. On the other hand, if the \$50 billion system cost now only handles 50 billion pieces, then the cost is one dollar per piece. Affordability is a function of volume, fixed costs and variable costs.

Given this observation, it becomes obvious that: (a) if mail volume is declining and network costs are relatively fixed and actually growing new delivery points, and (b) if labor costs per hour are continuing to rise, it is inevitable that the cost per piece – the measure of affordability – will continue to rise. For most of the last 40 years, the happy circumstance is that mail volume has grown fast enough to offset increased costs associated with new delivery points and increased labor costs.

However, with mail volume now declining instead of rising, fixed costs must be allocated over a decreasing number of mail pieces and any increase in cost per hour will only make it worse. The result

is that prices will have to rise to balance the costs, and because of price elasticity of demand factors, the mail volume will drop even faster.

While these facts are true for all considerations in this analysis, they are particularly significant here. Mail volume is dropping and costs cannot drop as fast. As a result, the cost per piece and the price per piece will inevitably rise. As a consequence, any business model that solely relies on mail for revenue will continue to lose revenue, continue to incur operating losses, and ultimately jeopardize the ability to offer not merely affordable universal service.

C. Direct and Indirect Financial Effects of Alternatives

The preceding analysis illustrates why the Market Intensification Model, no matter how well operated, cannot sustain the Postal Service. Whether mail volume declines at a shallow slope or a fast one, the outcome will be the same – there will not be sufficient revenue to pay the costs of a nationwide system.

The financial effects of maintaining the current business model will not only result in current losses. The current business model will also become unable to maintain infrastructure, including facilities, equipment and vehicles. Whether delivery occurs on six, five or even three days a week, the result is a financially strained system that cannot provide the upkeep that a sophisticated network requires, and as a result, operational and service failures will occur, thereby driving customers who need reliable delivery to use alternate services or methods, thereby increasing the loss of volume and revenue.

The indirect effects are more difficult to measure, but can be more consequential. The Postal Service payroll is about a billion dollars a week. The economic impact of the Postal Service can be viewed two different ways. If there is a ten percent revenue reduction because of reduced mail volume, the impact of that is about \$100 million per week in lost payroll – a substantial loss to the economy. However, if Postal revenues can be increased, that can result in substantial increase in economic activity. Another consideration, however, is the substitution effect – what happens if the USPS does lose \$100 million in payroll each week. It is correct to say that the USPS lost that payroll, but if mailers spent money on \$100 million in something else, then it is a neutral action. Consequently, it is important to keep in mind that loss of postal economic activity may or may not adversely impact the economy, depending on how the money not spent at the Post Office is alternatively spent.

While the direct financial impact of a payroll reduction may be difficult to rationalize because of substitution of other goods and services for postal products, there is an undeniable adverse impact if the mail becomes slower and results in adverse conditions for those who depend on the mail. Financial industry billings will not be able to rely on the consistency of the turnaround time when billing for credit cards and other statements. Advertising mailings may not get through the systems on time, sale dates are missed, and direct mailing firms lay off employees because advertisers cannot rely on the service. Magazines and newspapers delivered by mail either have to close out their issues earlier, creating stale news, or have to risk late delivery if some part of a deteriorating infrastructure fails. In a way, it is like the heartbeat of the economy slowing, causing the transactions, messages, and advertising in circulation to move more slowly. Moreover, this impact would not be felt universally in the U.S. population. It would fall heaviest on the citizens who do not regularly use the Internet and automatic bill paying. Whatever jobs are lost would likely not be in the board room, but in the mail room.

The business model selected absolutely must generate revenue that is not reliant on the movement of paper from one place to another. Paper transmission of written content is a contracting industry, in the mail, in magazines and newspapers, in hard-copy textbook publishing, and in popular reading. The iPod and Kindle are only forerunners of what is to come.

D. Implementation Issues

The consequences of a postal system failure also illustrate the importance of the implementation of any changes to that system. Postal Service performance has a huge direct and indirect impact on the economy and particularly on those without Internet services or other alternatives to basic mail service. For these reasons, it's essential that any changes to the network must be carefully planned to identify all direct and indirect impacts, and then implemented with caution. It would be most prudent to implement modifications in the current business model in multiple steps, rather than all at once, so that the changes can be evaluated as they are introduced.

The traditional academic admonition that "further study is recommended" whenever change is proposed is entirely appropriate here. Given the scale of the organization and the complexity of its stakeholder relationships, a first step would be to organize teams to study in-depth each model and its implications. Experimentation with specific initiatives on a managed pilot scale would be appropriate. In any event, scale and complexity mean that a five to ten year implementation schedule is appropriate.

E. Human Capital Issues

The Postal Service employs more than 600,000 workers, about one-half of one percent of the entire U.S. workforce, or one out of every 200 workers. All of the models offered imply a major commitment to better managing labor costs and increasing workforce flexibility. When a business model or regulatory structure change impacts the workforce, there will be a significant dislocation of those who are affected unless that flexibility is created. Impacted employees must be prepared to be re-skilled and re-deployed and willing to adopt new roles whenever possible if they are to remain employed.

F. Optimization of Infrastructure, Retail Access and Convenience

A significant consideration in selection of a business and regulatory strategy is how best to utilize the infrastructure that is in place with the current business model. There are about 400 processing plants and 36,000 retail post offices in the postal network, plus another 57,000 stores and banks that sell stamps.

Even if the Postal Service makes no changes in the business model, there is still the question of how to best utilize the buildings, equipment and vehicles – 221,000 vehicles and the largest fleet in the world. The reduction in mail volume, coupled with the continued growth of new homes and businesses that expect delivery means that less mail is spread over more delivery points. That challenge exists no matter what business model is selected for future USPS operations. The Postal Service has in the past moved equipment and vehicles and makes capital investments in infrastructure to achieve the best return on the investment and support service requirements.

However, the question becomes more complex when considering the possibility of franchising or outright selling postal operations in areas of the U.S. If the franchise or privatization choices are selected as business models, the infrastructure will not only have to be optimized, but also will have to be identified as assets that are either transferred in sale to private sector operators, leased to franchisees, or otherwise accounted for financially.

Another dimension in franchising and sale can also arise. An unscrupulous applicant might purchase postal assets such as buildings, vehicles and equipment and then sell those assets for profit while jeopardizing mail service. The solution might lie in contract provisions that do not impede the sale of assets, but do require that the franchisee or private operator achieve performance standards as a contract condition.

Retail access and convenience is a related matter and must be addressed whether the Postal Service retains operations, establishes franchises, or sells operations in specified markets. This matter goes to the heart of the question of what is access and convenience and for whom. For someone with Internet access and the ability to print shipping labels and postage on the home computer, access may be easy to achieve via computer and that person may also be able to conveniently visit a Post Office ten miles away. For those without Internet or reliable transportation, however, access in the same environment could be materially different and more difficult. This illustrates how access and convenience are not entirely objective measures.

Finally, access and convenience should be viewed in the context of both ordinary environments and also in the unusual circumstances of natural disasters such as hurricanes or even something simple like a power outage. The person who has easy access via computer and Internet may not have access during such circumstance, so any business model must be evaluated under foreseeable but uncommon situations, not just normal conditions.

G. Safety and Security of Mail and Postal Employees

Safety and security of the mail and employees is important in all possible business models, but especially when the models rely to some extent on global operations in emerging countries, domestic franchising or privatization of operations. Each of the proposed business models and regulatory structures can accommodate provisions that maintain safety and security provisions for postal employees and the mail.

The Global Expansion Model clearly poses additional risks for employees when projects are in emerging economies where safety and security are larger issues than domestically. Effective training and preparation of employees who are potentially redeployed on a voluntary, temporary, or contracted basis will be essential. There are well-established practices in place within all global businesses today for preparing employees for such projects.

Another concern that could arise relates to the Market Leverage Model that offers USPS or government products and services within the current Postal Service distribution, retail and/or delivery networks. In this model, there may be non-postal activity such as registration for Social Security, issuance of drivers' licenses, or other retail activity. There could also be non-mail products or supplies on the workroom floors of post offices. The safety and security of the system is maintained by assuring that non-postal personnel and customers are not permitted into the areas where mail is kept, as is the policy now.

Products and services would need to be screened to assure that neither mail nor postal employees incur risk of harm or risk of loss because of these products. The same process would be used in the Open Market Model, which expands the Market Leverage Model beyond USPS-branded products and government products and services to embrace revenue streams that are not necessarily USPS-branded or government services. One illustration of this could be delivery employees reading utility meters once a month on the routes. If a carrier left the vehicle to accomplish a new task, there are already policies in place regarding locking the vehicle, and the mail would remain safe even if the carrier is away from the vehicle. Note that this occurs now as carriers leave their vehicles to deliver packages or to place mail in mailboxes on the doors of homes on park and loop routes.

The final concern for safety and security of the mail and employees relates to the Franchise and Privatization models. In these models, the workers would not be postal employees but employees of the franchisee or the private company that has purchased the assets and right to conduct postal operations. At first impression, this might appear to be a dramatic change, but a closer examination reveals that this is in many ways "business as usual" for the Postal Service. Today, there are many facilities, transportation operations, retail service counters, and delivery routes staffed by non-postal personnel, and usually in vehicles or buildings that are not postal-owned, either. Contract terminal operations have existed to support postal operations in many cities in the U.S. for many decades. Transportation of the mail is predominantly by contracted service, going back to the railroads, stage coaches, and to aircraft contracted and flown by such notable contractors as Charles Lindberg.

Many retail services are provided by contractors, including contract post offices and contract stations and branches. These contract services, like transportation, have been in operation for many decades, and have demonstrated the ability to provide good service, excellent access, and low cost of operation.

Finally, contract delivery has been provided for decades by Box Delivery Highway Contract Routes. This delivery alternative utilizes competitive bidding to award contracts to deliver mail in areas that range from the desolate (the bottom of the Grand Canyon) to the beach homes in parts of Florida. Like contractors in retail, transportation and distribution operations, these contractors are subject to background checks, screening, and other security precautions.

The mail and postal employees have worked with contractors for the majority of the time since Benjamin Franklin served as the first Postmaster General. Franchises and private sector operations are not widely recognized, but have been and still are a significant part of the current business and regulatory model. The possible regulatory structures of franchising and sale to private operators are not that far removed from today's model.

H. Minimize Areas of Inefficiency/Waste and Improve Operations

This requirement of the Postal Accountability and Enhancement Act is addressed in many ways. First, the Market Intensification Model focuses on improving the current business model. The other models build on this foundation, variously adding global mailing services and turnkey operations for emerging markets (Global Market Expansion Model), and the increased efficiency of using the current distribution, retail and delivery platforms and networks to generate additional revenue (Market Leverage Model and Open Market Model).

In addition, the regulatory alternatives include the franchise and independent private sector owned operations (Privatization) structures. This means that multiple franchisees and private sector operators can develop new efficiencies, services and improvements in their respective operating areas. Their motivation is significant – they can devise processes that reduce costs in their own operations, and that enable them to operate at a cost lower than their colleagues and competitors in other operating areas. If the franchises or privatized operations are competitively bid, then the efficiencies represent a knowledge-based asset for those who develop the processes. The franchise and privatized operations create competition among the multiple providers of postal services, similar to what occurred with the “Baby Bells” when AT&T was broken up many years ago.

I. These Business Models and Regulatory Structures Present All Possible Alternatives

It is beneficial to remember that what has been considered here are not just four possible business models and four possible regulatory structures. The business models presented here are the only four possible combinations of products/services and markets:

1. Current Products/Services in Current Markets (Market Intensification model)
2. Current Products/Services in New Markets (Global Expansion model)
3. New Products/Services in Current Markets (Market Leverage model)
4. New Products/Services in New Markets (Open Market model)

The regulatory structures are similarly all-inclusive:

1. Government Agency with agency authorities and limitations, and potential for regular Congressional financial appropriations (Government Agency model)
2. Government Entity with non-standard authority and limitations, and without potential for regular Congressional financial appropriations to agencies. (Current model)
3. Private entity subject to revocation by the government (Franchise model)
4. Private entity not subject to revocation by the government (Privatization model)

J. Business Models and Regulatory Structures Can Be Diverse and Evolve

Each of the four fundamental regulatory structures likely works. Each has desirable attributes and areas that raise concerns. The best regulatory structure will to some extent be influenced by what business model – or combination of models – is selected. The regulatory frameworks and business models can also be uniform across the U.S. or could be differentiated for various good reasons. For example, it could be that the processing and distribution network is best operated under the current regulatory model, while retail and delivery operations, being localized, would work well as franchises.

There is also a time dimension to be considered. A certain business model or regulatory framework may be suitable as a first step away from the current business model and regulatory framework, but there may be good reason to assess that first step and then evaluate whether it is advisable to take another step, or to perhaps test one or more of the alternatives in specific geographic areas of the U.S. These models and structures are tools that can be used at appropriate times and in specific ways. It is not simply a matter of “pick one” business model and then match with one regulatory structure.

PART THREE: RECOMMENDATIONS

I. Recommended Actions

A. Recommendation: An Initial Focus on the Role of the U.S. Postal Service and the Restrictions Placed on It.

There cannot be any serious consideration of business models until the role of the U.S. Postal Service in an open economy is defined more clearly. Resolution of the regulatory structure must occur before the business models can be further developed because many of the elements of the discussed business models will require that the USPS perform activities that it may not now be permitted to do. There must be an articulation of a defensible economic rationale for what the Postal Service is allowed to do to achieve the postal mandate of mail service that is universal, accessible, and affordable.

There are two fundamental roles that should be distinguished: oversight and execution. The oversight role is that of assessing if the postal mandate is being achieved. Currently, this is performed by USPS Governance in the body of the Board of Governors and in the Postal Regulatory Commission. Execution of the mail service role is performed by the U.S. Postal Service. To clarify the role of the USPS and the restrictions on it, the focus should answer these specific questions:

1. Oversight – If the selected business model included franchising of some operations or outright privatization of mail delivery, what government entity would be responsible for assuring that the postal mandate of universal, accessible and affordable mail service is maintained? Would the USPS be the organization that establishes and assesses the franchisors? Would USPS audit private entities, would some other government entity do it, or would there be no oversight?
2. Execution – If the USPS remains the entity responsible for carrying out the postal mandate of universal, accessible, affordable mail service, is the scope of operation limited to only core mail products, or will the USPS have the authority to conduct other activities? Specifically, if mail volume is insufficient to provide the revenue needed to pay for operation of the national postal network, will the USPS be allowed to conduct the types of activities that are explained in the Global Expansion, Market Leverage, and Open Market business models, as discussed in this paper? If the USPS is not permitted the freedom to generate non-mail revenue to close the gap that will exist between mail revenues and mail expenses, then the only alternative ways to close the gap would be Congressional appropriation, or price increases for mail that would likely result in further reductions in mail volume, leading to a price up/volume down spiral that would jeopardize the ability of the system to meet the postal mandate.

Beyond these two roles of Oversight and Execution, there remains the question of how a government entity such as the Postal Service would co-exist with any private-sector operators of mail service, either as franchisees or as privatized businesses not restricted by revocable franchises. Would the Postal Service be viewed as a preferred entity to execute the mail operations, on equal competitive footing with the franchisee or private operators, or not the preferred operational entity and only used as a “provider of last resort” in the event that private businesses do not or cannot provide mail service in

certain geographical areas or markets? These are public policy questions that have to be resolved before a business model can be selected.

To make the case for the Postal Service leading necessary change, there are what appear to be six “absolute truths” that can be succinctly summarized:

1. Traditional mail volume and revenue is declining at a rate in excess of ten percent annually, and this will continue as technology and demographics drive a shift from paper-based transactions and communication to the electronic alternatives.
2. The postal network, as measured by the number of delivery points, will continue to rise at a rate of 1.0 to 1.5 percent per year indefinitely even while mail volume per delivery point drops.
3. While variable costs have been reduced significantly, the fixed nature of network costs, coupled with the steady growth of delivery points, means that the system cost will remain relatively constant even as the volume and revenue drops.
4. As a consequence, operating losses will grow even under the best scenarios.
5. To maintain accessible universal service, the Postal Service will have to raise prices on the remaining volume which will endanger the affordability of the mail and will in all likelihood hasten further reductions in volume.
6. The only way to achieve accessible universal service at an affordable price will be to either: (a) rely on Congressional appropriations to cover the revenue-expense gap in mail operations; or (b) allow the Postal Service to generate revenue that utilizes the current network and assets, so that the financial loss in mail service can be made up by non-mail related products and services.

The Postal Service has historically been barred from enterprises that were not directly tied to mail delivery. The mail business is in decline, and if Congress does not want to cover the gap with appropriations, it will have to authorize the Postal Service to do some business that could also be done by private sector businesses. The most acceptable approach may be to partner with private businesses rather than directly compete with them.

This message, or one like it, should be crafted and then form the basis of a major communications strategy with Congress, with mailing industry stakeholders, with internal stakeholders such as employees, unions and management associations, and with consumer interest groups. If Congress is hearing different messages from various stakeholders, then it will be hesitant to act. The first step is to get all stakeholders behind a consistent message. To get agreement, the message should focus on the need for change, not necessarily how to do it. If the parties all agree that USPS cannot stay where it is now, then the discussion can commence about what path or paths to follow. This is the battle that must be won to assure a viable ability to provide accessible, universal and especially affordable mail service to the American public.

B. Recommendation: Select a Business Model and Regulatory Structure Based on Key Requirements and Recognized Strengths.

Once the role and restrictions issue is resolved, the most ideal business model combination can be defined. The selection of a business model is influenced by four primary considerations.

1. It is essential that the selected business model provide affordable and universal service and that mail services will be accessible to the public.
2. Second, the model must be financially viable with substantially less domestic mailing service revenue than exists now, perhaps even with no more than half the current revenue because that may be the future.
3. The selected model must tap new sources of revenue that are not dependent on delivery of hard-copy written content. While candidate products and services could be almost limitless, it would be logical to look first at revenue sources that could leverage the current distribution, retail and delivery assets.
4. The selected model must be responsive to the operating costs and particularly the labor costs that exist now. The financial liabilities of legacy labor costs must be resolved in some way to allow the business model to be viable.

In addition, the Business Model and Regulatory Structure should leverage the recognized strengths of the U.S. Postal Service.

1. Multiple studies demonstrate that the U.S. Postal Service is highly trusted by the population and customers that it serves.
2. The USPS processing and distribution network connects all areas of the U.S. and links to worldwide distribution networks.
3. The Postal Service delivery network goes everywhere, every day.
4. The delivery employees know the neighborhoods, the business areas and the customers they serve. That knowledge has significant potential value.

The analysis in this paper has examined some general possibilities about how to generate additional revenue to cover financial losses in mail service operations. Before any business model or regulatory structure or even isolated strategy is tried, additional research and analysis will need to be done to develop the business case: the market to be served, the revenue expected, the cost incurred, the benefits, the obstacles, and the solutions. When the information is more fully understood, pilot projects can be activated.

C. Recommendation: Expand Beyond the Core Business.

There is no single product/market solution that meets all these requirements and assures a successful future; multiple solutions are required in the form of new product/service and market initiatives to best meet the magnitude of the challenge. Simply doing traditional domestic mail delivery better will not by itself be adequate to assure affordable universal service unless subsidized by Congressional appropriation.

What can work is some combination of: (1) the Market Intensification Model, coupled with (2) leveraging the current domestic market by introducing new products and services in the Market Leverage business model, (3) generating revenue by offering mailing service products in non-domestic markets in the Global Expansion model, offering turnkey mailing services in non-domestic markets with particular emphasis on emerging markets that do not have a state-of-the art postal services now, and (4) opening up the domestic postal networks to allow non-postal partners to utilize the distribution, retail and delivery platforms in the Open Market model. Note that opening the domestic markets to non-

postal partners will not give partners direct access to mailboxes. Only the Postal Service would have that access for the continued safety and security of the mail.

D. Recommendation: Support Evolution, Not Revolution in Business Models.

Because of the size and scope of the U.S. Postal Service, any significant change to the organization or its processes could have substantial impact on the stakeholders and on the national economy. It is prudent to evolve into the next business model in a series of steps and stages, evaluating outcomes at appropriate milestones. A more sophisticated and complex organization design, along with regulatory structure, is therefore required to execute such a complex set of staged initiatives.

Structure follows strategy, and rethinking of the current design will provide for: (1) continuity of core commitments in the traditional products and services, (2) increased focus on developing and supporting international initiatives and operations, and (3) selecting, designing, and overseeing new products/services and market ventures, whether launched in-house or through joint ventures and alliances with other providers. While the current organization has successfully demonstrated significant entrepreneurial thinking and action (e.g., automated mail sorting and sequencing), additional new competencies and skills will need to be introduced into the organization at a fairly early point in this process. Talent recruitment will need to accelerate and come from both internal and external sources.

E. Recommendation: Regulatory Structure Change Must Go Beyond Pricing Flexibility.

The past several years have witnessed a robust conversation about the need for pricing and related flexibility to compete in the marketplace that is emerging for the Postal Service. That was achieved to some extent with the passage of the Postal Accountability and Enhancement Act of 2006.

There are other types of flexibility that will likely be needed to one degree or another. They can involve more on pricing, or could be related to purchasing/contracting, governance, financing, the ability to raise cash through not only bonds but even equity-sharing, and especially the flexibility to conduct business activities that have in the past been off-limits for the Postal Service.

F. Recommendation: Experiment with Franchising and Privatization in Pilot Projects

The four regulatory structures – government agency, current independent establishment, franchise and privatized – are a continuum from the most regulated to the least. Recognizing that the current model is the starting point and that the government agency structure has already proven to be inadequate, it would seem evident that the logical regulatory step would be to introduce some less-regulated structures in the near term with the understanding that these would be evaluated after implementation to determine if the franchise and/or privatized structures were better than the current structure at protecting affordable universal service and reasonable access.

With appropriate enabling legislation, the Postal Service could designate some pilot areas to implement franchising and privatization, while retaining the current regulatory model in the remaining parts of the U.S. The results of the franchise and privatization pilots would provide valuable data to enable an understanding of what is best to do, and how best to do it. Note that there are already performance factors in place that could be used to assess franchise and privatized operations – EXFC, Customer Satisfaction, internal costing sampling and other activities.

Introducing business models, organizational design and regulatory structure changes in a sequenced pilot fashion would also provide stakeholders, including large mailing organizations, consumer advocacy groups, employees and unions, postal suppliers and contractors, and especially Congress the opportunity to learn how well the various business models and regulatory structures achieve the postal mandate. Stakeholders can observe the relative strengths and weaknesses, analyze what is happening, and provide valuable input about how the evolution of the postal system will progress.

The sequenced introduction of pilot areas for franchise and privatization would provide the Postal Service the opportunity to evaluate the party's ability to maintain affordable, accessible universal service. The Postal Service could focus on assuring that the start-ups protect mail and service standards. A sequenced introduction would also permit postal employees to be re-skilled and facilitate the transfer of any displaced postal employees to nearby postal facilities that remain as USPS-operated installations. As the complement of USPS employees continued to decline, additional operating areas could be considered for franchising or privatization until a desired mix of postal-owned, franchised, and privatized operations is achieved.

II. Recommendations for Further Study

There is additional work that can facilitate and expedite the development of business models and related matters.

A. Knowledge to Support Development of Business Cases

While this paper has identified the categorically possible business models and regulatory structures, additional work is needed to be able to build a business case for the new business model. These studies could develop answers relating to sources of revenue, the ability of the USPS to take on the additional workload in various strategies, skill/training requirements, and other details that need to be known.

B. Contrast and Comparison with Business Models in Other Countries

It would be valuable to establish a conversation with the USPS counterparts in other nations. This serves two purposes. First, it allows the discussion of possibilities, including what has worked and what has not, and why. If the USPS hosts that discussion, then it establishes the USPS as the repository of this type of knowledge, laying the groundwork for USPS to later roll out the Global Expansion business model because it will already have an understanding of the current issues of other nations.

C. Develop the Project Management Approach for Testing in Pilot Projects

The Postal Service already has considerable experience at testing and rolling out major change, as was ably demonstrated in postal automation of mail processing and delivery point sequencing. A similar effort is required to determine how to construct the test of various business models and regulatory structures in designated areas. The study can also help define how the assessment of the test should be conducted and evaluated.

D. Identify “High Return – Low Risk” Initiatives That Can Be Implemented Immediately

While the business models require diligent testing and a longer timeline to execution, the process of developing these models will surface things that can be done in the short term. The initiatives that have a profile of “High Return – Low Risk” can be identified and implemented on a ‘fast track’ basis. Examples can include advertising on postal vehicles, and service-for-fee opportunities helping the postal services in other countries.

E. Identify the Opportunities for “One-Stop Government Service” in the Market Leverage Business Model.

Identifying what services offered by federal, state and local government might be centralized into a “One-Stop Government Service” initiative at the local Post Office will take time, and the results of this study may ultimately determine whether this is a viable strategy within the Market Leverage business model.

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