UNITED STATES POSTAL SERVICE®

Transformation Plan

April 2002

Message from the Chairman of the Board, Robert F. Rider, and Postmaster General & CEO, John E. Potter.

The Postal Service is delivering on its commitment to the Senate and the House of Representatives to develop a comprehensive Transformation Plan. The Congress's recognition of and concern for the seriousness of the situation facing the Postal Service has been most encouraging to the Governors and postal management.

Successful transformation will require strong and committed leadership from the Governors, the Postmaster General and all postal employees. Working together with our many stakeholders, including the executive and legislative branches, we will forge a new and modern business model for an institution that has served this country and evolved with changing times since 1789. We recognize our responsibility to take definitive action and to offer the citizens of America a clear and compelling view of current and planned actions, and our vision of where we are headed. At the same time we want and encourage all our stakeholders to remain actively engaged in discussions about postal issues and the Postal Service's future. To that end, we call your attention not only to the Executive Summary, but to all the supporting materials, especially the appendices. These sections provide the detailed information that will enable further dialogue and understanding.

This *Transformation Plan* is about enabling the Postal Service to successfully carry out its long-standing mission of providing affordable universal service. It is about maintaining a fundamental principle and vision that delivery of mail is an important and vital government service, regardless of where one lives or what one's station in life might be. Equal access and opportunity to communicate through the mail to meet personal and commercial needs supports a basic American value of equality.

We commit to leading this transformation of the Postal Service to ensure the continuation of affordable universal service and to prepare the organization for the challenges of change in a dynamic marketplace.

Robert F Rider

Robert F. Rider

John E. Potter

John E. Potter

United States Postal Service Board of Governors

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I. Introduction

We live in challenging times. Long-term technological and commercial trends, often termed the Second Industrial Revolution, are fundamentally reshaping national and international services for collection, transport, and delivery of all types of postal products. These trends will compel a fundamental transformation in our national approach toward the Postal Service as an institution and the delivery services sector as a whole.

At stake is the future of what has been, since this nation's founding, the right of every American to send and receive mail. The Postal Service exists as a governmental entity whose mission is universal service to all. That mission is a direct reflection of the values on which this country was founded, and it is those values of equality of opportunity that drive Postal Service management today just as they drove the managers of the Post Office Department.

> *"The Postal Service has been a reliable, trusted provider of communications for more than two centuries. It is a basic and fundamental service provided to the people of America by their government. It helps keep Americans in touch, and it is the hub of a $900 billion mailing industry. We are working to keep this critical national asset strong and vibrant, today and far into the future."*
>
> —Joint statement by the
> Postmaster General and the
> Chairman, Board of Governors

In this *Transformation Plan*, the Postal Service respectfully submits to Congress and to the American people our views on the steps that must be taken now and the long-term options that appear feasible. With the valuable assistance of our stakeholders,[1] we have prepared this report as a decisive response to the challenges posed, a response that postal leadership embraces and commits to execute fully and effectively.

Today, a commercially and financially viable Postal Service remains vital to the American economy. The Postal Service delivers more than 200 billion pieces of mail each year (over 40 percent of the world's mail). It collects nearly $66 billion in revenue annually and is the eleventh largest enterprise in the nation based on revenue. The Postal Service anchors a $900 billion domestic mailing industry that employs roughly one in fifteen American workers. The Postal Service employs nearly 770,000 career employees, which makes it the second largest civilian employer in the nation. More than seven million Americans visit post offices each day. Additionally, more than 1.7 million new delivery points are added to the postal network each year.

The future role of the Postal Service, however, is uncertain. For any organization to remain viable and flourish, it must change. As technology, commerce, and society evolve, so too must government and corporate business models. This is no less true for the U.S. Postal Service than for any other enterprise.

The Postal Reorganization Act of 1970 (PRA) succeeded. It created an independent governmental entity well designed to deliver postal services in a more businesslike manner. The Act created a structure that enabled the Postal Service to function effectively over the last 30 years. With effectiveness came dramatic growth for the mailing industry, which contributed to economic growth and increased satisfaction for postal customers.

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[1] This plan incorporates the comprehensive feedback received on the *Outline for Discussion: Concepts for Postal Transformation*, September 30, 2001.

The institutional model adopted in 1970 was not, however, designed to cope with the fundamental changes that are today reshaping the delivery services marketplace. These trends include the following:

Changing customer needs. With access to more information and more options than ever before, customers have a broad range of choices for delivery of messages, money, and merchandise—our three businesses. A single, basic, universal service, the premise of the PRA, is no longer sufficient to meet increasingly varied customer requirements.

Eroding mail volumes. Electronic alternatives to mail, particularly electronic bill presentment and payment, pose a definite and substantial risk to First-Class Mail® service within the next five to ten years.

Rising costs. Despite major gains in efficiency and productivity through automation of letter mail, the costs of maintaining an ever-expanding postal network are rising faster than revenue, especially costs outside the direct control of the Postal Service, such as retirement and health benefit liabilities.

Fixed costs. Universal service requires a significant infrastructure to deliver postal services.[2] Almost one-half of current postal costs are spent on these resources and that level does not increase or decrease when volume changes or when productivity increases. This creates a challenge for cost containment.

Merging of public and private operators into global networks. Former national foreign postal services, some privatized, have entered the U.S. domestic market; giant private firms that now dominate global parcel and express markets are entering an increasing portion of the postal value chain.

Increasing security concerns. Rising security concerns will require expensive and sophisticated countermeasures.

Consideration of these trends leaves no doubt that the time has come to address fundamental long-term questions. We at the Postal Service do not presume to have all of the answers. We do, however, in this report, offer our approach to transforming the Postal Service into an enterprise suited to the 21st century.

In the near term, we have concluded that substantial improvements in the efficiency of the Postal Service can be accomplished without major revisions to current law, provided our customers, our employees, and policymakers fully recognize and embrace the fundamental long-term transformation we are beginning. In this report, we describe our specific plans and seek support from Congress where incremental statutory changes are needed.

In the long term, we believe that fundamental restructuring of the legislative and regulatory framework for postal services is required. The public debate about postal modernization led by Congress over the last five years has illuminated important issues, many of which raise implications that stretch beyond legislative remedies presently contemplated. We need to address these larger issues and reach a national decision on the future of the Postal Service.

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[2] Examples include more than 38 thousand post offices, stations, and branches, 240 thousand delivery routes to service over 137 million delivery addresses, 215 thousand vehicles, and significant annuitant retirement costs.

Over the next two to three years, it is vital that significant progress be made toward defining the long-term structure and role of the Postal Service. In support of that process, this report outlines three alternative models for the future role of the Postal Service. These range from a Government Agency, offering subsidized residual services not provided by the private sector, to a Privatized Corporation, a competitive company owned by private citizens. From among the conceptual models identified, we offer our own preliminary conclusion that a middle ground is the most appropriate: a Commercial Government Enterprise, owned by the government but structured and operated in a much more businesslike manner, with attributes appropriate to the unique role this institution plays in the nation.

In developing this report, we gratefully acknowledge the assistance of the full range of stakeholders in the postal industry. At the outset, therefore, we would like to articulate a firm commitment to all of these stakeholders, and especially to our customers. During this crucial transformation period, in order to maintain our financial viability and fulfill our universal service mission, we commit that we will:

- Foster growth by increasing the value of postal products and services to our customers;
- Improve operational efficiency; and,
- Enhance the performance-based culture.

This report describes how we will honor these commitments while remaining faithful to the vision that has inspired the post office for more than two centuries: that the Postal Service should bind the nation together by providing all Americans with vital communication and delivery service.

II. Meeting the Challenge

In order to address the challenges we face today and to prepare for transformation, we must push business effectiveness and operational efficiency to the limits permitted by current postal laws. With the support of customers, employees, and policymakers, there is much we can do, and are doing now. Building upon current efforts, we will implement the following specific strategies to support our commitments:

Growth through Added Value to Customers

Flexibility and growth will be essential for the Postal Service to transform successfully. To fulfill its universal service mission, the Postal Service must offer affordable products and services that serve the entire spectrum of its customer base, from large corporations to individual consumers. The Postal Service must also find ways to use existing resources to generate new revenues to offset anticipated losses from electronic diversion. Our products and services must also be flexible enough to adapt to 21st century technological advances.

With these requirements in mind, we will implement a number of specific growth strategies to increase value to our customers. We will:

- Work with the Postal Rate Commission (PRC) to create more streamlined processes for introducing targeted pricing initiatives, such as negotiated service agreements, and more regular and predictable price changes, such as phased rates.
- Expand access to postal services by doing business when and where our customers prefer.
- Move simple transactions to less expensive channels, improving customer service and increasing retail contribution.
- Develop “intelligent mail” products that not only track and trace from origin to delivery but also integrate information throughout the entire cycle of multiple business transactions.
- Work with customers to make sure databases are updated frequently and accurately, and explore the use of publicly available databases to improve the overall accuracy of address information.
- Make it easier to use postal services by aligning mail preparation and prices to customer needs and capabilities.
- Explore more innovative payment options for our customers through third party credit.
- Enhance revenue opportunities by leveraging existing assets and infrastructure, including postal-owned vehicles and facilities.
- Work with all package mailers to create a package offering that is simple, easy-to-access, information-rich, and takes advantage of our vast retail and delivery presence.
- Work with customers to add features that enhance the value of traditional products.
- Continue to seek opportunities to leverage our brand and assets to create new products and services with minimal investment.
- Strive to protect postal employees and customers from exposure to biohazardous material and to safeguard the mail system from future attacks.

Operational Efficiency

Cost containment is the most important customer-focused strategy, especially for large business mailers who rely most heavily on the postal infrastructure. In any network business, however, it is difficult to control costs when volume declines while the network itself continues to grow. This is the challenge faced by the Postal Service: increasing costs may have to be spread across a declining volume base.

In this difficult environment, we will achieve cost savings by implementing a number of specific measures designed to improve operational efficiency over the next five years. We will:

- Reduce operating cost by automating the flat mailstream and mail forwarding operations.
- Continue improving annual productivity through techniques such as benchmarking, standardization of best practices, and complement planning and scheduling.

- Explore new workshare and mail preparation opportunities to eliminate handlings in the presort-to-delivery supply chain.
- Experiment with new methods of reducing the time letter carriers spend in the office, for example, sorting flats into delivery sequence.
- Reduce transportation costs and improve transportation management by implementing network planning, routing, and tracking programs.
- Redesign the postal logistics network so that the number and location of processing centers, processing strategies for mail, and transportation modes and routes are optimized to meet customer service requirements at minimal total system costs.
- Revise purchasing regulations to allow for acquisition of goods and services in a manner similar to that followed by businesses.
- Explore alternative purchasing strategies for automation equipment and information technology to include leases and fees for services contracts.
- Optimize the retail network by lifting the self-imposed moratorium on post office closures and working with the PRC to significantly streamline the process for closing post offices.
- Pursue regulatory and legislative reform to provide the Postal Service the latitude to adjust service levels and delivery frequency to standards commensurate with the affordable universal service obligation.

Performance-Based Culture

Breakthrough productivity initiatives will be achievable only if we are able to make significant progress in our third commitment: enhancing our performance-based culture. For this, we must maintain an effective, diverse, and motivated workforce whose members know what is expected of them and who are recognized for individual and team accomplishments. The challenge to assure continuity of leadership has never been more important than it is today. Approximately 55 percent of Postal Service officers and senior executives and 36 percent of managers will become eligible to retire over the next five years. To address these challenges, we will:

- Enhance retention and recruitment strategies. Flexible and responsive retention tools and recruiting practices are necessary to address the attrition challenge.
- Strengthen succession planning to identify, to develop, and to select current and future leaders.
- Maximize the potential of available training and development programs in order to have a pool of potential successors at all levels of the organization.
- Change the culture of the Postal Service by improving our management of employee performance with data. This will be achieved by better defining expectations and measuring performance against those expectations. Accountability will be enhanced through greater use of performance-based pay to recognize individual and team efforts.
- Build a highly effective and motivated workforce by reinforcing management responsibility for a safe, secure, satisfying, and diverse workplace.

- Continue working with the labor unions to improve relationships, to reduce grievance costs, and to jointly examine modifications to the impasse resolution process we are recommending to Congress. The spirit of cooperation that resulted from the anthrax crisis set a solid foundation for future relationships.
- Optimize the ability to reposition the workforce by implementing data-driven assessment tools that will assist in determining skill needs and availability by location.
- Move repetitive transactional work to a shared services environment and explore outsourcing to reduce costs and increase efficiency.
- Improve the collective bargaining interest arbitration process to include a period of mediation. This would enhance the opportunity for the parties to reach mutual agreement on contractual issues.
- Reduce workers' compensation costs by implementing programs and developing employment opportunities for injured workers within and outside the Postal Service and by working with the Department of Labor on new initiatives and regulatory changes.

Enabling Functions

Enabling functions support attainment of the commitments described above. Focused financial management will enable the Postal Service to reduce outstanding debt, using it in the future for capital improvements where the value added by the investment exceeds the cost of debt. Enhanced financial management will also increase reporting transparency. Adopting business-driven purchasing and materials management procedures will enhance supply chain management. Applying information technology with universal connectivity will enable us to enhance security, add valuable product features, and manage operations in real-time. A continuing commitment to mail security will deny use of the mail to criminals while protecting the public and the Postal Service against external attacks and workplace disruptions.

Regulatory and Legislative Reform

Successful transformation of the Postal Service also depends in part on adoption of moderate regulatory and legislative reforms. These reforms will allow us to test new opportunities, to prepare for long-term structural transformation, and to prove our ability to deliver mail in a less constricted environment. Only in this manner will stakeholders have an opportunity to evaluate the extent to which such reforms add value. We will therefore seek expeditious implementation of the following regulatory, legislative and administrative changes:

Prices and Financing. Within the framework of the current rate-making process, the Postal Service will request several reforms to respond to customer pricing needs and restore postal finances to a more sound footing. We will seek approval for negotiated service agreements and other targeted pricing initiatives, reforms in procedures for introducing experimental mail classifications, phased rates, and inclusion of costs in the revenue requirement to finance the expansion of the delivery network on a current basis. The Postal Service believes that some of these reforms can be implemented administratively with the assistance of the PRC. In the event that efforts to achieve these changes identify hurdles that cannot be cleared within the scope of our existing statute, we will ask Congress to enact legislation to remove those hurdles.

Facilities. The Postal Service will lift the self-imposed moratorium on post office closings and consolidations. The ultimate goal is to better serve our customers. A combination of rural delivery and alternative retail strategies may provide the most convenient access for the customer. To optimize facility networks, the Postal Service will also seek relief from legislative restrictions on post office closings and consolidations. Currently applicable administrative procedures should be streamlined or repealed, and appropriations riders referring to post office closings and 1983 service levels should be discontinued.

Flexible, Business-Driven Purchasing Procedures. Consistent with the way businesses purchase goods and services, the Postal Service will revise its purchasing regulations to the extent allowed by present law.

Labor and Employment Reforms. The Postal Service will seek more effective mediation procedures, including appointment of a neutral mediator by the Secretary of Labor, to help resolve bargaining impasses. In addition, repeal of the statutory salary cap is needed.

Our Commitment

In total, these near-term, customer-focused, operational, and performance-based strategies will generate $5 billion in savings and cost avoidance through 2006, of which $1 billion will be in post office operations. These savings will enable us to achieve some debt repayment and to hold rates steady from mid-2002 until calendar year 2004. If a rate increase is needed at that time, a moderate, negotiated increase will be pursued.

III. Preparing for the Future

The ultimate goal of Postal Service transformation should be to promote an efficient, reliable, and innovative delivery services sector that meets the diverse economic and social needs of the nation and all its citizens. It is becoming increasingly clear that the current structure of the Postal Service may soon be unable to support the achievement of that goal. Therefore, it is imperative to explore alternative business models to determine how best to structure the organization for future success.

Alternative Models

Fundamental structural transformation of an institution as large as the Postal Service will take many years to implement completely. Peering a decade or more into the future, therefore, this *Transformation Plan* reviews the full range of roles the Postal Service might be called upon to assume. While there are a number of potential paradigms for addressing the nation’s postal policy objectives, this *Plan* describes three conceptual alternatives to the current model. Each would require structural legislative reform. The three alternatives are:

- **Government Agency.** An entity focused on providing essential services not adequately provided in the market and supported by government subsidies.

- **Privatized Corporation.** A business entity with private shareholders.
- **Commercial Government Enterprise.** A government-owned enterprise that would operate more commercially in the market to provide postal and related services.

In the Government Agency model, the nation would abandon the businesslike experiment begun by the PRA and retreat to a more standard government model. The Postal Service would concentrate more on its role in providing essential universal services and less on markets where customer requirements can be met by the private sector. The Postal Service might offer a stripped-down menu of products and services, eliminating a number of services currently offered and adjusting the workforce to the modified offerings and attendant lost volume. Significant declines in mail volume, especially First-Class Mail, would likely accelerate this process, shifting the center of gravity of the Postal Service toward delivery and retail services. It appears certain that, as before the PRA, the Government Agency created by this approach would be unable to fund public services entirely through postal revenues. The government would need to directly underwrite this shortfall. Over time, as revenues lag while the network continues to grow, the subsidy burden on the taxpayer could be expected to intensify under this model, a trend which would increase the pressure on traditional levels of service and access.

The second model, Privatized Corporation, would represent a complete conversion of the Postal Service into a privately-owned company dedicated to maximizing shareholder value. Postal Service managers would be subject to the supervision of a Board of Directors representing private shareholders with their own money at stake. There would be no expectation that the government would protect shareholders from commercial failure. Employees would no longer be under any form of civil service, and private sector labor and employment laws would apply. To address universal service coverage by the delivery sector as a whole, new regulatory safeguards may be needed. Other postal providers might be allowed to compete for delivery of universal services under contract with the government.

The third option, commercialization, carries the businesslike transition initiated by the PRA to the next level, but stops short of private ownership. Under this model the Postal Service would be a Commercial Government Enterprise wholly owned by the federal government. Postal Service managers would operate under more businesslike conditions. The Postal Service would offer both traditional and nontraditional products and implement market-based pricing, discounts and incentives, and business-based financing. The universal service obligation might be met under contract between the government and the Postal Service. A new labor model would be probable.

Recommendations

The near-term regulatory and legislative reforms described earlier will help to stabilize the postal system’s financial base until more permanent legislative solutions are developed.

Long-term solutions have been the subject of ongoing debate and continuing disagreement within the postal community. The ultimate decision regarding the appropriate legislative framework is not the Postal Service’s to make. Our experience with the current system, however, leads us to certain conclusions about the changes that seem necessary. Therefore, we have included in this plan recommendations for transformational reform, recognizing that these matters will need to be debated further and resolved within the public policy arena.

In our view, of the three alternative models identified, the Commercial Government Enterprise is the option that will best allow integration of the postal system into the modern economy while preserving the ability of the Postal Service to fulfill its mission of universal service. While a conceptual model leaves many important details to be filled in, it appears that in principle, reorganization of the Postal Service as a Commercial Government Enterprise should permit major improvements in operational efficiency. Greater efficiency, in turn, should enable a financially viable Postal Service to maintain necessary universal services without direct government subsidies.

Transformation of the Postal Service into a Commercial Government Enterprise will likely require an extraordinary level of commitment from postal stakeholders. In the current political environment, postal reform legislation has faltered due in large part to an absence of consensus among affected parties. Basic economics will inexorably introduce tradeoffs between financial self-sufficiency and affordability, on the one hand, and the costs of underwriting an ever-expanding universal service network and other governmental obligations, on the other hand. We believe that a modern, self-sufficient postal system can be structured to continue providing universal service for all, at affordable prices. To do so, however, requires new flexibility to adjust networks and services to modern conditions and to minimize entrenched governmental rules and expectations that carry with them costs and inefficiencies. If the postal community is not able to achieve this break with the past, then it appears to us that the remaining options will be still more unpalatable to most stakeholders. We have not found much support for a Privatized Corporation that would reduce universal service, or a Government Agency that would require renewed federal subsidies. More likely, a continued stalemate would force the Postal Service to operate under its present, increasingly outmoded business model until enough customers abandon the system to make financial failure unavoidable.

A commercialized structure has been favored by liberalized national posts, either as a final operating model or as a transition to a fully privatized entity. Foreign policymakers have also generally concluded that restructuring the post office as a government-owned, commercial enterprise offers the best chance of achieving national policy goals in increasingly competitive markets.

The following are some of the changes that would be necessary to achieve a workable Commercial Government Enterprise:

Net Income and Retained Earnings. Production of net income and accumulated retained earnings are necessary to finance the expanding delivery network, decrease outstanding debt, and fund investments in technology.

Markets. The Postal Service should be free to make use of its assets and explore service offerings in related markets in order to help fund continuing universal service responsibilities.

Purchasing. Under a more effective, modern business model, legislative restrictions on the way the Postal Service acquires goods and services, including transportation, should be removed so that it can operate in a more businesslike manner.

Regulation. The Postal Service should have broad flexibility to set prices within overall parameters managed by the PRC and the Board of Governors, so that it could offer more moderate and predictable rate changes and so that users of monopoly services are not overcharged. Review of pricing and classification should be conducted through a complaint process. Outside the scope of the monopoly, pricing should be regulated under the antitrust and fair competition laws applicable to other businesses.

The Postal Service's universal service mission should continue, with the goal of preserving access to mail services for Americans nationwide on an economically sound basis. The standard for the number of delivery days and service levels should be flexible to accommodate changing conditions. The Postal Service should be able to make changes, subject to review for compliance, with broad criteria under a complaint system.

Labor and Employment. In order to increase the accountability of the organization with respect to overall performance, the Postal Service should negotiate with its employees' bargaining representatives about all employee benefits, along with wages and other working conditions. In labor impasses, the parties should be encouraged to resolve their differences themselves, through a compulsory mediation process similar to essential-service bargaining under the Railway Labor Act, which assures consideration of the public interest.

Consistent with other organizations in the mailing community, the Postal Service should follow private sector employment laws including those governing workers' compensation, equal employment opportunity, and alternatives to traditional employee dispute resolution processes. The Postal Service and its employees should not have costly, multiple avenues for complaints about workplace disputes.

IV. Conclusion

By any reasonable measure, transformation of the Post Office Department by the Postal Reorganization Act into a more businesslike Postal Service has been a success. After three decades of progress, however, pressing issues have been uncovered by a changing economy. The organization's structure and business focus are not aligned with the challenges of today's commercial environment. The Postal Service does not have the flexibility essential for successful management of a modern business. Postal laws create a tension between a public policy mission and structure and the businesslike necessity to deliver what customers want and will pay for in the marketplace. Until transformation is accomplished, the ability of the Postal Service to finance a continually growing universal service obligation without a government subsidy will be in serious doubt.

Today, all stakeholders face the need to reexamine the mission and structure of the nation's Postal Service. Alternative organizational models described in our plan represent possible future pathways for reform. No model comes with an assurance of success, and none accomplishes all possible goals. Each model offers benefits and risks. The postal community spans a wide range of interests, with a diversity of perspectives on these issues. Resolution of differences has already proven difficult, but a consensus for change is necessary to equip the national postal system to perform its mission for the country in the decades ahead.

After careful consideration and consultation with stakeholders, the Postal Service believes that transformation requires action both in the near term and in the longer term. Both courses must be pursued concurrently. Near-term strategies include those steps we are taking now to improve value to our customers, enhance operational efficiency, and foster a more performance-driven culture. These strategies require only modest legislative and regulatory changes. Legislative reform for the longer term is needed to define a legal framework for the postal system over the next 30 years that remains consistent with the shared vision of the United States as a place where all citizens, in every part of the country, can participate equally and easily in the life of the nation.

Leadership Commitment

Successful transformation will require strong and committed leadership. Working together, the leadership of the Postal Service will forge a fundamentally new business model for the institution grounded in a business culture of performance and accountability. We recognize our responsibility to take definitive action and to offer our stakeholders a clear and compelling view of what we are doing and where we are going. We accept and welcome the role of Congress, our customers, our labor and management associations, and other stakeholders in this endeavor.

The Need For Transformation

Section 1 — The Need for Transformation

When Congress enacted the Postal Reorganization Act (PRA) of 1970[1] and established the Postal Service as an independent, self-supporting federal entity, the legislation rectified a service crisis marked by inconsistent delivery and widespread public dissatisfaction. The new Postal Service was to meet its responsibilities in a businesslike fashion by ensuring that revenues from the sale of products and services were sufficient to cover all operating costs.

For three decades, the Postal Service has served the nation well. It has maintained universal service, improved service quality, and held postage rate increases to levels commensurate with inflation. Nonetheless, because of sweeping changes in technology and business practices, the institution is facing a vastly different commercial environment than it did in 1970. As a result of these macroeconomic changes, the rate of growth in mail volumes has been declining since 1997. In 2001, the total volume of mail decreased slightly, following a general downturn in the economy. Facing both weaknesses in the economy and terrorist attacks, in the first half of fiscal year 2002 the Postal Service saw its largest mail volume decline since the Great Depression.

> *If I've learned nothing else as Postmaster General, I have become convinced that we cannot allow the Postal Service to drift toward the crises of the 1960s that ultimately compelled postal reform in 1971. We have to make some very fundamental, critical changes. We have to come to grips with the reality that the legislation that created the Postal Service more than 30 years ago now puts us out of step with our customers, our competitors, and the marketplace. You and I both know, today we are unable to respond effectively in the highly competitive marketplace of the 21st century.*
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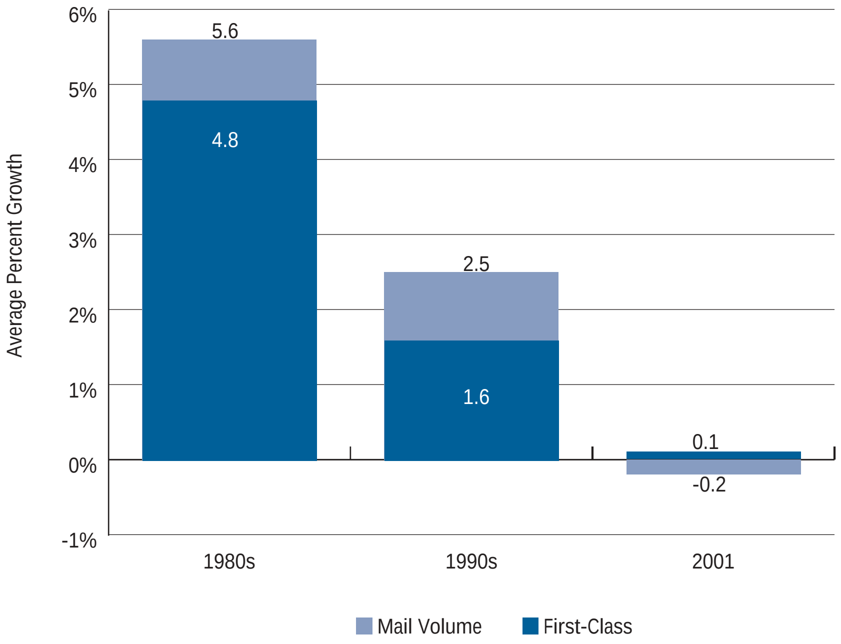
> —Postmaster General John E. Potter,
> address to National League of
> Postmasters, February 25, 2002

VOLUME GROWTH BY DECADE



Source: Postal Service Internal Records

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[1] Postal Reorganization Act, Title 39, U.S. Code, Sec. 101 (a).

In April 2001, the General Accounting Office (GAO) placed the Postal Service's transformation efforts and its long term outlook on its "high risk" list to focus attention on challenges facing the organization. Subsequently, in June, Congress asked the Postmaster General to prepare a plan that would address the structural reform of the organization. On September 30, 2001, the Postal Service published the *Outline for Discussion: Concepts for Postal Transformation*, which established the framework for a comprehensive discussion among Postal Service stakeholders.[2] The process of input, analysis, and discussion that followed resulted in this *Transformation Plan*. The transformation planning effort has been led by the Postal Service's Board of Governors, the Postmaster General, and Executive Committee and conducted by a cross-functional postal management team.

This *Plan* is presented in four chapters:

- **The Need for Transformation.** Presents the case for change.
- **Meeting the Challenge.** Identifies actions the Postal Service is taking now and the moderate regulatory and legislative changes needed to enable those actions.
- **Preparing for the Future.** Discusses potential future business models, the Postal Service's recommendation, and the statutory changes required.
- **Conclusion.**

This chapter describes the challenges the Postal Service faces and the perspectives of postal stakeholders on transformation issues.

1.1 Reasons for Transformation

In 2001, the Postal Service delivered 207 billion pieces of letter mail, periodicals, advertising mail, and packages to approximately 138 million addresses six days a week. This volume represents over 40 percent of the world's mail. In one week, the Postal Service delivers the same volume that United Parcel Service (UPS) delivers in a year; and in two days, the Postal Service delivers the same volume that FedEx delivers in a year.[3]

Measured by revenue, the Postal Service is the 11th largest domestic enterprise and the 33rd largest worldwide.[4] It receives virtually no taxpayer dollars, charges among the world's lowest prices for letter mail,[5] and anchors a $900 billion domestic mailing industry.[6] With nearly 770,000 career employees, the Postal Service is the second largest civilian employer in America after Wal-Mart.[7] When combined with private sector employees in the mailing industry, 1 in 15 American workers makes a living from a postal-related job. These employees and private businesses in turn contribute to the American economy. In 2001, the Postal Service's payroll, excluding benefits, totaled

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[2] See Appendix B, Executive Summary of *Outline for Discussion,* for more information. To read the full report, go to www.usps.com/strategicdirection.

[3] To see the *U.S. Postal Service 2001 Annual Report,* go to www.usps.com/history/anrpt01/.

[4] See Tables 1 and 2 in Appendix A, *Charts, Graphs, and Tables,* for more information.

[5] See Chart 1 in Appendix A, *Charts, Graphs, and Tables,* for more information.

[6] The growth of the U.S. mailing industry resulted in large part from the flexibility gained by the Postal Service under the Postal Reorganization Act of 1970 and is one of the major success stories of that legislation. Further information on the composition, scope, and concerns of the mailing industry can be found in Appendix C, *Overview of the Mailing Industry.*

[7] See Table 3 in Appendix A, *Charts, Graphs, and Tables,* for more information.

$38 billion. In that year, the Postal Service spent $17.8 billion on supplies and services, nearly $1 billion in rent, and $64 million in taxes on leased facilities. Clearly, the postal industry is vital to America's citizens and its commerce. Given the breadth and scope of this industry and the significant role it continues to play in the economy, why should the Postal Service change?

As the GAO has indicated, financial losses in the last three years and volume losses in the last 18 months raise questions about the viability of the current business model. The Postal Service believes there are two cogent and fundamental reasons for revising the legal framework of the organization. First, three decades of experience with the Postal Reorganization Act of 1970 indicate that the charter of the Postal Service should be modified to serve the ongoing needs of the nation more efficiently and effectively. While the basic charter of the Postal Service has remained static since its inception in 1970, the mailing industry and private sector delivery companies have evolved to meet the changing needs of the marketplace. Indeed, innovation and competition were not primary concerns of the 1970 Act. The Act was designed to allow the Postal Service to do what it did in 1970 in a more businesslike manner. By definition and structure, a government entity has goals and mandates that the private sector does not have, and these inhibit the flexibility needed for direct competition. In the far different and more competitive environment of 2002, a revision of the Postal Service's 1970 charter is overdue.

The second, and ultimately more important, reason for transformation is that the future will not be like the past. In a number of possible future scenarios, the Postal Service may soon find itself increasingly ill-equipped to serve the postal needs of the nation. While the precise shape of the future cannot be known, an inventory of global economic changes impacting the Postal Service is sobering: a potentially sharp decline in mail volume, a major increase in costs due to security and other factors, and consolidation of operators and markets into global delivery services. If these developments persist—and governments of many industrialized countries that have studied these issues say they will—future postal success will require a more flexible institution with the organizational adaptability and managerial tools of commercial businesses. While such flexibility may possibly prove unnecessary (the future may resemble the present), it will be impossible to transform an organization the size of the Postal Service once the future has arrived.

From these twin perspectives, the major drivers of transformation are summarized below.

Potential Declines in First-Class Mail® Volume

As indicated above, the rate of growth of total mail has been declining since 1997, turning slightly negative in 2001. Single-piece, First-Class Mail volumes have declined for four straight years, with a 2.7 percent decrease in 2001. This mail category includes bill payments, which are especially vulnerable to diversion. Postal Service models indicate that electronic diversion is the largest contributing factor driving the decline in First-Class Mail, single-piece letters.[8]

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[8] See Docket No. R2001-1, USPS-T-7, Testimony of George Tolley, page 37, www.prc.gov.

IMPLICATIONS ON COST COVERAGE

A decline of $1 Billion in Single-Piece First-Class Mail (FCM) results in a lost contribution of $432 Million.

		Volume (Thousands)	% Change
	FCM Single Piece	(2,403,846)	(4.6%)
	Offsetting Increases*		
	Standard Mail	7,078,689	7.9%
or	Priority Mail	313,353	25.6%
or	Express Mail	49,609	69.9%
or	Parcel Post	1,509,790	465.7%

* Making up the lost contribution would require an increase in the amounts noted above.

Source: Postal Service Internal Records, FY 2000 *Cost and Revenue Analysis*.

The electronic "diversion" of mail volumes, particularly of First-Class Mail, directly impacts the Postal Service. While conventional wisdom places the Postal Service directly at risk from this "new economy," the actual impact on mail remains unknown. Appendix E, Electronic Diversion of Mail Volumes, *provides an economic review of the diversion issue.*

Mail volumes were down significantly following the terrorist and anthrax attacks in the fall of 2001. While that volume decline cannot be attributed to electronic diversion, only time will tell whether the loss is temporary, or whether the events of last September and October have accelerated the rate of adoption of alternatives to the mail. Overall, it is dangerous, in the words of a large postal stakeholder group, to assume that mail volume will continue to rebound with the economy.[9] Given the growing volatility of mail volume, there is an urgent need to build flexibility into the postal model.

The Postal Service's financial condition is particularly sensitive to the volume of First-Class Mail. First-Class Mail comprises 48 percent of total mail volume and 69 percent of total contribution.[10] In other words, First-Class Mail covers more than two-thirds of institutional costs, that is, costs such as those related to the network of post offices and delivery points. A substantial reduction in First-Class Mail volume would mean that the contribution this class makes to institutional costs would have to be made up by decreases in operating costs, increases in other class volumes, increases in rates, and/or a change in the universal service obligation. Offsetting losses from the crucial First-Class Mail contribution to overhead with increased contribution from other postal products and services is unlikely.

Increasing Cost Burdens

Despite significant gains in efficiency and productivity through automation, Postal Service costs are rising faster than revenues.

Most postal employees are covered by collective bargaining and are paid an average wage/benefit premium in excess of comparable private sector wages and benefits. The vast majority of current postal labor requirements are inextricably tied to infrastructure issues, such as the postal retail network and the rising number of delivery points. Significant reductions in labor costs cannot be achieved without addressing these issues.

In 2001, compensation and benefits accounted for 76 percent of total Postal Service expenses. These costs increased 3.7 percent over the previous year. Postal Service employees are covered under the federal Civil Service Retirement System (CSRS), the

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[9] See Charts 2A and 2B in Appendix A, *Charts, Graphs and Tables,* for more information.

[10] See Chart 3 in Appendix A, *Charts, Graphs and Tables,* for more information.

Dual System, or the Federal Employees Retirement System (FERS). Coverage is based upon the starting date of employment with the Postal Service. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Postal Service retirement and health benefit costs will continue to escalate over the next 10 or more years due to the overlap in funding requirements under the retirement systems that cover current employees and postal annuitants.[11] Annual operating expenses for retirement costs, including annuitant health benefits, are anticipated to grow from $9.7 billion in 2001 to $15.8 billion in 2011. Further, increases in the number of Postal Service retirees, the growth in annuitants' health benefits, and cost-of-living adjustment costs will continue to escalate. Finally, not until all employees fall under FERS retirement will these costs stabilize.

Another area of significant cost is the current employee dispute resolution process. The Postal Service currently has overlapping and duplicative processes for employees to file complaints concerning workplace disputes. This generates excessive administrative expense associated with managing these processes.

Significant Fixed Costs

The "everywhere, every day" universal service obligation requires a significant infrastructure investment. Almost one-half of total postal costs are spent on fixed costs. The "everywhere" responsibility requires the provision of service to the ever-increasing number of delivery points. The Postal Service adds 1,700,000 new addresses annually and there is a significant cost of providing this additional service. These new delivery addresses necessitate the addition of 4,800 new carriers to make delivery to over 513,000,000 new delivery stops each year. Additional fixed costs, such as those associated with vehicles and facilities, are incurred to support this growth. In the past, the annual growth in mail volume has served to offset the cost of providing new service, but that is no longer the case.

The "every day" portion of the universal service obligation also contributes significantly to the level of fixed costs. An enormous infrastructure is necessary to support postal operations. A significant portion of postal costs is spent on fixed resources and does not increase or decrease when volume changes.[12] Letter carriers travel their complete routes, trucks transport mail between facilities each day to meet service commitments, and retail facilities are open each business day no matter what level of activity occurs. As the Cost Trends chart illustrates, nearly one-half of all postal costs are fixed, and their proportion of total cost will continue to increase. This includes more than 38,000 post offices, stations, and branches, 240,000 delivery routes to service over 138,000,000 delivery addresses, 215,000 vehicles, and significant annuitant retirement costs.

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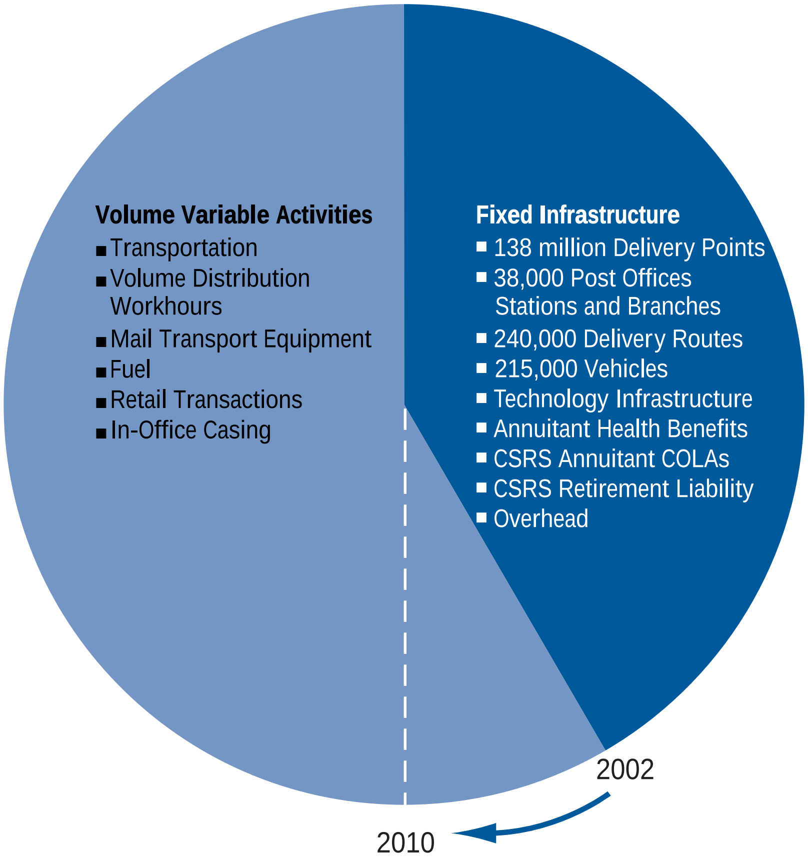
[11] See Appendix D, *Escalating Retirement Costs,* for more information.

[12] See Appendix F, *Fixed Versus Variable Costs,* for more information.

COST TRENDS — FIXED VERSUS VOLUME VARIABLE COSTS



FY 2001 Total Expense $67.5 Billion

Source: Postal Service Internal Records

Expanding Communications Alternatives

The Internet and the World Wide Web, not even invented in 1970, have dramatically changed the communications market.[13] Within the next decade further innovations such as mobile commerce, broadband, interactive TV, data mining software, and new printing technologies will change the way businesses and consumers interact. While hard copy mail retains tremendous effectiveness, there is little doubt that its share of the overall communications market will shrink.

Of greatest impact on the Postal Service are electronic alternatives to business correspondence and transactions, particularly for First-Class Mail items such as bills, statements, and payments.[14] First-Class Mail volumes have already been affected by the telephone, fax machine, Internet, and other electronic communications, including online bill presentment and payment, bill payments by telephone, electronic filing of tax returns, direct deposit of tax refunds, Social Security payments, and other government transactions.

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[13] See Chart 4 in Appendix A, *Charts, Graphs, and Tables,* for more information.
[14] See Chart 5 in Appendix A, *Charts, Graphs, and Tables,* and Appendix E, *Electronic Diversion of Mail Volumes*, for more information.

The Internet is also forcing the Postal Service into greater competition with the private sector by changing the mix of mail. The Internet and electronic commerce are stimulating growth for other postal products, such as package delivery and targeted ad mail. These products are subject to competition from traditional sources (e.g., newspaper and TV ads and other package delivery firms).

Aggressive Competition in Postal Markets

The Postal Service is losing share in the overall delivery services market.[15] Giant corporations now dominate parcel and express markets. Other companies, such as consolidators and presort bureaus, have invested significantly in the upstream worksharing portions of postal processing and could develop into major competitors in the future.

Competitors such as UPS and FedEx are expanding into other businesses, including an increasing portion of the postal value chain. For example, UPS has entered the “hybrid” mail market, where messages are generated electronically and printed close to the final destination. UPS also recently entered the presort business. Under the current regulatory structure, competitors have far more flexibility to respond to changes in market conditions and to target specific customers than does the Postal Service. Should the Postal Service continue to lose ground in competitive markets, the loss of valuable revenue will jeopardize its ability to fund universal service.

Increasing Competition from Global Delivery Service Providers

The global competitive landscape for posts is changing irreversibly.[16] With the rise of multinationals, deregulation, and free trade agreements, international posts have followed the airline, telecommunications, public utilities, trucking, bus, rail, and steel industries to less regulated, more competitive markets. The liberalization of the European Union (EU) provides economies of scale for former national postal services to emerge as global enterprises offering a wide variety of services. Liberalization of posts in Canada, Asia, and Latin America expands the competition.

Additional information on global competitors of the Postal Service, including financial information, presence in the United States, and scope of global operations can be found in Appendix G, Global Postal Competitors in the United States*.*

Foreign postal operators such as Deutsche Post World Net (DPWN) and TNT Post Group (TPG) are moving well beyond traditional postal services, offering logistics, financial services, and electronic services. Four foreign posts—DPWN, TPG, Consignia (United Kingdom), and La Poste (France)—have limited operations in 18 major metropolitan centers nationwide, including New York, Boston, Washington, DC, Houston, Salt Lake City, Los Angeles, San Francisco, and Seattle. These operations feature some sales offices and offer mail, parcel, logistic, and financial services to the American market.[17] DPWN recently acquired a controlling interest in DHL, the leading global express company, originally a U.S. firm. DPWN owns one of the largest global freight forwarders, also based in the United States. In addition,

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[15] See Chart 6 in Appendix A, *Charts, Graphs, and Tables,* for more information.
[16] See Appendix H, *Postal Transformation: The International Experience,* for more information.
[17] See Chart 7 in Appendix A, *Charts, Graphs, and Tables,* for more information.

DPWN has created its own Philadelphia-based top management training school, Deutsche Post World Net University, in partnership with the University of Pennsylvania's Wharton School.[18]

Outside the United States, the delivery services sector is likely to be characterized by continuing regulatory reforms, cross-border acquisitions and alliances, and new product development. Playing an important role in this process is the Universal Postal Union (UPU), an intergovernmental organization consisting of 189 countries. Until 1998 the Postal Service had the lead responsibility for representing U.S. interests at the UPU. That role has been transferred to the State Department. Changes in the structure and direction of the UPU will impact the Postal Service both at home and abroad.[19] A strong partnership with and representation by the State Department will continue to be important for Postal Service success in this area.

As foreign posts enter more and more of the U.S. postal value chain, the loss of revenue experienced by the Postal Service could potentially put the provision of universal service in deeper peril.

1.2 Perspectives on Transformation

Stakeholders in the United States Postal Service offered comments on postal transformation through an outreach program that included discussion proposals, Web-based and traditional mail channels, focus groups and public surveys, stakeholder group meetings, Board of Governors-directed panel discussions, and employee surveys. To ensure that stakeholders had ease of access and a context for commentary, the Postal Service published two *Federal Register* notices and a report titled *Outline for Discussion: Concepts for Postal Transformation.* Analysis of the commentary and input received suggests broad stakeholder agreement on the following themes:

- Postal Service transformation is necessary and desirable.
- Transformation should get underway as soon as possible.
- The Postal Service should take a leadership role, rather than wait for others to solve its problems.
- Universal service must be maintained, although not necessarily in its current form.
- The Postal Service should continue to emphasize secure, accessible and affordable delivery.
- There is no clear mandate for full privatization of the Postal Service.

Within the distinct segments of the stakeholder community, other areas of agreement could be noted. The following is a brief summary of those perspectives.[20]

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[18] International Post Corporation, Market Flash, Issue 224, February 2002.
[19] See Appendix I, *Overview of the Universal Postal Union,* for more information.
[20] See Appendix J, *Stakeholder Outreach: Process and Results,* for more information.

Consumers

By and large, consumers expressed a high degree of overall satisfaction with the Postal Service. While it could be marginally more efficient, overall they stated that they like the service they receive. However, when told that greater financial pressures would be confronting the Postal Service, they expressed a willingness to entertain such initiatives as changes to the laws that govern the Postal Service, modifications to the universal service mandate, and modifications to service levels.

Postal Employees

A number of individual employees, as well as organizations representing employees, chose to comment on the *Outline for Discussion*. A survey of Postal Service executives was conducted on the topic of the strategic transformation of the Postal Service, and efforts were made to solicit the views of mid-level managers and Advanced Leadership Program enrollees and graduates. Additionally, the Postal Service Board of Governors facilitated a panel session with the presidents of unions and management associations to collect first-hand input from these stakeholder groups.

Employees generally agreed that universal service must be preserved; that transformational changes should be made quickly; that strategic initiatives should be introduced to promote growth; and that flexibility should be created to allow the organization to become more competitive.

Mailers and the Mailing Industry

Mailers have been engaged in an ongoing discussion with the Postal Service regarding transformation. Additionally, many mailers provided written comments to the *Outline for Discussion*. Small business customers were also included in focus groups and surveys. The Postal Service Board of Governors facilitated a panel session with six mailers to discuss transformation. The findings of the Mailing Industry Task Force, presented at the October 2001 National Postal Forum, were also reviewed as part of the input assessment process.

As a whole, the mailing community acknowledged the need for transformation and felt that the Postal Service should: 1) not underestimate the seriousness of the problem, 2) be bold and explicit in its recommendations, 3) move quickly to implement proposed initiatives which would not require legislative action, 4) hold the line on large and frequent rate increases 5) pursue cost-cutting measures, and 6) strive to increase productivity. Several said that the universal service mandate should be reviewed and modified. Others said the *Outline for Discussion* failed to convey a sense of urgency. Many of the mailers recommended that a presidential commission be established to respond to the long-term problems of the Postal Service. Others urged that the Postal Service work to raise its debt ceiling and to address the issue of its unfunded liabilities.

Suppliers

While some suppliers commented on the *Outline for Discussion*, the main outlet for supplier feedback has been meetings with suppliers and the Supplier Quality Council. The purpose of the Supplier Quality Council is to provide a forum for suppliers to dialogue with the Postal Service to enhance performance and operations.

A unanimous opinion voiced by suppliers was for the Postal Service to recognize the need for transformation and for it to act quickly. Suppliers also were concerned about the reductions in capital spending on supply chain improvements. The main topic of discussion at these meetings was the strategic direction of the Postal Service. Specifically, suppliers were concerned about buyer/supplier alignment and making it easier for the Postal Service to do business with its suppliers.

Public Policy Community

The public policy community, which includes independent policy institutes and other independent observers, has addressed the subject of transformation in papers, articles, testimony, books and other discussion documents issued since the Postal Service was called upon last spring to develop a transformation plan. In Appendix J, *Stakeholder Outreach: Process and Results*, an annotated bibliography includes some of the publications that were considered in the planning process. There were no overarching trends in the comments the policy community offered other than that the Postal Service is facing major challenges and must make substantial changes to respond.

An Ongoing Process

The process of collecting stakeholder input on postal transformation and, with this publication, the *Transformation Plan*, will continue. The objectives and strategies described in the *Plan* will be integrated into the annual strategic planning process, and refined through additional analysis and review. As part of that process, stakeholder input will be solicited, assessed and incorporated. A variety of channels and approaches will be used to ensure ease of access for any interested stakeholder.

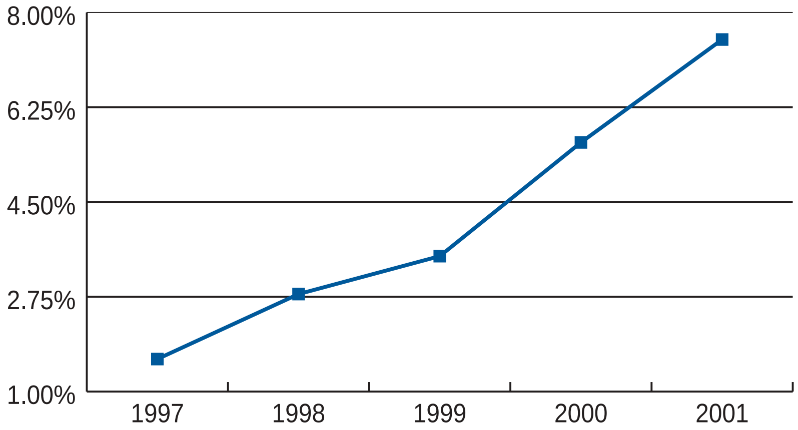
Meeting The Challenge

Section 2 — Meeting the Challenge

An internal transformation of the United States Postal Service has already begun.

In the summer of 2001, Postal Service leadership was reorganized and an executive committee was created to develop and to implement policy approved by the Board of Governors. At the time, the Postal Service was achieving record levels of delivery performance and customer satisfaction. During the previous 24 months, total factor productivity improvements had saved the Postal Service $2.5 billion in expected costs. In addition, as the Output per Workhour graph below indicates, cumulative labor productivity increased 7.5 percent since 1996, with larger gains in 2000 and 2001. This was largely driven by the intense focus on improving productivity that resulted in a reduction of 21 thousand career employees. The organization recorded nine consecutive quarters of increased productivity, while adding almost 4 million new addresses over the same period.

CUMULATIVE CHANGE IN OUTPUT PER WORKHOUR



Yet that performance record, the Postal Service concluded, was insufficient to keep up with rapid and significant changes in its business environment. To succeed in 2002 and beyond, the organization would need to go much further. An additional 26 million workhours—the equivalent of 13,000 jobs—would be cut. Administration of the Postal Service would be streamlined—“the most sweeping organizational changes in ten years,” the Postmaster General would state—with new emphasis on the traditional mail delivery business. There would be 20 percent fewer officers, 800 fewer employees assigned to postal headquarters, and 2,000 fewer administrative workers systemwide. Selected mail processing operations and facilities would be consolidated.

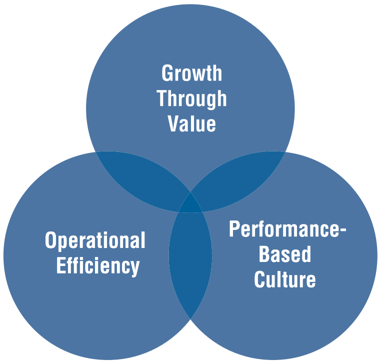
The national tragedy of September 11, 2001, and October’s bioterrorism raised unexpected obstacles to transformation, but at the National Postal Forum held in Denver in the fall of 2001, Postmaster General Potter asserted that the broad change initiative would continue. “Our operationally-driven culture has to find new ways, under our existing regulatory structure, to add value to our existing products,” Potter stated. “It also means that this same operationally-driven culture must take on new ways of encouraging revenue growth….To develop the types of breakthrough performance I am convinced we can achieve, we are going to have to continue the businesslike methods of the last ten years….We're going to have to take on internal and external issues where we previously said, 'Oh, we can't do that.'"

Today, the Postal Service has initiated a series of transformational strategies across all its functional areas. The program of strategies and initiatives outlined in this section of the *Plan* flow from three overarching imperatives that were identified by the Postal Service during the process of transformation planning:

- Foster growth by increasing the value of products and services;
- Improve operational efficiency; and
- Enhance the performance-based culture.

To achieve these imperatives, basic support functions are also undergoing transformation. Taking fundamentally new approaches in its enabling functions, the Postal Service will enhance financial management; adopt flexible, business-driven purchasing procedures; strategically apply technology; and ensure the safety, security, and privacy of the mail.

TRANSFORMATION IMPERATIVES



Foster Growth Through Customer Value: The Postal Service will improve the quality, affordability and convenience of its products and services.

Improve Operational Efficiency: The Postal Service will utilize cost management, new technology, and workforce planning to improve operational efficiency.

Enhance Performance-Based Culture: The Postal Service will manage its human capital to create a performance-based corporate culture.

The principles of management that flow from these transformational imperatives support numerous improvement strategies that can be implemented with only modest changes to existing regulations and laws. To foster growth by increasing the value of products and services, the Postal Service must both reshape the channels through which customers access products and services and improve the reliability, effectiveness, and convenience of the products and services themselves. To improve operational efficiency, the Postal Service must rethink all aspects of its logistics systems, including mail processing, material handling, purchasing, and managing transportation services. To enhance a performance-based culture, the Postal Service must redesign the incentives and workplace environments for its human capital, both managers and employees. For the Postal Service to be successful in the near term, enabling strategies and moderate legislation must be implemented. Each of these strategies is discussed on the following page.

2.1 Foster Growth through Customer Value[21]

In today's economy, creating customer value means both improving quality and affordability of products and services and providing the ability to access and use these products and services at times and places that are most convenient to the customer. For major mailers, the Postal Service will increase the range of customizable products that respond to the specific needs of these businesses. For small businesses and consumers, the Postal Service will improve the simplicity and accessibility of its products and services. Retail and products and services are the main areas of growth in the Postal Service.

2.1.1 Retail: Expand Access to Postal Services

Most Americans purchase postal products and services at retail outlets. Post offices provide local access to more than seven million Americans daily, be it to mail a bill payment, send a package overseas, pick up a certified letter, or buy a money order. Post offices also serve as delivery locations where 18 million customers receive their mail at post office boxes. The postal retail network is vast and includes more than 38,000 post offices, stations, and branches staffed by Postal Service employees. Limited counter services are also offered at more than 4,400 privately operated contract retail units. Finally, customers can also purchase postage stamps through the mail, from more than 32,000 vending machines, online at www.usps.com, and at 40,000 commercial retail outlets and ATMs.

The Postal Service's major retail challenge is to meet its customers' ever-increasing needs for access while reducing infrastructure and operating costs. The enormous scale of the retail infrastructure and the status of post offices as community centers in many areas have traditionally limited options for responding to population growth and changes in market demand. As customer expectations change and demand shifts geographically, the retail infrastructure has not kept pace, particularly in high-growth, metropolitan communities.

About 31 percent of all customers visit post offices for stamps only in spite of several underutilized alternative channels. Customers could bypass a post office trip by buying stamps at vending machines, supermarkets, ATMs, online, and by mail. Many of these options are available 24 hours a day, seven days a week. These alternatives are also less expensive for the Postal Service than selling stamps at a post office. However, a large percentage of customers are unaware of these services, and for anything more complex than buying First-Class Mail® stamps, many customers believe they must go to a post office. This is an inconvenience to consumers and an unnecessary cost to all postal ratepayers.

During the next five years, the Postal Service will provide customers with easier and more convenient retail access. Postal services will be available where customers need them—at home, at work, where they shop, or at the post office. The Postal Service will promote the convenience of existing, underutilized alternatives and develop new low-cost solutions using technology, partnerships, and product simplification.

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[21] See Appendix K, *Growth- and Value-Based Strategies,* for more information.

The local post office will remain the core of the retail network, increasingly integrated into a flexible set of customer contact options, including the Internet, letter carriers, call centers, and partnerships with commercial retailers. Redirecting simple transactions away from expensive counter operations will produce cost savings and two important customer benefits. First, customers will have more choices. The Postal Service will serve them where they live and work. Second, customers who have more complex needs and require service at a post office will find shorter lines and more efficient operations. New services will be introduced that meet the needs of these customers and produce new revenue.

Improving customer service, increasing customer choice, and reducing retail costs will only be possible if the Postal Service eliminates, aggressively, redundancy in its physical network. A retail optimization process will be used to achieve a stable and efficient network capable of providing tailored services to the market. While this effort will initially focus on contract postal units, the current moratorium on post office closings will also be lifted so that a comprehensive approach can be applied across the entire retail network.

The following four strategies will transform retail operations:

- Move simple transactions out of post offices;
- Create new, low-cost retail alternatives;
- Optimize the retail network; and
- Develop new retail services that increase customer value and postal revenue.

Retail Strategy 1: Move Simple Transactions Out of Post Offices

Approximately 450 million stamps-only transactions take place in post offices each year. Given the number of low-cost alternatives already in place, these transactions present an immediate opportunity for productivity gains. However, shifting simple transactions to less expensive operations will require the Postal Service to change customer behavior—particularly the mindset that all stamp purchases and mailing transactions must take place at the post office.

Although the Postal Service markets a straightforward product line, many customers are unfamiliar with some of the basic services and how best to use them. Addressing this need for product information is central to the retail component of the *Transformation Plan*. Improvement will be accomplished through communicating aggressively and continuously with customers, highlighting the ease and convenience of buying stamps and completing simple mailings without having to visit a post office.

COMPARISON OF ACCESS OPTIONS

Stamps Sold At	Share of Sales	Cost to Postal Service per Dollar	Customers Aware of Service
Post Office Counters	80%	$0.240	100%
Supermarkets Drug Stores, and Other Large Retailers	7%	$0.016	70%
USPS Vending Equipment	6%	$0.140	64%
Contract Postal Units	5%	$0.100	n/a
Through ATMs	1%	$0.016	18%
Stamps by Mail, Stamps Online, and all Other Means	1%	n/a	n/a

Retail Strategy 2: Create New, Low-Cost Retail Alternatives

Although opportunity exists to make better use of existing low-cost retail alternatives, entirely new solutions are needed to extend the times and places service is available without the addition of new post offices. This objective will be accomplished by making self-service easier and a trip to the post office unnecessary.

Major competitors offer a range of convenient options for customers to handle most aspects of shipping without visiting a service center. Unlike the Postal Service, these competitors do not enjoy an expansive retail network. Thus, out of necessity, these companies offer billing and credit accounts; pursue retail partnerships and aggressive self-service and drop box deployment; offer reliable, affordable pickup service; and lead many industries in the adoption of new technologies, notably call centers and the Internet. These services are an important cost and competitive advantage and are valued highly by customers.

Expand Self-Service

Vending equipment has long been an important component of postal retail service, but performs a relatively narrow function—selling stamps for cash. Three-quarters of the Postal Service’s vending equipment is located in post offices, offering customers an alternative to counter service. The Postal Service is testing new self-service equipment that provides more services than just selling stamps. The Automated Postal Center, for example, is a secure kiosk that accepts credit and debit cards and provides customers with access to 80 percent of the services they currently receive at the counter. This equipment enables customers to weigh a package, determine the most appropriate mailing solution, print required forms, print the postage, and mail the package. Of course, customers will also be able to buy stamps. Expanded self-service capabilities will allow the Postal Service to serve its customers where they work, shop, and live.

New Functionality for www.usps.com

The Postal Service's Web site, www.usps.com, is a vital tool for providing low-cost retail access. The site has the potential to handle most of the transactions that commonly take place in post offices, especially when combined with carrier pickup directly from the home or office. Customers can now use www.usps.com to file address changes. Soon they will be able to weigh packages, pay for postage, and print postage indicia from their personal computers. If promoted aggressively to retail customers, these services and others that follow will increase the quality and decrease the cost of access to postal services.

Retail Partnerships

The Postal Service is pursuing a number of partnerships with commercial retailers. These partnerships will range from supermarkets selling postage stamps to business service retailers offering a full range of postal products and services. A particularly promising solution is now being tested with a national retail chain. The stores offer only those services most commonly requested by nonbusiness customers, for example, First-Class Mail, light weight domestic Priority Mail, and selected special services such as delivery confirmation. The limited product line minimizes training, equipment, and cost. This service extends the Postal Service brand, improves access for infrequent shippers, and enables post offices to concentrate on high-value business customers.

Product Simplification

While the complexity of the rate and classification schedule is appropriate for large shippers, it does not necessarily serve retail customers. A number of opportunities exist to simplify service for retail customers such as, prepaid mailers, and billing by mail for post office box holders. Billers, catalogers, online shippers, and other business-to-consumer mailers will be encouraged to expand the use of courtesy reply and prepaid returns. This approach will not only help speed the payment or merchandise return; it will also save the customer a trip to the post office.

Leverage Commercially-Developed Innovations

The Postal Service will continue to support and leverage commercial innovation in the postal industry. An excellent example is PC Postage™, which allows customers to pay for and print secured postage using a personal computer. Products such as this have the potential to increase dramatically the number of customers that have access to the convenience of metered postage, while adding simplicity and reducing costs.

Another opportunity currently under discussion is the installation of commercial ATMs in post office lobbies. This proposal would give customers the ability to conduct their banking business as they would at any other ATM, and also provide self-service for stamp purchases.

Retail Strategy 3: Optimize the Retail Network

As simple transactions are redirected to lower cost alternatives, post offices will scale down staffing and concentrate resources on more complex, higher-margin business. Offices will handle these transactions more efficiently by improving staff scheduling, converting to a more flexible workforce, collecting and using better data on customer traffic and transactions mix, and setting and meeting post office-level productivity targets. A rigorous network optimization process will be used to ensure that the Postal Service provides the right level of retail access at the least possible cost. Redundant retail operations will be consolidated, starting with poor-performing contract postal units.

See Appendix N, Procedures for Closing Postal Facilities, *for more information concerning Congressional oversight of Postal facilities.*

The objective of the Retail Network Optimization program is to tailor retail services to the individual needs of communities. This program will implement a Retail Network Plan that expands services in markets where the Postal Service is underrepresented and reduces the physical infrastructure in markets where the organization is overrepresented. The result will be a balanced network that meets customer needs through a variety of alternatives. The program will include a baseline review of the existing retail network to identify redundancy and service gaps; to document costs associated with support; and to develop service standards based on community type, travel time, distance, and hours of operation.

A national database of the approximately 38,000 post offices, stations, and branches that comprise the retail network is being created. The database will contain all operating costs, revenue, productivity, market penetration, customer valuation, logistics, demographics, and technology connectivity. The baseline review will be the foundation for decision-support modeling of network optimization and restructuring scenarios.

The Postal Service will employ a criteria-based methodology using this database to accommodate growth and eliminate redundancies. Threshold values including proximity to other postal facilities, retail productivity indicators, number of households, deliveries, walk-in revenue, small business accounts, and other criteria will determine the appropriate channel to be used to serve customers. Redundant, low-value access points will be replaced with alternative access methods.

Retail Strategy 4: Develop New Retail Services That Increase Customer Value and Postal Revenue

Shifting simple transactions away from counters provides an opportunity to concentrate on the needs of many retail customers, especially businesses. Select offices with high concentrations of business customers will be converted to business service centers. New services built around the Postal Service's core mission and unique capabilities will be provided to add value to customer visits and revenue to the Postal Service.

Government and Other Services

Post offices also provide a number of services for government organizations. In the near term, the Postal Service will expand and enhance existing nonpostal services such as passport applications and international electronic funds transfers. Concurrently, several new services are also being explored, including identity verification, retail bill payment, and a variety of services related to package mailing and returns.

Leverage Retail Assets

Beyond its vast retail infrastructure, the Postal Service possesses a number of valuable assets, including its long-established and trusted brand, ubiquitous customer contact, and extensive retail capabilities. These assets are attractive to many potential partners and are one reason that FedEx decided to place its drop boxes at thousands of post office locations, an arrangement that has benefited both organizations. The Postal Service will explore additional opportunities to partner with other organizations.

Complementary Retail Products

In past years, the Postal Service experimented with the sale of a variety of merchandise in post offices. These offerings provided invaluable insight into product procurement, distribution, inventory control, and pricing strategies. As a direct result, the Postal Service has been able to successfully launch the ReadyPost® line of packaging supplies, a $60 million business.

In the near term, the Postal Service will prioritize merchandise sold at post offices to products that directly complement traditional businesses. Further, the Postal Service will manage and market its products more aggressively, more intelligently, and with greater attention to bottom-line returns. Most post offices will sell merchandise in three main categories: packaging supplies, stationery, and stamp-related products. All categories will be managed against tight cost and revenue thresholds, with products and in-store merchandising support provided by dedicated national vendors (e.g., Hallmark produces the ReadyPost products).

Rationalization of the retail network is an essential step to ensure increased value for Postal customers. The following section addresses strategies to improve and grow Postal Service products and services to further enhance that value.

2.1.2 Products and Services: Improve Value and Growth

To increase the use of traditional products the Postal Service will leverage technology and will develop new features and services to make the mail channel more competitive. Using product design and pricing strategies, the Postal Service will tier its customers and develop customized and innovative services for large mailers, and simpler, more convenient services for smaller mailers. To this end, the Postal Service will engage in effective channel management approaches to analyze how its customers differ in terms of contribution, growth potential, and needs—and then align its resources according to these differences to optimize the demand chain.

In particular, the Postal Service will:

- Use technology to enhance the value of mail;
- Design rates and mail preparation to match customer capabilities and needs;
- Position mail as a key communications medium and as a customer relationship management tool;
- Enhance package services;
- Map channel strategies around customer needs, contribution, and growth potential;
- Develop new products and services; and
- Leverage existing assets.

Each of these strategies is discussed below.

Products and Services Strategy 1: Use Technology to Enhance Value

The capture of real-time information has revolutionized postal products and services. In the global delivery market "track and trace" services are becoming the norm rather than the exception. In coming years customers large and small will expect immediate feedback regarding the status of their letters and packages. This was a key message in *Seizing Opportunity: The Report of the 2001 Mailing Industry Task Force.*[22] Meeting this expectation will require a complex union of postal services and digital technology. In addition, business customers will need other forms of "intelligent mail" that not only feature the ability to track and trace from origin to delivery, but also allow integration of postal information into the entire cycle of multiple business transactions.

Technology integration into the mail system via intelligent mail could greatly expand the mailing industry's business.

—Mailing Industry Task Force Report

The Postal Service stands on the threshold of this delivery service enhancement. The organization currently offers delivery confirmation services for packages and "accountable items," such as certified mail and return receipt service. Large business mailers can now track their mailings in near real-time with Confirm™, a new service that uses PLANET CODE™ technology to store information about the mailer's identity and the mail piece itself in a unique barcode.

To retain existing customers and attract new ones, the Postal Service must expand application of this technology and implement new services that increase the "intelligence" of the mail. In the near term, Confirm and PLANET CODE will provide customers with transit and delivery information for virtually every piece of mail. Emerging Postal Service technologies, such as image lift, two-dimensional barcodes, and print-to-Web applications, will build on this concept and provide seamless service between Postal Service operations and the customer.

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[22] The Mailing Industry Task Force, a group composed of chief executives of 11 industry-leading companies and the Deputy Postmaster General, was convened to assess the current state of mail as a communications channel and to determine how mail could be enhanced to ensure its viability in the future.

Delivery information is only as good as the quality of the address data. The Postal Service aims to help customers deliver to the correct address each and every time. To meet this objective, the Postal Service will work with customers to make sure databases are updated frequently and accurately. The Postal Service will also explore the use of publicly available databases to improve the overall accuracy of address information.

These efforts will make mail more measurable, providing clear signals to operations managers where bottlenecks are slowing delivery. This, in turn, will lead to service improvements, making mail more predictable and reliable. By knowing when a mail piece will be delivered, businesses can create marketing and advertising events based on day-certain communications and can plan their remittance and other inbound operations around a more predictable mailstream.

Products and Services Strategy 2: Design Rates and Mail Preparation to Match Customer Capabilities and Needs

To generate new revenue growth in the future, the Postal Service must offer products and services that can accommodate customers of varying sizes and mailing capabilities. Postal Service rates, preparation requirements, and payment options must be flexible enough to attract small, medium, and large businesses and consumers. Communications efforts must be targeted to reach segments of the market that have been reluctant to use postal services. Rate rationalization, innovative preparation requirements, and targeted communications are key strategies for growing revenue in the future. The current joint mailer/Postal Service Product Redesign initiative will be the primary vehicle to accomplish these strategies.

Postal Service customers need simple solutions for their mailing needs. Ease of use will be an essential ingredient for increasing the customer base in the future. As part of the *Transformation Plan*, the Postal Service is looking at developing pricing strategies for packages which emphasize size rather than content. The Postal Service will continue to promote the deposit of mail closer to the point of delivery, producing the least combined-cost mailing solution. For businesses that mail in bulk, but only in moderate amounts relative to their overall operations, the Postal Service will offer the option of simpler requirements and preparation rules. As a result, these mailers will be able to avoid most of the complex requirements they are now compelled to master.

At the other end of the spectrum, the capabilities of “mail-intensive” customers (businesses for which mail is a core part of their operations) have developed to the point that they should be recognized with additional cost savings. The Postal Service will offer these sophisticated mailers a rate and preparation structure that rewards additional types of cost reduction while providing flexibility for mailers to select the preparation activities they wish to perform to obtain discounts.

Pricing of products is a key transformation area.[23] In order for customers to evaluate internal investment decisions, they need advance knowledge about rate changes. Therefore, the Postal Service will propose a system of phased rates so customers can anticipate postage costs and plan appropriately.

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[23] See Appendix L, *Transforming Pricing in the U.S. Postal Service,* for more information.

Many customers have unique relationships with the Postal Service based on their business models and mailing requirements. While they exist within the current pricing and preparation requirements, unique service agreements could provide efficiencies for the customer, the Postal Service, and the mailing community at large. The Postal Service will pursue customized pricing arrangements which might include negotiated service agreements (NSAs).

The Postal Service will also transform the *Domestic Mail Manual* (DMM) into series of hard copy documents and electronic systems. This initiative will make it easier for customers to understand and use postal mailing requirements. In addition, the Postal Service is in the process of developing a Corporate Pricing Plan that will describe and define the scope of change needed to transform the current approach to pricing.

Expanded payment options are also a key ingredient in maintaining a strong customer base. In the future, the Postal Service will offer more flexible payment options, such as third-party credit/debit accounts and “smart cards.”

In order to successfully transform, the Postal Service must reach out to untapped segments of the market. Future revenue growth will rely on communicating specific product information to target markets. Through the use of personal messaging and hands-on seminars, the Postal Service will focus on product requirements for small and medium businesses.

Products and Services Strategy 3: Position Mail as a Key Communications and Customer Relationship Management Tool

Today’s communications market is more volatile than ever before. In the face of constant predictions of threats from electronic media, traditional service providers like the Postal Service find that the key to growth lies in providing customers personalized and relevant information and communications, when, where, and how they want them. Mail has become a critical component of a value chain that links businesses to consumers and businesses to other businesses. The Postal Service will position itself as the primary provider of universal paper-based communications services.

A large part of First-Class Mail is driven by remittance mailers, who depend on the Postal Service for timely and reliable fulfillment of their payments. Fulfillment involves far more than delivering merchandise. It involves delivering a relationship—a mortgage payment received on time or a tax filing obtained and confirmed. Businesses in all industries use mail as their trusted service fulfillment provider. In this increasingly connected economy, the Postal Service will promote mail as a customer acquisition, service fulfillment, and customer retention tool. It will continue to enhance mail to position it as a customer relationship management tool. The Postal Service will continue to analyze its customers’ business processes and will identify innovative ways to help customers optimize these processes.

Products and Services Strategy 4: Enhance Package Services

While the future of hard copy letters and transactions is subject to debate, there is little disagreement that package services are a growing market. The transformation strategy for package services centers around controlling costs, managing price, and enhancing service.

In order to acquire a competitive position in package services, the Postal Service will focus on reducing processing and transportation costs. It will work toward consolidating and aligning its processing points to realize economies of scale in Priority Mail processing and to leverage surface transportation. It will look to merge Priority Mail with similarly-shaped mailstreams on automated equipment to reduce the manual sorting that is required to prepare Priority Mail for carrier delivery.

Rate and product design simplification will be key package strategies. Today the Postal Service has nine different rates for mailing a book: Express Mail, Priority Mail, First-Class Mail, Standard Mail, Parcel Post, Parcel Select, Bound Printed Matter, Media Mail, and Library Mail. To control costs and promote ease of use the Postal Service will seek to standardize rate structures, mail preparation and parcel processing regardless of weight and content.

The Postal Service must also enhance service by making it convenient for customers to access the full range of package services at home or the office. The Postal Service is building an Internet capability that will allow expedited package customers to print and pay for postage online as well as to schedule carrier pickup service.

As more and more Americans shop by mail, an increasingly important component of the parcel business is returns. The Postal Service will develop package return services that meet the needs of shippers and are easy to use for the consumers who need to return items. This may include the use of shared information systems and the development of new products that encourage mailers to pick up returns at the facilities where they are entered in bulk. Improved and expanded refusal and forwarding endorsements will also be pursued.

Products and Services Strategy 5: Map Channel Strategies around Customer Needs, Contribution, and Growth Potential

In today’s competitive markets, differentiation is achieved as much through the services surrounding the products as through the products themselves. Managing relationships with customers is critical to growing competitive advantage. The Postal Service is challenged with limited resources and must optimize its channel strategies to realize the full potential of the demand chain.

To this end, the Postal Service is evaluating its customer base to understand how its customers differ by contribution, growth potential, and needs, so as to align its resources to optimize the demand value chain. The Postal Service employs numerous customer-facing channels such as a direct sales force, retail outlets, mail acceptance units, carriers, and the Internet. To acquire and sustain a competitive advantage, it is imperative that the Postal Service optimize its channel strategies so that sales and service functions are organized around value tiers and resources are allocated accordingly. By leveraging customer values and needs, the Postal Service can deploy differentiated treatment for high growth potential customers. By allowing for change in current processes, employee behavior can be better aligned with determined business objectives.

Customer relationship management strategies will be employed to retain valuable customers, to increase revenues from those customers who show the greatest potential, and to acquire new customers.

International mail accounts for a small but significant portion of the Postal Service's total revenue. The Postal Service will retain and increase international market share by improving service quality, introducing end-to-end services that consistently meet or exceed customer needs, and enhancing existing product offerings, and introducing line extensions and new services to meet the value chain requirements of customers.

Products and Services Strategy 6: Develop New Features and Services

Customers will continue to demand new features for existing products and new products that leverage the Postal Service's core competencies. The Postal Service has recently explored initiatives in the e-commerce area and is evaluating and reviewing each initiative for its growth potential and relevance in the marketplace. Using new criteria the Postal Service will seek opportunities that minimize direct investment and leverage its strong brand and assets. Relationships with partners will produce revenue shares commensurate with risk, value, and investment.

Products and Services Strategy 7: Leverage Existing Assets

In the future, the Postal Service may leverage existing assets and infrastructure affected by network and operational changes. These assets could include postal-owned vehicles and retail and distribution space. The enterprise will consider revenue-generating opportunities that may result from the sale or new use of these assets.

The Postal Service operates one of the largest transportation services in the world. Consequently, there is great potential to add revenue through the innovative use of the transportation infrastructure. Utilizing excess capacity on postal-owned and contract vehicles, the Postal Service could offer transportation services for nonmail items or mail that has not yet been inducted into the postal system.

Postal Service retail and distribution units may have the capacity to generate revenue by incorporating nonpostal services that would complement the existing structure. Such retail ventures could offer customer accessibility and convenience, especially in thinly populated areas. On the distribution side, space may become available for warehousing and merchandise fulfillment as the result of operational consolidation.

2.2 Increase Operational Efficiency[24]

The Postal Service is implementing strategies in nine operational areas to improve the efficiency and effectiveness of its network and processes. These areas are:

- Enhance already efficient letter processing;
- Complete automation of flats processing;
- Expand mechanization of material handling operations;
- Improve delivery efficiency;
- Deploy next generation package sorting equipment;
- Optimize transportation and distribution networks;
- Increase retail/customer service productivity;
- Improve performance management; and
- Manage realty assets.

Operational Efficiency Strategy 1: Enhance Already Efficient Letter Processing

Collecting, sorting, transporting, and delivering the nation's mail to every household and business across the country—from Alaska to Puerto Rico—is an enormous task. To accomplish this task, the Postal Service utilizes a physical infrastructure that includes more than 38,000 post offices and contract units, 270 processing plants, 63 airport mail facilities, 21 bulk mail centers and a number of other facilities. The Postal Service also partners with private sector contractors for highway, air, rail, and water transportation services.

The Postal Service handles three basic shapes of postal items: letters and cards, larger size pieces called flats, and packages. Letters—generally First-Class Mail and Standard Mail letters and cards—account for 71.3 percent of total mail volume. Flats consist of large First-Class Mail, Priority Mail, and Standard Mail envelopes, magazines, or large advertising circulars and account for 27.3 percent of volume. The remaining 1.4 percent of volume primarily contains Priority Mail and Package Services.

Like other large businesses, the Postal Service relies heavily on modern technology to improve efficiency and to control costs. Automation equipment has been central in this respect. During the 1990s capital investments for equipment focused on development and installation of high-speed letter sorting equipment and today the Postal Service has a world-class letter distribution system. Letter mail productivity in processing plants improved nearly 50 percent from 1993 to 2001. Reductions in time devoted to sorting allowed the Postal Service to reduce the number of city delivery routes by 4,100 from 1995 to 2001 while simultaneously absorbing an increase in the number of delivery points.

The Postal Service will invest in additional equipment and software technology to automate the forwarding of letters, an investment that will produce significant savings in 2004 and 2005. The Postal Automated Redirection System (PARS) will handle the forwarding of undeliverable-as-addressed (UAA) letter mail more efficiently than today's

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[24] See Appendix M, *Efficiency-Based Strategies,* for more information.

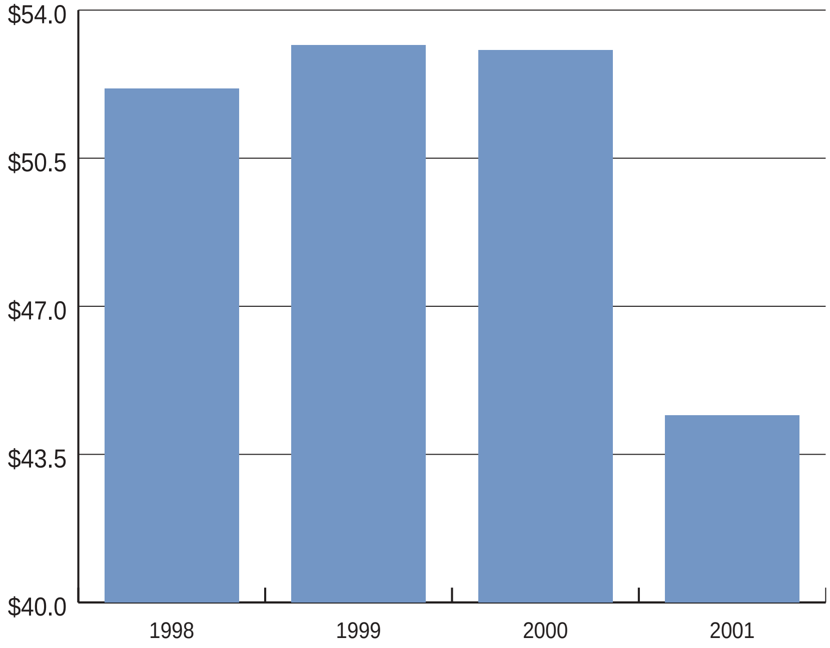
manual or mechanized processes, with the UAA mail intercepted earlier in the sorting process, resulting in a reduction in total handlings.

With the exception of mail forwarding, there are no new major automated equipment initiatives left for letter mail. The Postal Service will continue to improve the quality of automated letter operations and will work to reduce/eliminate the nonautomated letter mailstream through equipment modifications and customer incentives.

Operational Efficiency Strategy 2: Complete Automation of Flats Processing

New automation programs are now being developed for the flat mailstream. The Postal Service has deployed the new Automated Flats Sorting Machine 100 (AFSM 100) to improve productivity and control costs for flat-sized pieces. The AFSM 100 is based on state-of-the-art flat sorting technology and processes mail more efficiently than older, mechanized equipment. As the Total Flats in Plants graph indicates, in fiscal year (FY) 2001 flats distribution costs in plants decreased approximately $8 per thousand when compared with the prior year.

TOTAL FLATS IN PLANTS: COST PER 1,000 PIECES



The innovative design of the AFSM 100 offers several key features, including an automatic feeder, a tray take-away conveyor with adaptability to robotic handling, and online video coding for non-OCR readable flat mail. Earlier generation FSM 1000 models sort thicker, hard-to-handle, flat-sized pieces. Automated flats feeders and optical character readers will now be installed on all FSM 1000 models. These enhancements will increase machine throughput and permit more than 70 percent of the mail pieces fed to this equipment to be sorted automatically rather than keyed manually. Additional technology upgrades will improve address recognition, enhance feeder systems, and add tray handling systems. The Postal Service will expand flats processing initiatives to include walk sequencing and is exploring changes to customer preparation requirements as discussed further in the *Plan*.

Operational Efficiency Strategy 3: Expand Mechanization of Material Handling Operations

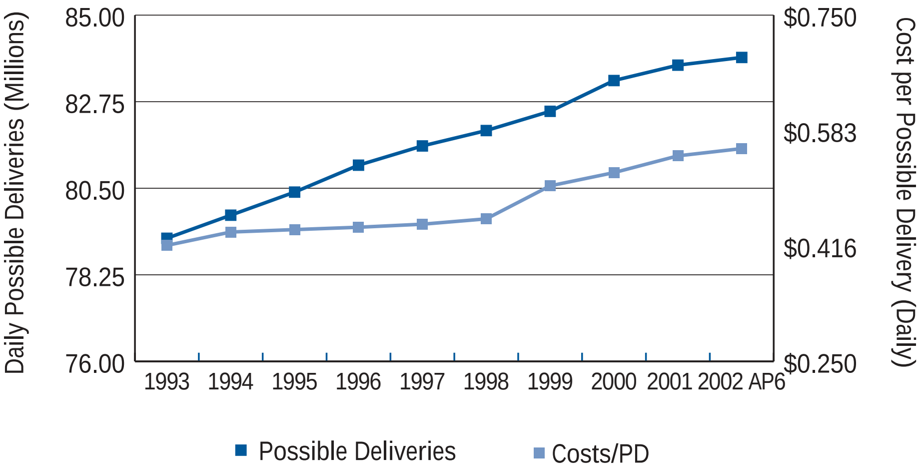
To improve the movement of the nearly 86 million pounds of mail processed daily, the Postal Service is investing in tray sorting machines that will reduce the manual sorting of letter and flat trays. A recommended strategy for achieving savings in material handling operations is to deploy low cost tray sorters (LCTS). Limited deployment of the LCTSs has helped reduce material handling workhours. LCTSs have been deployed for inbound tray sorting operations and outbound dispatch operations.

For the future, the Universal Tray System (UTS) is under development at the Integrated Processing Facility in Fort Myers, Florida. Ultimately, the UTS will be the primary means for achieving physical integration within the plant and will be capable of handling trays, bundles, packages, and sacks. The Postal Service will also continue to work with customers and the mailing industry to explore product redesign and worksharing options that will reduce the number of tray and piece handlings and improve efficiency in postal operations.

Operational Efficiency Strategy 4: Improve Delivery Efficiency

Capital investment in equipment to improve delivery operations is also a priority. The delivery function is the largest cost center and is growing due to the addition of approximately 1.7 million new delivery points each year. Much of the cost for street delivery is fixed and does not vary with volume, i.e., driving to the route, walking or driving the route, and accessing the customer mailbox take the same amount of time each delivery day regardless of volume. In order to control this growing cost area, new equipment needs to be developed that will allow the Postal Service to reduce costs in delivery operations at a rate greater than the rate of growth in delivery points. As the chart on the following page shows, between 1993 and 2002, the number of possible city delivery points has grown approximately 6 percent and the cost per delivery point has grown approximately 33.5 percent. While approximately 72 percent of letters to carriers are automatically sorted in delivery point order ready for street delivery, flat-size pieces must be sorted manually to delivery point order. The Postal Service has not yet developed an automated sequencing equipment system for flats that is operationally feasible. Automated sorting of flats in Delivery Point Sequence would offer significant new opportunities for savings. The Postal Service has tested a number of pieces of equipment, but none has produced the desired result. The Postal Service intends to continue testing equipment and concepts that may enable it to capture this opportunity.

CITY DELIVERY TRENDS



The long-term vision for delivery operations is a seamless operation that culminates in one bundle of mixed letters and flats for each delivery point, called the Delivery Point Package (DPP). This vision is dependent on having high-speed mail sorting and packaging equipment that will efficiently sort and merge the letter and flat mailstreams in delivery sequence for the letter carrier with the addresses on all of the pieces properly oriented. If the processing equipment can be designed, the labor-intensive manual preparation of mail in sequence for street delivery would be reduced using state-of-the-art packaging technology. The packaged volume would then be made available at a central carrier point or location, making the need for delivery unit sortation obsolete.

The Postal Service is evaluating the benefits and costs of implementing this delivery vision. As a first step, the Postal Service will evaluate the use of additional flat firm holdouts and carrier shelf sortation for flats based on the barcode or the ZIP+4® code. The next step will be to determine what customer and operational changes will be needed to sort flats in Delivery Point Sequence and to formulate methods for capturing any resulting savings. The final steps will be to gradually reduce the number of bundles that a carrier must handle on the route from the current three to two to one, culminating in DPP.

The current definition of a flat is broad and allows a wide latitude for size, thickness, and materials. This latitude significantly increases the complexity, cost, and time needed to adapt technology. Success with the above concepts could mean that the definition of a flat may need to be narrowed or standardized in the future. The Postal Service is working with customers and the mailing industry to determine if product redesign changes can be incorporated into the mailing regulations for flats that would enable greater processing efficiencies in the future.

“The largest challenge to the organization as I see it is the continually rising cost of the delivery infrastructure.”

—Postal Service Employee

In the near term, the Postal Service is actively deploying the Delivery Office Information System that provides timely data to delivery supervisors to enable them to make more efficient decisions. The Postal Service is also pursuing the following productivity improvement initiatives in delivery operations:

- Managed Service Points system improves the uniformity of daily delivery and has produced savings in street delivery operations.
- Delivery Performance Achievement and Recognition System uses benchmarking techniques to improve and recognize good performance.
- Rural Delivery Improvement process is designed to improve performance through enhanced training of supervisors.
- Carrier Optimal Routing system is being tested to optimize carrier routes and travel paths using optimization algorithms. If successful, it will allow the Postal Service to structure more efficient routes and reduce vehicle costs.

The Postal Service is also testing the Segway™ Human Transporter (HT), a two-wheeled, battery-powered transport device that the carrier stands on to move between delivery points. If successful, use of the HT would reduce the carrier's time on the street and allow the expansion of the number of delivery points per route. This device is being tested on a variety of routes, terrain and climates. Tests will continue through 2002, and if successful, deployment could begin in 2003.

Operational Efficiency Strategy 5: Deploy Next Generation Package Sorting Equipment

Package volumes and bundles of mail prepared by customers as part of worksharing, whereby the customer pays less postage in exchange for performing certain mail processing functions, have increased. To improve the Postal Service's ability to handle packages, two equipment projects are planned. The Singulate, Scan, Induction Unit (SSIU) equipment is being deployed to 19 of the 21 bulk mail centers (BMCs) to improve productivity and sort accuracy. The SSIUs will allow parcels to be sent, one at a time, through a dimensioning unit, a weigh-in-motion scale, and a scanning tunnel that will read the package's barcode. Packages will then be automatically inducted onto sortation equipment. Deployment began in January 2001 and is expected to be completed in November 2002.

Automated Package Processing Systems (APPS) is the Postal Service's next generation of sorting machines for small parcels and bundles of mail. It will replace the older labor-intensive machines in larger offices. APPSs will increase processing capacity and introduce optical character reading and other advanced technologies to the small parcel and bundle operation in processing plants. APPS will improve productivity and sort accuracy.

Operational Efficiency Strategy 6: Optimize Transportation and Distribution Networks[25]

The Postal Service manages a vast transportation infrastructure that moved over 27 billion pounds of mail through its network last year at a cost of $5.5 billion. Over the past decade transportation costs have been rising faster than mail volumes. Recent events have further exacerbated this situation by restricting commercial airlift for Priority Mail products and requiring a heightened state of physical security.

To address these challenges the Postal Service has implemented several tactical measures for containing costs and improving service, including diversion of volume from air transportation to service-responsive surface transportation.

New information systems to improve transportation performance are also planned. These will enable managers to route mail and record its location as it moves through the network. The Postal Service will use these information systems to measure the performance of each transportation lane and carrier as well as the performance of the origin and destination terminals. Information from such systems will be used to optimize network design, improve transportation efficiencies, and enhance service. The following systems are critical to improving network operations in the future:

- Surface Air Management System is a replacement system for the aging Air Contract Data Collection System and handles mail assignment to air carriers and supporting payments to the carriers.
- Transportation Optimization Planning and Scheduling system will replace the automated dispatch generation system and will introduce a more dynamic and industry-standard route optimization engine for all transportation.
- Surface Air Support System is a logistics information platform system that will integrate scanned data from existing postal transportation systems to ensure service performance accountability and accurate payment verification.
- Transportation Contract Support System will support the solicitation, award, and administration of highway, air, rail, and water contracts.

The Postal Service implemented a dramatic change to its transportation network by initiating an alliance with FedEx, which in the fall of 2001 began transporting nearly four million pounds of mail daily on its day and nighttime air networks. The FedEx network replaced a disparate set of air transportation networks with a more streamlined network that meets the needs of Express Mail, Priority Mail, and First-Class Mail. The transportation agreement with FedEx provides many improvements over the former network design, including:

- Lower costs through the use of shared FedEx capacity as opposed to dedicated capacity purchased from other providers;
- Opportunities for improved service performance;
- Simplified and centralized network management resulting from the replacement

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[25] See Appendix N, *Procedures for Closing Postal Facilities,* for more information.

of multiple providers and networks with a single air transportation solution; and

- Improved information technology capabilities through the integration of Postal Service systems with FedEx's vast information collection infrastructure.

For surface transportation, the Postal Service has developed a national hub-and-spoke network to efficiently move mail volumes that are insufficient to justify direct transportation. The Postal Service has also developed a Mail Transport Equipment Service Center program that directly contributes to improving mail processing productivity and business mailer satisfaction. Network complexities are inherent in a system that provides service to a multitude of mail classes and shapes, which are transported between approximately 932 three-digit ZIP Codes.

For mail processing the Postal Service has deployed the most advanced automation technology available in order to keep pace with productivity demands. While the Postal Service is exploring more comprehensive network initiatives as discussed below, there are some opportunities that have already been identified. For example, the Postal Service will eliminate costly annexes through better space utilization. The Postal Service intends to announce plans for plant consolidations by the end of 2002.

The Postal Service's present financial situation coupled with rapid advances in supply chain management technology make this the ideal time to initiate sweeping logistics changes in transportation and distribution processes throughout the organization.

To this end the Postal Service has initiated a network optimization effort, the Network Integration and Alignment (NIA) initiative, with a charter to create a flexible logistics network that reduces Postal Service and customers' costs, increases overall operational effectiveness, and improves consistency of service. NIA will offer the analytical means to redesign the existing network and provide rapid response capability. This initiative is intended to develop the blueprint for future network operations management within the Postal Service.

This process will produce a set of network optimization and simulation models that will enable the Postal Service to analyze a variety of network alternatives that address the complexities and uncertainties of the operating environment. These models will also determine which facilities remain viable and necessary within the future infrastructure and which distribution and transportation roles will be performed by those facilities that remain as parts of an optimal, fully integrated network.

The NIA effort will enable the Postal Service to balance distribution strategies against service needs and logistics costs. The new network design will offer the mailing industry an opportunity to identify impacts of alternative workshare concepts.

NIA mandates a shift in focus from optimizing the performance of a particular product line or geographic area to optimizing the performance of the entire logistics network and mailing industry value chain. NIA will focus on balancing the distribution strategy against service needs and logistics costs. The mail processing network infrastructure will be redesigned to meet volume forecasts, customer requirements, and competitive pressures. Streamlining and simplifying the distribution network will permit consolidation of sorting facilities and elimination of excess resources. Optimization analysis will determine the design of a least-cost, service-responsive logistics network configuration. Processing facility roles and functions will be determined by overall system requirements. This effort will also contribute to the overall strategic objective of a 10 percent transportation cost avoidance by FY 2006.

NIA will be aligned with the Mailing Industry Task Force’s recommendation that the Postal Service-private sector postal network should be treated as interdependent components of the mailing industry value chain. The mailing industry and customers at large will benefit from restructuring through increased efficiencies. Worksharing strategies will be evaluated in coordination with product redesign efforts. By jointly improving business practices, the Postal Service can move aggressively to become more efficient.

Network redesign will provide an opportunity for new business development strategies. Further contracting of logistics services and distribution activities will be analyzed. The Postal Service may also position itself to become a provider of transportation management services for the private sector.

The NIA effort affects $5.5 billion in transportation costs and approximately $20 billion in processing and distribution costs. As a national initiative, the NIA will model more than 500 facilities, including processing and distribution centers/facilities, bulk mail centers, Priority Mail processing centers, international service centers, air mail centers, facility annexes, and hub-and-spoke facilities. The network strategy will be developed by the fall of 2002.

Operational Efficiency Strategy 7: Increase Retail and Customer Service Productivity

The most significant cost savings in post office operations will result from the following:

- Standardization of operations to ensure optimal efficiency throughout the postal network.
- Continued automation of mail processing operations that occur in the backroom of post offices.

Retail / Customer Service Productivity Improvement

The Postal Service will continue its efforts to deploy processing equipment and implement best practices that standardize operations to increase productivity and to reduce costs. This continued effort is expected to provide significant productivity improvements.

The Postal Service has detailed retail transaction data from approximately 9,600 of its largest post offices as a result of the deployment of Point of Service (POS) ONE equipment. This data will be used to determine customer demand at counters and to staff accordingly. The information also enables the Postal Service to determine the number and types of transactions that can be shifted from the full service counter to other alternatives.

In addition, improvements from letter and flat mail distribution efforts discussed earlier will contribute to backroom retail cost reductions. A significant contribution will come from the deployment of PARS.[26]

Facility Design Changes

The Postal Service will also review the design of its post offices. As new vending alternatives are developed and deployed, the Postal Service will determine the best way to provide access to postal services for up to 24 hours a day, seven days a week. Design changes will reduce construction costs and provide easier access.

Operational Efficiency Strategy 8: Improve Performance Management

In addition to capital investment to drive down operating costs and network modeling to ensure an optimal distribution and transportation structure, the Postal Service will continue its focus on improving productivity by standardizing and monitoring performance.

The Postal Service has established national productivity targets for all operations. Cost reductions are budgeted based on the relative performance of each plant or district compared to those targets. Expectations for organizational goals and targets for the next fiscal year are established and communicated during the budget planning phase so that managers throughout the organization are familiar with and have a plan for attaining their goals.

Best practices have been identified and operations are being standardized around these best practices. Numerous tools have been developed to assist the field operations managers in monitoring their performance, planning their complement and properly scheduling their people.

This intense focus on productivity and standardization of operations has produced two of the most productive years in Postal Service history.

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[26] See Appendix M, *Efficiency-Based Strategies,* for more information.

Operational Efficiency Strategy 9: Manage Realty Assets

Facilities management strategies are designed to ensure that the disposition, by sale or lease, of excess or underutilized real estate assets held by the Postal Service is conducted in a manner consistent with the best interests of the organization. Funds derived from such actions become available for redeployment across the full spectrum of identified postal operational priorities.

Revenues come principally from the following:

- **Postal Service properties for sale.** The sale of fee simple, leased fee, and leasehold interests (including excess land, buildings, and air rights/other developmental rights).
- **Short-term leasing.** Leasing of excess space in postal owned buildings to the private sector (outleasing) and the General Services Administration.
- **Developmental leasing.** The long term leasing of excess space and development rights via a third-party developer.
- **Developmental added value properties.** Enhancement of the value of select high-profile properties suited for commercial development, including disposition strategies.
- **Other programs.** Tax appeals and acquisition of properties with favorable rents and purchase options.

In the future, it is expected that the inventory of excess properties will decrease—fewer new facilities will mean fewer former facilities available for sale. However, consolidation of processing may generate excess space for disposal.

The Postal Service is committed to improving operational efficiency through a highly motivated workforce.

2.3 Move Toward a Performance-Based Culture[27]

The Postal Service will implement the following strategies to move the organization towards a performance-based culture and maximize the performance of Postal Service employees:

- Retain and recruit quality employees;
- Develop future leaders;
- Ensure training and development;
- Create a performance-based pay system;
- Build a highly effective and motivated workforce;
- Improve labor/management relations;
- Improve workforce planning;
- Expand shared services and explore outsourcing;

> *"The Postal Service of the future must find a way to restructure their employment model to encourage and capture the creativity and capabilities of every individual within its organization and to discover more effective methods to manage this...expense."*
>
> —Business Customer

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[27] See Appendix O, *Performance-Based Strategies,* for more information.

- Improve the collective bargaining interest arbitration process; and
- Reduce workers compensation costs.

Performance Strategy 1: Retain and Recruit Quality Employees

Changing business needs are altering the skill requirements of Postal Service employees. Additionally, the Postal Service must compete with private industry to retain and recruit job candidates in many parts of its organization, from lower-skilled positions to essential technical and professional positions. This competition comes as the postal workforce is aging. By 2006, 55 percent of executives and officers, 36 percent of managers and supervisors, and 19 percent of career employees will reach eligibility for regular retirement.

As one of the nation’s largest employers, the Postal Service enjoys a workforce rich in talent and skills. By providing developmental opportunities, and recruiting from within for needed skills, it has the ability to use this talent base to its advantage. To the extent there are gaps, particularly in areas requiring a specialized skill that cannot adequately be met from this talent base, the Postal Service will seek candidates from the external labor market.

In retaining and recruiting managers and employees, the Postal Service faces two major challenges. The first challenge is to retain employees with skills that are critical to the future success of the organization. The second challenge is to concentrate recruitment efforts on bringing talent, skills, and experience from within the organization and the outside labor market to address potential loss of postal leadership.

The implementation of retention strategies begins with the collection and analysis of geographic turnover rates by job category over time. The Postal Service is currently conducting a detailed study of retention rates, with preliminary analysis to be completed by August 2002. This analysis will provide the evidence of turnover trends arising from the loss of specialized skills, and also provide the Postal Service with the ability to monitor shifts in the diversity of the workforce makeup. This data will help in the development of any new pay initiatives as well as identify any employment practices that could be barriers to retention. This information will be compared with similar federal government and private industry trends for the same periods in the same geographic areas.

Upon completion of this initial analysis, a Human Resources team will determine which positions are affected and make retention recommendations by specific position. Wider application of current pay incentives will be introduced on a case-by-case basis. The Human Resources team will continue to explore other avenues for retention and develop further pay recommendations in an additional report to be completed by 2003.

The Postal Service can demonstrate that one of the factors constraining its ability to provide compensation that is comparable to the private sector is the statutory salary cap. Current salary compression for selected manager, executive, and officer positions makes it more difficult to retain and recruit key talent. However, several pay strategies have been successfully used to address retention issues for nonbargaining positions. One strategy gives higher-graded positions which are difficult to fill, larger standard salary adjustments than those in lower grades. The second strategy is to allow an employee a salary level above the maximum range under special circumstances. Finally, retention incentives within the maximum salary range have been used to retain specialized skills. These initiatives and others may be expanded to retain and recruit the specialized skills required.

The Postal Service will modify and automate recruitment and hiring processes to make them easier to use and more accessible to potential employment candidates. The Postal Service will further utilize technology to improve application processes at all levels, will pilot redesigned hiring procedures in several sites by the end of 2002 and will implement a comprehensive recruitment plan based on an attrition analysis that will address redeployment and recruitment needs over the longer term. All recruitment efforts will be mindful of the need to have a diverse workforce and will be used in conjunction with Postal Service retention efforts.

The Postal Service will concentrate recruitment efforts on bringing talent, skills, and experience from within the organization and the outside labor market to the Postal Service. For critical line supervisor positions, the Associate Supervisor Program will be the standard for retaining and recruiting the best talent. For other critical positions in the field and at headquarters, the Postal Service is introducing new Management Intern (MI) and Professional Specialist Intern (PSI) programs open to internal and external applicants to build a strong bench for hard-to-fill positions. The MI program will provide two years of training and outplacement to a field manager position. The PSI program will focus on developing a candidate to assume technical or professional responsibilities at headquarters. In addition, the Postal Service will pilot a centralized recruitment effort composed of human resources teams that will attract skilled technical candidates for positions, such as CPAs, accountants, economists, and psychologists. The Postal Service will begin testing centralized recruitment for specialized jobs by the end of 2003 and increasing hiring visibility by holding hiring activities at relevant industry events. The Postal Service will also use a centralized recruitment approach for selected craft positions such as electronic technicians, automotive mechanics, and truck drivers. Finally, to expand alternative recruiting and hiring options, the Postal Service will develop partnerships to outsource recruitment activities.

Performance Strategy 2: Develop Future Leaders

Since 1994, the backbone of the Postal Service’s leadership strategy has been the succession planning program which incorporates identifying, developing, preparing, and selecting individuals for executive positions in the Postal Service. Each officer discusses successor recommendations individually at an annual succession planning meeting with the Postmaster General and Deputy Postmaster General. A successor list is then prepared for each executive position and distributed to all of the officers. Officers refer to this plan for “successor” candidates when filling executive positions.

Having a strong succession planning program has enabled the Postal Service to meet its current demand in filling executive positions. However, as the Postal Service experiences an increase in executives leaving for other federal agencies and private sector firms, and as retirements begin to increase, more will have to be done to identify and prepare talent for executive positions. Strategies include reinforcing leadership accountability in the entire planning process with particular emphasis on developing high potential individuals. Additionally, the Postal Service will continue its commitment to provide educationally enriching opportunities as well as challenging leadership assignments to key executives. Finally, as both recruitment and training initiatives, the Postal Service will implement the MI and PSI programs to establish a baseline pool for future leadership.

Performance Strategy 3: Ensure Training and Development

The Postal Service continually faces the challenge of developing and maintaining a pool of well-prepared potential successors at all levels of the organization. Development programs and job skills training are available to support employee career paths from entry level, through supervisory and management, and into executive positions.

To train a flexible and agile workforce, the Postal Service offers training that is “just in time,” dynamic, current, and widely available. Development programs such as the Associate Supervisor Program, Career Management Program, and the Processing and Distribution Management Program form the foundation for managerial training and development. To build reserves for executive positions, the Advanced Leadership Program (ALP) is continually refreshed and kept current with both internal and external curricula.

Leadership development for mid-level managers, supervisors, and postmasters addresses the need for leadership development in critical field operations positions. This program focuses on developing talent around specific leadership competencies, especially critical positions where skill gaps exist. The process allows local management teams to forecast future needs using data and trends analysis, establishing pools of qualified employees for all major job families. It also uses technology to deliver, to track, and to administer training.

The Postal Service will be implementing a number of leadership development activities beginning in 2002. Plans are currently underway to implement the MI program. Executive Development/Training will focus on emerging business trends and enhancing coaching skills. By 2003 the Postal Service plans to have partnerships with universities and/or learning organizations to provide ongoing executive development. Also in 2003, the PSI program will be developed.

Performance Strategy 4: Create a Performance-Based Pay System

The Postal Service has led the federal government in building market-based, performance-driven compensation systems. While considerable organizational success has resulted from these innovations, there remains room for improvement in the total compensation strategy that will help drive transformation of the Postal Service. The performance-based pay program is currently being redesigned.

> *"[The Postal Service] needs to establish a pay for performance process that is equitable for everyone."*
>
> —Labor Organization

The foundation for the redesigned performance-based pay program, to be known as the National Performance Assessment, will be a solid performance evaluation system that will clarify expectations and provide feedback on progress towards performance objectives. The development of objective performance measures through the use of metrics will provide clear links between performance and rewards and help improve accountability at all managerial levels and at all operational levels of the organization. A multifunctional group will develop objective performance measures for administrative and enabling groups.

As the first step in implementing the new performance management system, Human Resources will consult with the management associations as required by law. The consultation process should be completed in 2002 and will focus on three primary pay plans for building performance-based compensation now and into the future: 1) individual merit pay programs to build individual accountability throughout the managerial ranks, 2) exceptional individual performance programs to recognize outstanding individual performance, and 3) team incentive plans to encourage cooperation towards organizational success.

The Establish Committee, a senior level officer group that approves goals and ensures that they align with the overall objectives of the organization, will deploy the National Performance Assessment goals to the appropriate levels of the organization. Operations and functional managers will then develop local goals and objectives and target levels of performance to achieve the national goals. This process will enable the organization to have clear expectations and line-of-sight to all levels of management, and will motivate managers to achieve challenging organizational goals.

The new performance assessment system will be implemented in phases. In 2002, operations executives are being evaluated under this system; in 2003, headquarters/field support executives will be evaluated under this system, including key field operations managers and EAS 18 and above grade levels. By 2004, the Postal Service intends to have the National Performance Assessment System in place for front-line supervisors at the EAS 16 grade level.

Performance Strategy 5: Build a Highly Effective and Motivated Workforce

Among the mechanisms the Postal Service currently uses to assess the workplace environment are employee surveys, identification of nonharmonious worksites, counseling for troubled employees, the Employee Assistance Program (EAP), and workforce training so all employees recognize and correct unacceptable workplace behaviors.

The transformation challenge is to build on programs already in place to create managerial accountability for workplace environment issues. In addition to improving Voice of the Employee (VOE) survey results, the Postal Service will make district and area leadership accountable for the following activities: identifying troubled worksites and developing effective plans for correcting problems, supporting the District Joint Employee Assistance Plan (EAP) Advisory Committees, maintaining trained Threat Assessment Teams and properly prepared Crisis Management Teams, supporting continuous education initiatives on diversity, and providing violence awareness and sexual harassment prevention training with acceptable regularity. The Postal Service will also develop data systems that can predict potential problems before they arise so that proactive actions can be taken.

Performance Strategy 6: Improve Labor / Management Relations

Building a solid relationship with unions, management organizations, and employees does not happen overnight. Good labor/management relations are built over time through communication, shared experiences, and cooperative efforts.

A voluntary program, developed by the Postal Service in the mid-1990s called REDRESS®, uses mediation to resolve disputes in the workplace that relates to the Equal Employment Opportunity Act. More than 78 percent of the complaints referred to REDRESS are resolved by the parties prior to litigation. In addition, the number of employees who file formal complaints decreased from 1.25 per 100 employees in 1999 to .85 per 100 employees in 2001. During the past two years, the Postal Service has shifted control of the REDRESS program from headquarters to the field, allowing greater innovation and autonomy in managing the program, reducing headquarters staffing, and improving dispute resolution rates overall.

The Postal Service has also worked cooperatively with employee organizations. Development of Joint Contract Interpretation Manuals with the National Association of Letter Carriers (NALC) has improved the ability to resolve issues and disputes with that union. Both parties identify their jointly shared interpretations of contract provisions and ensure that their field counterparts understand this information. Coupled with joint training initiatives, this effort has improved the Postal Service's ability to deal with workplace problems. A similar Joint Contract Interpretation Manual is nearing completion with the National Postal Mail Handlers Union (NPMHU).

In another innovation between labor and management, alternatives to the Postal Service's traditional grievance process have proved highly successful with the NALC. Use of labor and management dispute resolution teams has cut disputes in half and is reducing the prior backlog of NALC grievances by more than 1,000 cases per month.

The anthrax incidents exemplified how the Postal Service's employee and management groups can pull together to address a shared problem. The Mail Security Task Force was composed of the top leadership officials of the Postal Service, the management organizations, and the labor unions. The presidents and officers of these organizations met on a daily basis to share concerns and to map strategy to deal with the unprecedented assault on the mail system, on employees, and on the American public. The task force was mobilized within hours of the anthrax incidents and became the information and strategy focal point in the weeks that followed. Communication and cooperation among all Postal Service employee groups have never been more productive, and the Postal Service intends to build on these successful efforts.

Performance Strategy 7: Improve Workforce Planning

The current restructuring efforts within the Postal Service are designed to provide an effective and efficient organization that is responsive to its core mission. Structure and staffing are designed to be flexible and accommodate future transformation. At the same time, the focus is to ensure that sufficient resources are available to support the core mission of processing and delivering the mail. The Postal Service will continue to assess its organizational structure and alignment as business changes. The measures of success are support of the core mission, alignment with the mission, elimination of duplication, and reduced costs.

The Postal Service strategy is to build and maintain a flexible workforce that can be readily adjusted to changes in customer demand and operational efficiencies. Use of data driven assessment tools will assist in determining skill needs and availability by location. Once needs are determined, the Postal Service will use cost-efficient ways to reposition employees. The Postal Service will continue to standardize complement management activities and provide staffing strategies that not only increase workforce flexibility but also meet business demands and operational requirements. Repositioning employees will require using all currently available processes as well as considering additional options for rightsizing.

Performance Strategy 8: Expand Shared Services and Explore Outsourcing

To reduce administrative costs, the Postal Service is expanding a “shared services” approach, a consolidation of services that delivers administrative services better, faster, and less expensively. Used successfully in a growing number of companies, “shared services” refers to sharing technology, people, and other resources within and across administrative functions in order to reduce costs and improve quality. In the Postal Service, effective shared services efforts include three key components: 1) reengineered, standardized processes; 2) technology integration (standards, shared tools, pieces that fit together); and 3) effective planning and implementation of staffing changes.

The Postal Service will apply the shared services model to most high-volume or repetitive administrative activities, and because the Postal Service employs nearly 770,000 career employees in a very large network, many administrative functions lend themselves to a shared service approach. For example, the Postal Service is making a significant investment in new enterprise technology, replacing 30-year-old human resources and payroll systems.

By the end of 2002, shared services in accounting will begin a national rollout, a pilot of injury compensation shared services will be completed, and pilots of shared services in hiring and testing and personnel benefits will be underway. During 2003, the Postal Service expects further developments in human resources, purchasing, and facilities shared services efforts. These efforts will pave the way for full implementation of the shared services model in transactional processes in these functions during 2004. Finance estimates that shared services in accounting will be fully implemented by 2004.

In addition to moving administrative processes toward shared services, the Postal Service will also continue its decades-long history of outsourcing many noncore activities, including purchased transportation services, contract stations for retail services, and equipment and vehicle maintenance. The Postal Service has traditionally obtained the best source services in order to better utilize internal resources, reduce cost, and increase quality.

In the future, the Postal Service will explore the possibility of outsourcing additional activities including mail preparation, retail services, terminal activities, and container distribution. By exploring the potential for outsourcing other activities, the Postal Service will be able to determine the cost efficiencies and service enhancements that may be available. This process will also permit the Postal Service to determine how employee impacts may be minimized.

The Postal Service is also studying establishment of an Employee Stock Ownership Plan (ESOP) for EEO investigative work. Through an ESOP, the Postal Service can maintain the continuity of needed expertise and knowledge while allowing for a more efficient and cost-effective means of providing this service. Overhead costs of the Postal Service would be reduced by an employee-owned company through which employees would earn incentives for increased productivity and profitability. As the Postal Service gains experience during this initial ESOP endeavor, it will explore opportunities for additional ESOPs in the areas of vehicle maintenance, transportation networks, and administrative functions.

Performance Strategy 9: Improve the Collective Bargaining Interest Arbitration Process

In the near term, the Postal Service will explore a revised interest arbitration process. Under current law, 39 U.S.C.1207(b), a fact-finding process is led by a panel of three persons chosen by the Federal Mediation and Conciliation Service. Generally, this fact-finding process has been unsuccessful, and the parties have frequently waived the process in favor of proceeding directly to interest arbitration. The Postal Service proposes that legislation be enacted to replace this statutory process with one in which a single mediator is selected by the Secretary of Labor. The selected mediator would be required to be an individual of nationwide reputation and professional stature and a member of the National Academy of Arbitrators. Such credentials should ensure that the individual selected would be able to mediate a dispute affecting hundreds of thousands of employees and a vital national communications network.

Performance Strategy 10: Reduce Workers Compensation Costs[28]

As the Postal Service continues to be more operationally efficient by eliminating manual jobs and consolidating operations, there are fewer positions available for employees with on-the-job injuries. Many of the traditional positions that these employees have filled have recently started to evaporate at an ever-increasing rate. If the Postal Service cannot accommodate an injured worker, then it must find new job responsibilities that fill an organizational need to ensure optimal human capitalization. If a sufficient number of positions cannot be found within the Postal Service, then postal management will endeavor to expedite the out-placement process to private industry through the Department of Labor.

Workers' compensation costs could also be reduced by appropriate legislative and regulatory changes to the Federal Employees' Compensation Act (FECA). Areas of possible regulatory change include mandatory FECA retirement at age 65 for all present and future disabled employees, expedited outplacement of rehabilitated employees to private industry, and the use of private industry companies to reduce costs.

Certain enabling strategies are critical if the Postal Service is to increase the value of its products and services, to improve operational efficiency, and to foster a performance-based culture.

2.4 Enabling Strategies[29]

The transformation of the Postal Service now underway necessarily involves a restructuring of functional activities that facilitate and enable the work of the organization. These enabling strategies encompass: 1) enhancements in financial management that will ensure that the Postal Service reduces outstanding debt, improves its financial reporting transparency, finances expansion of the delivery network on a current basis and explores alternative investments for deferred retirement liabilities; 2) expanded use of supply chain management business practices: 3) enhancements to the Postal Service technology infrastructure that will guarantee security and universal connectivity to support modernization in all areas; and 4) commitments to ensure the safety, security, and privacy of the mail.

2.4.1 Enhance Financial Management

The Postal Service is implementing three strategies to enhance financial management:

- Reduce outstanding debt;
- Improve financial reporting transparency; and
- Finance delivery network expansion on a current basis and explore alternative investments for deferred retirement liabilities.

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[28] See Appendix P, *Federal Employees' Compensation Act Overview,* for more information.
[29] See Appendix Q, *Enabling Strategies,* for more information.

Financial Strategy 1: Reduce Outstanding Debt

The Postal Service's strategy for debt management is to reduce outstanding debt through generating net income. Debt will be used in the future for capital improvements where the value added by the investment exceeds the cost of the debt. Under current law the Postal Service may increase its outstanding borrowing by up to $3 billion annually, which includes a $2 billion increase for capital investments and a $1 billion increase for operating expenses. The Postal Service is subject, however, to a total debt limit of $15 billion, which has been in place since 1992, when it was raised from $12.5 billion.

Debt is a reflection of capital spending and overall financial performance. Over time, changes in debt are largely determined by the difference between cash flow from operations and capital cash outlays. Cash flow from operations is influenced by net income or losses, and noncash expenses such as depreciation. Capital cash outlays are the funds invested in capital improvements such as facilities, automation equipment, and information technology. From 1997 through 2001 Postal Service capital cash outlays exceeded cash flow from operations. Consequently, debt increased by $5.4 billion, from $5.9 billion to $11.3 billion, during that time. Cash on hand at the end of 2001 totaled approximately $1 billion, or less than one payroll.

While interest rates may or may not remain relatively low, a more important consideration is that the increase in debt, however necessary to preserve liquidity, has also increased financial risk by adding to the obligations of the Postal Service. In light of risks to mail volume growth, which create risks to cash flow, the Postal Service's capacity to service growing debt is limited.

Since cash flow from operations is linked to net incomes (or losses), stabilizing and reducing debt will require that the Postal Service recover its prior year losses and carefully plan its capital cash outlays so they do not exceed cash flow. As the past two fiscal years have demonstrated, the Postal Service cannot simultaneously generate net losses and reduce its borrowings.

The Postal Service will also continue to manage its mix of short- and long-term debt to lower its interest expense over time. By remaining within its $15 billion debt limit, reducing outstanding debt, and by managing its interest expense, the Postal Service can limit its risks.

Financial Strategy 2: Enhance Reporting Transparency

The Postal Service posts its annual report, quarterly financial reports, and quarterly revenue, pieces, and weight reports on its Web site, www.usps.com. The Postal Service has further enhanced reporting transparency by publishing its Accounting Period Financial and Operating Statements on its Web site. Revenue, pieces, and weight reports will continue to be published on a quarterly basis, as will the quarterly financial reports, with the exception of Quarter IV, which will be covered by the audited financial statements in the annual report. In addition, the Postal Service plans to further increase its reporting transparency by replacing the twenty-eight-day accounting period with calendar months.

The Postal Service, for financial reporting purposes, currently uses both a postal fiscal year (PFY) and a government fiscal year (GFY). Largely, the PFY is used for internal reporting and the GFY is used for rate cases and reporting annual audited financial statements. The PFY consists of 13 four-week accounting periods. Accounting period reporting is not unknown in private industry, but monthly reporting is far more common. Much of the data about the economy from state and federal government agencies and forecasts from governmental, commercial and educational sources are presented in a monthly format. In addition, much of private industry invoices, pays, and mails on a monthly cycle. Most of the Postal Service's customers and competitors report in a monthly format.

Conversion to calendar month reporting will provide the Postal Service financial data on a basis that enables comparative analysis with competitors as well as consistency in current external reporting of financial results. Financial data will be aligned with the vast majority of corporate reporting, external databases, government reports on economic data, and standard forecasts of economic activities. When implemented, this change should eliminate the present confusion that is created by the use of two reporting systems.

Certain expense and revenue data will also be more stable when reported on a monthly basis. Holidays will consistently fall in the same reporting period. The end of the month burst in transactional activities will occur consistently every reporting period. The change to monthly reporting will also facilitate conversion to any alternate fiscal year deemed appropriate in future reporting requirements.

Financial Strategy 3: Finance Delivery Network Expansion on Current Basis and Explore Alternative Investments for Deferred Retirement Liabilities

The universal service obligation requires that the Postal Service provide service to all communities and delivery points in the United States and its territories. In FY 2001, the number of delivery points served by the Postal Service increased by 1,736,256. Historically, the annual growth in mail volume has served to help finance the cost of a growing delivery network. The equivalent of 3,400 new carrier routes is required to serve this expanding network that totaled 137.7 million delivery points at the end of FY 2001. Serving these new routes requires hiring more carriers, purchasing new vehicles and equipment and building new facilities. At an average of 45 routes per facility, the equivalent of eighty new facilities is required at an average cost of $5 million. The resulting annual capital need for network growth is approximately $400 million for facilities alone. This requirement is in addition to the cost of maintaining and/or replacing older facilities.

There is no inherent return-on-investment associated with construction of facilities to support the Postal Service's expanding delivery network. Rather than debt financing, a mechanism should be provided to include these ongoing cost increases in the revenue requirement in future rate cases to provide their recognition on a current basis.

Postal Service retirement costs are expected to exceed the rate of inflation over the next 10 plus years. In FY 2001, the Postal Service paid $3.75 billion on its Civil Service Retirement System (CSRS) deferred retirement liability which exceeded $32 billion at the end of the year. The increasing number of CSRS annuitants and their annual cost-of-living-adjustments contribute to the increase in CSRS deferred retirement liability and to the escalation in retirement costs. Investment of CSRS retirement assets currently managed by the Office of Personnel Management in other than government securities at higher rates of return could increase income generation and minimize the increase in CSRS deferred retirement costs. Private sector, state, and local government pension funds diversify investments to maximize investment return and minimize risk. Investments are made in a combination of fixed income securities, common stocks, real estate, and other investments.

2.4.2 Expand Use of Supply Chain Management

The Postal Service has identified the supply chain management philosophy and attendant business practices as central to its efforts to further the business and competitive objectives of the Postal Service. Over the past several years, supply chain management has become one of the most important aspects of successful contemporary businesses; a few years ago, it became a major tenet of the Postal Service's Breakthrough Productivity Initiative. In general terms, supply chain management is the analysis of the purchase process and the supply stream, from the supplier's supplier to the customer's use and disposal, in order to increase customer satisfaction and decrease overall cost. Its institutionalization, in terms of business practices, organizational design and deployment, and supplier relations will lower overall costs and improve customer service.

2.4.3 Strategically Apply Technology

To raise the efficiency of postal operations and develop a performance-based culture, the Postal Service must make more effective use of information technology. Using industry-accepted practices and building on its current, robust technology infrastructure, the Postal Service will continue to reengineer its infrastructure and systems to take advantage of new technology and better business processes.

The Postal Service's technology infrastructure is one of five largest in the world with a network of more than 540,000 devices located across the nation and in many international locations. These devices control data and voice communications, process transactions, produce reports, and handle back-office processing. This array of devices supports more than 200,000 postal managers and employees, who use this infrastructure 24 hours a day, seven days a week, 365 days a year to conduct the business of the Postal Service. Approximately 1,800 employees nationwide are dedicated to support information technology at a cost of nearly $878 million annually.

Despite the enormity of this technology infrastructure, the Postal Service invests a significantly smaller percentage of its total budget on information technology than technology expenditures reported by other federal agencies and private sector competitors. Although the current technology environment is adequate to run today's business, the Postal Service has deferred investment in new technology infrastructure. The present infrastructure averages five to seven years old and some components are no longer supported by vendors, requiring the Postal Service to provide technical, operational, and maintenance support. During the next five to ten years, one of the major challenges faced by the Postal Service will be to reengineer and upgrade the technology infrastructure.

Technology Strategy: Designing Enhanced Technology Infrastructure

The Postal Service is actively working toward development of an “Information Platform” that will provide high-value, reliable, and accurate information to improve service and productivity for its internal customers. To build this Information Platform, the Postal Service is focusing on standardization and speed to market, eliminating costs wherever possible. The Information Platform will integrate applications and data, encapsulating it within a secure environment in order to deliver value-added capabilities to internal and external customers.

To accomplish the transformation described in this report, the technology organization of the Postal Service must continue to evolve into a service provider that supplies internal customers with technology that is easy to use and an infrastructure that is robust, reliable, universally accessible, and secure. This evolution will be accomplished through three major substrategies:

- Enhance security across all technology;
- Upgrade the infrastructure; and
- Ensure universal computing connectivity.

Enhance Security Across All Technology

The Postal Service has earned the trust of the public by bringing security and privacy to the nation’s mail. To accomplish its mandate of providing universal service while protecting public trust in the current technology-driven economy, the Postal Service must continually invest in the security of information technology. The Postal Service technology infrastructure supports a vast array of communications—including 1.3 million e-mail messages per day and 10.5 million visits to the www.usps.com Web site per month. These figures are projected to increase steadily.

The Postal Service’s *Information Security Five-Year Strategic Plan* provides the framework for identifying and managing risks associated with critical information and resources of the Postal Service. As a part of its strategic plan, the Postal Service will adopt the following information security initiatives during the next five to ten years:

- **Education and training.** Promote security awareness, training, and security risk management.
- **Certification process.** Certify and accredit Postal Service applications, focusing on those applications that are critical to operations or contain sensitive information.
- **Contingency planning.** Update and test business continuity and contingency plans.

- **Intrusion protection.** Enhance and improve external and internal protections and expanding intrusion protection capabilities to guard against emerging threats and vulnerabilities.
- **Automated monitoring.** Aggressively monitor compliance through oversight and automated monitoring.

The Postal Service will use a variety of performance metrics to ensure the effectiveness of these initiatives, including industry benchmarks and government best practices.

Upgrade the Infrastructure

The Postal Service is leveraging existing resources to create additional efficiencies and reduce operating costs. The Postal Service's greatest information technology asset is an existing data network that provides a dedicated information conduit to more than 15,000 locations. The network can be optimized by upgrading its three levels of computing—distributed, mainframe, and midrange—and by supporting shared services. The two types of shared services—corporate and technical—focus on streamlining internal application development and business processes (building integrated versus stove-piped applications) and internal back-office processes (restructuring finance and human resources). To best leverage the existing infrastructure, the Postal Service's initiatives include the following efforts:

- **Upgraded distributed computing infrastructure.** Replace out-of-warranty hardware and software products, including e-mail system and workstations. Consolidate ninety-four help desks into three help desks.
- **Upgraded mainframe computing infrastructure.** Upgrade backup capabilities, operating system software, and computer hardware.
- **Upgraded midrange computing infrastructure.** Improve midrange computing capabilities and production support.
- **Technical shared services.** As part of the infrastructure upgrades, these services provide mechanisms to build integrated rather than stove-piped applications.
- **Corporate shared services.** This initiative focuses on leveraging the upgraded infrastructure to reengineer enterprise-wide, back-office functions, such as systems that restructure accounting and human resources (e.g., SAFR and ICPAS).

Through these initiatives, the Postal Service is striving to provide greater value with information technology investments that reduce long-term support costs.

Ensure Universal Computing Connectivity

The technology infrastructure supports a vast number of voice and data requirements via its data communications network. This network provides a highly reliable infrastructure with 99.9 percent availability to its users 24 hours a day, seven days a week. Currently more than 8,200 of the Postal Service's largest sites have either fully redundant network connectivity or backup capability. This capability, which includes satellite support, allowed the Postal Service to continue communications at New York sites during the terrorist attacks on September 11, 2001.

Like other large organizations, the Postal Service is becoming more mobile and more reliant on technology. With network technology demands growing daily, it is imperative that the network infrastructure be able to meet the business needs of the Postal Service's internal customers and its business and interagency partners. The Postal Service is managing the following efforts to ensure universal computing connectivity:

- **Consolidated voice, data, and video networks.** The current local network infrastructure provides high-speed access to video, voice, and other high-speed applications. The Postal Service is focusing its effort on developing a single network infrastructure to support movement of the mail and access by the thousands of users that require enterprise technology resources.
- **Wireless technology.** Wireless technology will enable anytime/anywhere management of mail operations, applications, and business continuity/ contingency processes.

Summary

The Postal Service is aggressively moving to expand its Information Technology capabilities. Future enhancements to support its objectives include:

- Expansion of systems, infrastructure, and functional areas served;
- Improvement in overall performance;
- Expansion of user tools that facilitate access and analysis;
- inclusion of a wireless capability to provide mobility to the manager; and
- Enhancement of the security of information and systems.

2.4.4 Ensure Safety, Security, and Privacy of the Mail

The U.S. Postal Inspection Service is the federal law enforcement agency with jurisdiction in criminal matters affecting the mail. Founded by Benjamin Franklin, its historic and current mandate is to provide safety and security for postal employees, customers, and the general public. The security work of the Inspection Service addresses several aspects of Postal Service operations. The Postal Inspection Service is responsible for protecting the general public by denying criminal use of the mail to further illegal activities. Recent events have added terrorism to the list of such threats. The Inspection Service is also charged with protecting the Postal Service against robberies, assaults on employees, destruction of postal property, and similar crimes. The Inspection Service ensures the safety of postal employees, customers, and facilities so that all have a safe work and business environment. To continue and extend these critical functions, three strategies are envisioned.

Security Strategy 1: Prevent Use of the Mail to Defraud Consumers or Convey Dangerous Mailings

Protecting the public against criminal use of the mail is accomplished through investigations in the areas of mail fraud, illegal drugs in the mail, money laundering, and child exploitation. The Inspection Service often takes the lead in responding to mail fraud schemes relating to telemarketing, mail orders, insurance, and investments. This type of fraud is expected to increase as more promoters take advantage of the perceived anonymity of the Internet. While maintaining its proficiency with traditional mail fraud investigations, the Inspection Service must improve skills related to Internet cases. To meet these challenges, the Inspection Service will continue to:

- Reduce and deter use of the mail for procurement or delivery of materials that promote the sexual exploitation of children;
- Reduce and deter multistate illegal domestic and international telemarketing operations and direct mail operations;
- Reduce and deter deceptive mailing operations;
- Reduce and deter the use of the nation’s mail system by organized groups to transport illegal narcotics; and
- Reduce and deter use of postal money orders to launder money.

Security Strategy 2: Reduce Theft of Mail and Other Criminal Attack of Postal Products, Services, and Assets

Providing for the security of the mail and postal products, services, and assets is integral to the Inspection Service’s mission to protect the Postal Service from criminal attack. Inspection Service security programs address crimes which can undermine postal operations and erode the financial stability of the Postal Service.

Combating mail theft is essential to ensuring that the Postal Service is successful in its traditional function of delivery. Mail theft techniques have become more sophisticated. Criminals no longer focus on taking the single piece of mail from the mailbox, but on capturing large volumes of mail, from which they obtain information used to perpetrate other criminal endeavors. While the Inspection Service was successful in past years in reducing the number of these volume thefts, these illegal activities have resurfaced in certain geographical areas. To meet these challenges, the Inspection Service will:

- Reduce and deter attacks on postal vehicles, apartment panels, collection boxes, and collection box units;
- Identify and resolve domestic and international in-transit mail theft;
- Reduce and deter theft-related identity theft and identity take-over crimes; and
- Reduce and deter embezzlements, criminal misuse of Postal Service’s workers’ compensation, and postage fraud schemes.

Security Strategy 3: Ensure a Safe, Secure, and Drug-Free Work Environment

The Inspection Service must enhance its services, both in number and rigor, in order to protect postal employees and customers. Through its unique role of providing security and investigative services, the Inspection Service fosters a safe working environment and helps prevent injury. The Inspection Service will:

- Reduce and deter employee-on-employee assaults and credible threats;

- Deter robberies of postal employees and facilities; and
- Reduce and deter illegal drugs in the postal environment.

Security Strategy 4: Ensure that the Postal Service Maintains its Trusted Brand and Provides Top-Rate Privacy Protection

The Postal Service Privacy Office, established in November 2000, is responsible for ensuring that the Postal Service maintains its trusted brand in the changing privacy landscape. The Privacy Office is also responsible for managing Privacy Act and Freedom of Information Act (FOIA) compliance.

The Postal Service was among the first federal agencies to appoint a Chief Privacy Officer, who ensures that appropriate cross-functional groups are involved with setting policies and processes. The Privacy Office establishes and implements privacy policies that reflect best practices of both government and industry and develops processes to ensure compliance with statutes and policies.

The Postal Service currently complies with both federal requirements and commercial guidelines. Adherence to federal privacy laws strengthens the trusted brand of the Postal Service and allows the Postal Service to offer privacy assurances, backed by federal law, which private sector competitors do not. However, federal laws limit the ability of the Postal Service to collect, use, and sell customer data like other businesses. Federal privacy and FOIA laws also impose certain compliance requirements on the Postal Service that do not apply to private sector competitors.

The Postal Service has a trusted brand, developed over its 225-year history, based in large part on privacy and security protections. To ensure that the Postal Service provides top-rate privacy protections in today’s world, it will be vigilant in adapting to ever-changing legal and policy frameworks, new technologies, and business models and practices.

While the Postal Service commits to continue reducing costs and enhancing revenues now, the strategies of improving service, enhancing growth of products and services and promoting an incentive-based culture from within will not be enough to alter the fundamental challenges facing the Postal Service. Some moderate regulatory and legislative reforms are also needed in the near term. These are discussed in the following section.

2.5 Seek Moderate Regulatory and Legislative Reforms

The success of the Postal Service’s internal efforts to meet its three overarching transformational imperatives—increase customer value, improve operational efficiency, and promote a performance-driven culture—will require more than the implementation of the strategies outlined in the preceding pages. To meet the fundamental challenges facing the Postal Service, some moderate regulatory and legislative reforms must be adopted. These reforms will allow postal management to test new opportunities, to prepare for transformational reforms that will be needed in the future, and to

> *“We support the need to change legislation in order to encourage competitive pricing and alternative delivery methods”.*
>
> —Government Agency

prove its ability to deliver in a less constricted environment. With these considerations in mind, the Postal Service urges the Postal Rate Commission (PRC) and Congress to consider several steps that can be addressed in the near term.

Reforms required in the near term are summarized in this section and fall into four categories:

- Seek the maximum flexibility consistent with the current rate-making process;
- Rationalize retail network facilities;
- Adopt more businesslike supply chain management practices; and
- Reform labor and employment provisions.

Reform Strategy 1: Seek the Maximum Flexibility Consistent with the Current Rate-Making Process

Within the framework of the current rate-making process, the Postal Service will seek several reforms to respond to customer pricing needs and to restore postal finances to a more sound footing. The Postal Service believes that the following reforms can be implemented administratively by the PRC. The Postal Service will therefore ask the PRC to revise and update certain procedural regulations.[30] In the event that this effort identifies hurdles that cannot be cleared within the scope of existing statutes, the Postal Service will ask Congress to remove those hurdles legislatively.

Negotiated service agreements. Many of the Postal Service's customers want access to prices and services targeted to their specific business needs. One way to accommodate this need is through customized agreements such as negotiated service agreements (NSAs). The Postal Service, the PRC, and mailers have discussed this concept since at least the 1970s. The Postal Service will ask the PRC to develop more workable procedural rules to enable mailers and the Postal Service to put NSAs into place. To assure that the postal system and public benefit from this program, each agreement will be designed to increase overall contribution to the Postal Service, whether through increased revenues, reduced costs, or a combination of both. As the law stipulates, these agreements will not unduly discriminate against other mailers.

Targeted pricing incentives. Other industries routinely provide price incentives to attract and retain high-volume business. The Postal Service intends to evaluate the selective use of incentives within the existing classification structure to stimulate additional demand. This could include, but would not necessarily be limited to, seasonal incentives, peak period pricing, and declining block rates (incentives that increase in value as customer volume increases). These strategies could be used to help the Postal Service retain and increase volume otherwise subject to diversion.

Experimental classification. The PRC's current rules for expedited consideration of experimental classifications have been used sparingly. Changes are needed to make the process more workable. The Postal Service will ask the PRC to work with it and its customers to improve the process. The current process devotes considerable litigation time to whether the PRC considers the proposal to be an experiment and whether to invoke an expedited process. Opposition to an experiment prolongs the litigation. To

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[30] See Appendix R, *Postal Regulation,* for more information.

address these kinds of issues, the Postal Service will ask the PRC to make several changes: 1) to define an experiment more concretely, 2) to assure a prompt recommended decision, and 3) to allow quick fine-tuning adjustments over the course of an experiment as data are obtained.

"We would welcome a streamlined rate-making process which may allow for more moderate and predictable rate increases".

—Business Customer

Phased Rates. Postal Service customers generally have a strong interest in having postal rate increases become more predictable. Inconsistent increases in terms of magnitude and timing make it difficult for them to plan and run their businesses. The Postal Service will approach the PRC to request that it work with mailers and the Postal Service to revise procedural rules to facilitate adoption of phased rates. In a phased rate proposal, the Postal Service would request that the PRC adopt rules permitting rate changes to be implemented at defined intervals over a multiyear period. In addition to better planning for customers, rate phasing would provide the Postal Service a more predictable revenue stream without extensive litigation of every rate change. A well-designed phased rate proposal also may allow the organization to propose a series of rate changes that meet longer-term strategic goals.

Finance delivery network expansion on a current basis. As discussed earlier in the Financial Management section, the Postal Service will pursue a mechanism to include cost increases in the revenue requirement in future rate cases to provide on a current basis the cost for new facilities to serve the expanding delivery network.

Reform Strategy 2: Rationalize Retail Network Facilities

Recognizing that there are a growing variety of channels through which the Postal Service can provide high-quality services to its customers, the organization will begin to rationalize its retail network of facilities to offer alternative, less expensive customer access. Under existing law, the Postal Service will begin to implement the following actions:

- Lift the self-imposed moratorium on post office closings and consolidations. The continuing moratorium on closings hinders both service improvements and cost savings that could be produced through an optimal network of facilities.
- Coordinate the closing and consolidation of post offices and the closing of unnecessary contract postal units with retail access strategies to assure that customers retain adequate access to products and services. Issues such as access, efficiency, savings, and the impacts on small communities and employees will be taken into account.
- Work with the PRC to streamline the post office closing process to minimize turnaround time.

The Postal Service's internal effort to rationalize the facilities network will not be wholly successful, however, as long as existing statutory restraints remain in place. The Postal Service will therefore urge Congress to repeal administrative notice and appeal procedures mandated for closing post offices or replace them with more flexible procedures. In addition, the Postal Service will ask Congress to refrain from adding amendments to annual Postal Service appropriations bills that discourage post office closings and freeze service levels at the 1983 level. Without greater flexibility to adapt and change, the traditional network will grow increasingly obsolete and needlessly expensive, draining postal resources that could be used to improve the Postal Service's overall ability to serve the American public.

Reform Strategy 3: Modernize Purchasing Procedures

Consistent with the way businesses purchase goods and services, the Postal Service will revise its purchasing regulations to the extent allowed by present law. While much progress has been made over the years to make purchasing regulations reflect commercial best practices, more progress will be made. For example, the regulations, but not the Postal Reorganization Act, currently allow potential suppliers to protest sourcing or other business decisions if the supplier is dissatisfied with the process or the result. The revised regulations will further the business and competitive interests of the Postal Service by allowing the purchasing of goods and services under policies that will lead to favorable long-term relationships with important suppliers, will result in more expeditious purchases at superior, overall values and lower administrative cost, and will allow for dispute resolution with less litigation.

Reform Strategy 4: Reform Labor and Employment Provisions

In an organization that remains overwhelmingly labor-intensive, compensation and labor policies are too critical to the performance and cost of the postal system to ignore in the near term. The Postal Service believes that two areas should be addressed by Congress now.

Impasse Resolution

When labor and management fail to agree on wages and working conditions, the present statute empowers one individual, an outside arbitrator, to determine the final agreement. Labor agreements are, by far, the largest single element of the Postal Service's costs and therefore the primary determinant of prices and the key factor in the Postal Service's overall financial viability. The Postal Service believes that laws should be amended in the near term to increase the opportunity for the parties to resolve such disputes themselves.

Prior to arbitration, the current statute authorizes a fact-finding process (39 U.S.C. 1207(b)). In the past, the parties have found this process unsatisfactory and have frequently waived it. In place of this stage, the parties should have the benefit of a single mediator selected by the Secretary of Labor. The selected mediator should, by law, be an individual of nationwide reputation and professional stature and a member of the National Academy of Arbitrators. Such professional credentials should ensure that the arbitrator has the ability to mediate a dispute affecting hundreds of thousands of employees and a vital national communications network.

Salary Cap

Challenges faced by the Postal Service in today's environment place a premium on effective management. The Postal Service must be able to improve upon levels of cost reduction and productivity realized in the past, while still improving service for its customers. Achieving these goals is rendered more difficult by the current statutory limitation on salary, which may not exceed Executive Schedule Level I. As the organization endeavors to retain mail volume against diversionary threats, no competitor of the Postal Service will be similarly encumbered.

The upper limit on salaries prevents the Postal Service from approaching comparability to the private sector at the executive level. This limitation should be eliminated. The Postal Service should provide compensation for officers, executives, and other nonbargaining unit employees equivalent to compensation for comparable positions in the private sector. Comparable pay levels would not only help improve performance but also facilitate recruitment and retention for key positions.

2.6 Near-Term Commitment

The strategies presented in this section of the *Transformation Plan* identify steps that can and should be taken in the near term by the Postal Service, the PRC, and the Congress to begin the process of postal transformation. For its part, Postal Service leadership is committed to implementing those initiatives within its discretion as it strives to make postal products and services more valuable to customers, operations more efficient, and the workforce more effective. In addition, the Postal Service respectfully urges the PRC, and where necessary Congress, to address as soon as possible the moderate regulatory and legislative reforms identified in this chapter and committed to their respective authorities.

In total, the customer-focused, operational, and performance-based strategies outlined in this *Plan* will generate $5 billion in savings and cost avoidance through 2006, of which $1 billion will be in post office operations. These savings will enable the Postal Service to achieve some debt repayment and to hold prices steady from mid-2002 until calendar year 2004. If a rate increase is necessary at that time, a moderate, negotiated increase will be pursued.

While these near-term reforms will provide the Postal Service incremental additional opportunities and incentives to begin the transformation, in the longer term, a fundamental restructuring of the legislative and regulatory framework for the Postal Service will be required. The need to address these larger issues and reach a national decision on the future of the Postal Service is the subject of the next chapter.

Preparing For The Future

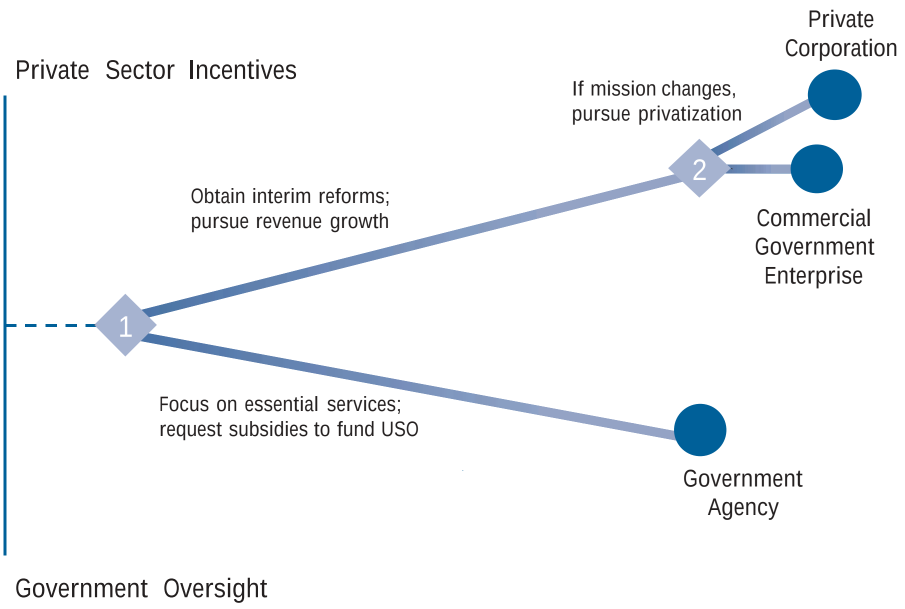
Section 3 — Preparing for the Future

The ultimate goal of Postal Service transformation is to ensure an efficient, reliable, and innovative delivery services sector that meets the future diverse economic and social needs of the nation. Fundamental structural transformation of an institution as large as the Postal Service will take years to complete. A transformation plan must, therefore, peer a decade or more into the future and accommodate, as well as possible, the full range of roles that the Postal Service may be called upon to play. A transformation plan must also take into account issues of transition so that legitimate and reasonable expectations of stakeholders—including the general public, mailers, and postal employees—are not overwhelmed by abrupt change. This chapter discusses three models that illustrate the range of possibilities.

- **Government Agency.** An entity focused on providing services not adequately provided in the market and supported by government subsidies.
- **Privatized Corporation.** A business entity with private shareholders.
- **Commercial Government Enterprise.** A government-owned enterprise that would operate more commercially in the market to provide postal and related services.

These three models are examined in broad outline. The Postal Service recognizes that many variations may be possible under each model, but believes that these three general approaches highlight the key policy choices needed to select a path for transformation.

U.S. POSTAL SERVICE TRANSFORMATION PATH



A graphic representation of the three models is displayed on a scale of government oversight and private sector incentives. The diamonds represent “decision points,” that is, external and internal factors that influence the degree and type of transformation required. Internal decision points include: cost and productivity issues, growth of delivery points, the effects on contribution of a changing mail mix, cash situation, capital requirements, financial results, and leadership objectives. External decision points include: government mandated security requirements, public trust in the mailstream, political climate around reform, diversion and competition, evolution of the universal service obligation (USO), economic and market conditions, labor reforms, pricing freedoms, and investment freedoms. At the decision points, these and other factors could be analyzed prior to continuing on a pathway.

The black lines indicate pathways along which the Postal Service might move. It is important to note that the Postal Service could move up or down a pathway in response to internal and external changes, such as legislative or regulatory decisions. Due to the challenges facing the Postal Service, there is a real threat that the current structure will not permit the Postal Service to fulfill its mission of universal service in the future. If so, movement down one of the pathways is inevitable.

Which pathway the Postal Service should follow is a public policy decision. Therefore, stakeholders need to evaluate differences among alternative models and the policy issues surrounding each. For each model, the *Transformation Plan* outlines the policy objectives; broadly describes the model; discusses possible consequences; and lists some of the possible legislative, structural, and financial implications.

3.1 Government Agency

At one end of the spectrum of possibilities, the Postal Service could be restructured as a Government Agency and focused on services that private companies cannot provide profitably, at least at prices and on the universal scale that policymakers deem appropriate to the needs of the United States. This model represents one approach to resolving frequent conflicts between two policy objectives implicit in current postal law: ensuring necessary postal services, on the one hand, and promoting competition in the delivery services market, on the other. As a Government Agency, the Postal Service would concentrate more on its role as an essential government service—somewhat similar to defense, the national park system, and the interstate highway system—and concern itself less with markets where customer requirements are already being addressed by the private sector. Under this approach, the Postal Service would have to reevaluate its products and services, potentially eliminating a number of services currently offered and adjusting the workforce to the attendant reduced mail volume. Given fixed network costs and declining volumes, this model is likely to require subsidies to cover the cost of universal service.

> *"I strongly believe there will be a continued need for a governmental postal system that continues to provide universal service."*
>
> —Consumer

Policy Objectives

Stakeholders may prefer the Government Agency model if they believe that the Postal Service in the future will be unable to cover the cost of continuing public policy obligations from revenues derived from postal products and services or if they believe that government participation in the economy should be reduced. The policy objectives of this option are:

- To ensure continuous provision of basic public postal services at affordable rates without undue or unreasonable discrimination, for example, by requiring retail access and universal delivery at a particular service level;

- To clarify the mission of the Postal Service to allow all participants in the market—managers, employees, mailers, and partners—to plan accordingly; and
- To minimize economic distortions that may result from participation by a regulated government entity in competitive private markets.

Description

The Postal Service is likely to evolve toward a Government Agency if, for reasons of public policy, it continues to lack the flexibility needed to operate successfully. Without a commercial focus, the Postal Service will likely feel increasing pressure to stop promoting competitive postal products satisfactorily provided by the market. Significant declines in mail volume, especially First-Class Mail®, would likely accelerate this process, shifting the center of gravity of the Postal Service toward noncommercial residential delivery and retail services.

While a Government Agency may be considered a step back from the declared intent of the Postal Reorganization Act, a move toward a more government-like Postal Service may be the logical outcome of viewing it as a public service that exists to provide a unique product—a uniformly priced, homogenous letter mail delivery service—that the government has determined should be available to all residents but whose volume seems likely to decline in the future. If the need for such a government service diminishes, the government entity providing this service could be scaled back correspondingly. In a country that celebrates private enterprise, with a limited tradition of public sector businesses, some may also consider devolution of the Postal Service into a Government Agency the most efficient economic policy.

In effect, a Government Agency would become less independent of government than the “independent establishment” envisioned in 1970. Rates would continue to be cost-based under the jurisdiction of an independent regulator. Even so, direct government subsidies are likely to be needed, probably in increasing amounts, unless universal service expectations are curtailed as mail volume subsides and postal networks continue to expand. Subsidies would, in turn, likely bring increased congressional oversight or legislative decision making in operations, pricing, and personnel matters. As a matter both of commercial practicality and economic policy, a Government Agency would have a more limited ability to operate in competitive markets, and therefore find itself less able to access new revenue streams than the current Postal Service.

The table below summarizes likely attributes of this model.

GOVERNMENT AGENCY

Mission/Public Policy	Meet public policy goals at minimal cost
Ownership	Government
Corporate Governance	Government agency or establishment
Regulation	Congressionally determined
Monopoly	Letter and mailbox monopoly
Universal Service Obligation	Government defined
Retail Flexibility	Explicitly defined under USO
Product Development	Limited to filling market gaps
Pricing	“Cost of service” regulation (current system),perhaps tied to appropriation process
Human Capital	Collective bargaining, arbitrator, federal employees, salary cap
Financial Requirement	Cost minimization with appropriation
Ability to Invest	Treasury approval required
Access to Capital	Treasury approval, legislated debt ceiling
Earnings	Break-even or losses with subsidy
Taxes	Not directly subject to taxation
Security	Postal Inspection Service or other federal agency
Key Metrics	Prices, size of subsidy, service levels

Consequences

For the Postal Service, an explicit policy decision to move the organization toward the Government Agency model has the benefit of clarity of mission and proper calibration of expectations. Postal management would be more focused on covering costs with revenues from traditional services and less concerned about evolving markets. The workforce would likely be reduced substantially over time, but employees would continue to be government employees compensated by federal funds in a manner consistent with federal policies. On the other hand, the complexities of managing a system that remains important to the mailing industry, as well as the general public, without a clear commercial future would be daunting.

For the government, as owner of the Postal Service, clarifying the role of the organization as a Government Agency may resolve some tensions between the business and governmental objectives of the Postal Service. Even so, the government may find it difficult to sustain unpopular mechanisms for funding the USO and other uneconomic social policies.

For customers, particularly large mailers, this policy option yields advantages and disadvantages. Customers will have confidence that their mail will be delivered as long as the government continues to support universal service. Indeed, if general government funds are used to pay for universal service, some might say that mailers would be subsidized by taxpayers. Customers may also benefit if this approach leads to more competition and more choices in the marketplace, for example, if upstream letter mail operations are further opened to entry. However, in a sector characterized by economies of scale, it is unclear that customers are better served by a more limited Postal Service as opposed to a more commercially competitive Postal Service. For example, many ground parcel shippers would today feel abandoned if they did not have the Postal Service as an alternative to private parcel companies.

Selection of the Government Agency model might turn on reaching some of the following judgments:

- Universal service is best provided by the public sector.
- The Postal Service’s traditional monopoly products will either generate sufficient revenue over the long term to fund social policy costs and universal service, or, if competition and electronic diversion make this impossible, taxpayers should subsidize the Postal Service.
- The public will be forced to adjust to lower levels of postal services in exchange for cost containment or higher government subsidies.
- The public is willing to reduce its expectations of postal service in exchange for retaining the Postal Service as a government obligation.
- If current trends continue and advertising mail becomes the Postal Service’s largest revenue product, the government should remain responsible for providing what is primarily a channel for commercial advertising.
- The Postal Service should focus on essential services as needed even while domestic firms and foreign posts will be able to provide competitive products as needed.
- Prices might again be set by legislation or through a government process reflecting congressional decisions on subsidy levels.

Legislative, Structural, and Financial Implications

The following are some legislative, structural, and financial implications of the Government Agency model:

- The USO would be defined by Congress and the Postal Service’s product orientation refocused to deliver only essential government services; this limited definition of postal services could substantially reduce mail volume. Other providers would be allowed and encouraged to compete in nonessential services.

- Funding would likely be a combination of user fees (postage) and government appropriations (taxes).
- Because the network would continue to expand to match household growth, Postal Service employment would not shrink as much as mail volume, but a large reduction from today’s employee complement could be expected. The majority of the workforce would be delivery employees. The cost-per-piece of mail handled would increase, resulting in friction between ratepayers and taxpayers over who should fund the postal network.
- A process, designated by Congress, would be determined for rate making. A regulator would be largely responsible for the determination of revenues from postage, and the Congress would provide an important component of funding through the appropriation process. In practice, subsidy levels might vary unpredictably from year-to-year based upon, not only Postal Service needs, but also the priorities of Congress.
- Labor negotiations might move away from private sector collective bargaining models and toward public sector approaches; craft wages might continue to provide a premium over private sector equivalents.
- The Postal Service would continue to pay no direct local, state, or federal taxes.
- Postal Service costs would be reduced further through additional streamlining and consolidation. As it grows smaller, and as restrictions against competing in the nonessential services market are implemented, the Postal Service will lose expedited mail volumes and a large share of parcel volumes. It would also likely lose a significant portion of its “essential services” volumes (bills and payments) to electronic alternatives.
- The Postal Service would likely lack sufficient funds for internal investments in value-added products and services, new equipment, and facilities.

As a Government Agency, the Postal Service would offer a minimal menu of products and services to the American public, eliminating a number of services currently offered, adjusting the workforce to the modified offerings and attendant lost volume, while maintaining an extensive retail network. The overall policy goal would simply be to keep the “deliverer of last resort” afloat, likely with government subsidies. Many stakeholders have indicated that the prospect of today’s Postal Service degrading into a Government Agency is unappealing.

3.2 Privatized Corporation

At the other end of the spectrum of options is the possibility of complete transformation of the Postal Service into a shareholder-owned, value-maximizing company. In addition to giving Postal Service managers a full range of private sector managerial tools, this model would place Postal Service managers under the supervision of a Board of Directors representing "residual claimants" (private shareholders) who have "real money" at stake. Privatization would also eliminate any implication that government ownership represents a guarantee against commercial failure. At the same time, privatization could resolve thorny regulatory issues that might continue to limit the viability of a government agency.

As a Privatized Corporation, the Postal Service would offer market-based products and services. Universal service, most likely, would be provided under contracts between a regulator and various operators, including the Privatized Corporation. The Privatized Corporation would be able to implement market-based pricing, discounts and incentives, and private sector financial practices.

> *"The imperative is clear for the [Postal Service] to become privatized. The [Postal Service] needs to emphasize its core mission, and to accomplish that, it needs to be able to operate like a private-sector business rather than a quasi-governmental entity."*
>
> —Business Customer

Policy Objectives

Privatization would be undertaken to achieve many of the policy objectives noted under the discussion of the Commercial Government Enterprise. In addition, privatization would support the following objectives:

- To improve the commercial prospects of the Postal Service by changing its governance to include genuine residual claimants (shareholders);
- To separate the government completely from participation in the operational and commercial aspects of the delivery services sector, although some regulatory responsibility by government would be retained;
- To remove restrictions and oversight based on concerns about the competitive use of assets paid for by government; and
- To realize funds from the sale of an asset no longer needed by the government so that the money can be invested in other government functions.

Description

For a Privatized Corporation, all or a significant portion of the ownership of the Postal Service would be held by private persons. Some shares could be held by employees and managers of the Postal Service. Obviously, the greater the fraction of shares held by private persons, the more thoroughly privatized the Postal Service would be; nonetheless, even privatization of a significant minority share has policy implications.[31]

Private owners may take a more personal interest in the commercial success of the Postal Service than officials representing the general public through the government. Private investors will necessarily have their own money at stake. A Board of Directors that is legally obligated to protect private shareholder interests is thus likely to be more focused on commercial success.

Full privatization of the Postal Service would also appear to address certain policy issues that have raised thorny questions about the conduct of some commercialized postal administrations, in particular Deutsche Post (DPWN).[32] With full privatization, these public policy issues seem to disappear. All of the assets of a fully privatized Postal Service would be paid for by investors' funds so that there would remain no accumulated benefits of government support and no accumulated costs of the universal service obligation on the company's balance sheet. These assets and liabilities would have been evaluated fairly and objectively, presumably, by the financial marketplace. Thus, a fully privatized corporation should achieve a significantly greater degree of commercial independence than other options.

The table on the following page summarizes likely attributes of a Privatized Corporation.

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[31] In some countries that have privatized ownership in the national post office, the government has retained a "golden share" giving it the right to veto major changes in ownership. Use of a golden share is under scrutiny by European competition authorities.

[32] When DPWN was established as a government-owned corporation, the German government transferred to DPWN ownership of the substantial assets of the former post office. DPWN in turn sold some of these assets and raised funds that were used to pay for acquisition of private companies like DHL. Private competitors complained that the assets sold by DPWN were paid for by tax dollars. Conversion of these assets into money and expenditure on competitive ventures, charged the critics, amounted to a large government subsidy. In response, DPWN argued that the value of such assets was no more than needed to compensate DPWN for the accumulated costs of the universal service obligation.

PRIVATIZED CORPORATION

Mission/Public Policy	Maximize shareholder value
Ownership	ESOP/private or solely private
Corporate Governance	Corporate Board of Directors
Regulation	Market Standard (independent supervisory regulator)
Monopoly	Little or none (e.g., mailbox only)
Universal Service Obligation	Government contract
Retail Flexibility	Market based
Product Development	Market based
Pricing	Market based
Human Capital	Strike/lockout, private sector, no salary cap
Financial Requirement	For profit
Ability to Invest	No restrictions
Access to Capital	Capital markets
Earnings	Retained: dividends to shareholders
Taxes	All federal, state, and local taxes paid
Security	Federal, state, or local law enforcement
Key Metrics	Share price, earnings

Consequences

For American citizens, mailers, and employees, the consequences of transforming the Postal Service into a Privatized Corporation offer the potential for major financial success. The six markets in which the Postal Service has core competencies are all projected to grow, some significantly, during the next decade. The six markets are retail, delivery (last mile), communications, financial services, logistics, and advertising.[33] Explicit authority to partner and compete in these markets offers opportunities for economic growth.

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[33] The table below presents a long-term vision of how these broad markets are likely to evolve over the next decade (Source: PricewaterhouseCoopers).

Markets	Projected Size in 2010
Advertising	$460 billion
Communications	$1.5 trillion
Financial Services	$1.1 trillion
Logistics	$1.3 trillion
Retail	$1.6 trillion
Last Mile (Delivery)	$135 billion

A Privatized Corporation presents risks as well as opportunities. Possible workforce reductions could place individual jobs at risk. The corporation itself would no longer have the backing of the government. Private companies fail as well as succeed; a Privatized Corporation could thrive or it could go bankrupt. Hence, the Privatized Corporation model implies a need for additional regulatory safeguards for the delivery services sector as a whole to ensure that universal service is maintained as needed in the public interest.

Selection of the Privatized Corporation model might turn on reaching some of the following judgments:

- Transforming a public service-oriented government Postal Service into a profit-oriented Privatized Corporation would increase efficiency and assure more responsive products and services for the majority of customers.
- Universal service as it is known today will not be crucial to the nation.
- The American people will be satisfied that a system of regulation can preserve universal postal service to an acceptable degree without direct government ownership.
- The American people will accept the sale of one of the most important organs of government remaining from the early days of the Republic.
- A transition plan can be structured for the successful marketing of products and services, the valuation of assets, and the restructuring of liabilities so that private investors, including employees, will be interested in becoming owners.

Legislative, Structural, and Financial Implications

Some of the legislative, structural, and financial implications for the Privatized Corporation model are as follows:

- The magnitude, timing, and parameters of an Initial Public Offering (IPO) would have to be determined so that a government-owned entity would be transferable to private ownership.[34]
- Future delivery standards and charges for mail service could become more variable geographically as market forces play more of a role.
- Transition to such a different model for supplying the nation’s postal needs may involve a period of difficult and even painful adjustments for customers and employees until market forces have been fully accommodated.
- Components of postal operations could be reorganized and diversified, leading to different owners by function, e.g., processing and transportation could be privatized while delivery could remain a governmental mandate, or perhaps by geographic area, e.g., the Baby Bells.
- Sources of funds for universal service would have to be identified. Options include 1) government-funded through service contracts; 2) subsidies; 3) monopoly[35] supported; or 4) provided for through a competitive fund.

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[34] See Appendix S, *Privatization — Process and Financing Issues,* for more information.

[35] See Appendix U, *Universal Service Obligation and the Postal Monopoly,* for more information.

3.3 Commercial Government Enterprise

The third model, a mid-range approach, is to transform the Postal Service into a Commercial Government Enterprise[36] as a way to introduce an updated, stable business and financial model suited to the 21st century. Universal service remains important to the American people and should be retained. Keeping universal service affordable will require a postal system able to participate efficiently and flexibly in the modern economy. To achieve these goals, it may be appropriate to keep the enterprise under public ownership to serve the public interest, with the management tools available to commercial entities to assure more efficient and economical performance.

> *"Looking forward, we envision a postal service that is able to adjust to a rapidly changing marketplace, able to identify and understand its customers [sic] needs and provide the services all of its customers have come to expect."*
>
> —Business Customer

A Commercial Government Enterprise represents a large step toward placing the Postal Service on a more businesslike footing. As a commercialized entity, the Postal Service would be expected to provide traditional and nontraditional products and services, implement market-based pricing, and adopt more commercial financing.

Policy Objectives

In several other industrialized countries that have addressed postal transformation, policymakers have concluded that restructuring the national post office as a government-owned, commercial operation offers the best chance of achieving national postal policy goals in increasingly competitive markets. The policy objectives of this approach are:

- To clarify the role of the Postal Service so that management is permitted and motivated to operate with the tools and incentives of a business, subject to public interest restraints administered by the regulator;
- To avoid congressional subsidy;
- To raise the efficiency, innovativeness, and performance of the Postal Service to levels closer to market standards;
- To create an organizational framework that will allow the Postal Service to participate effectively in the emerging global delivery services arena through alliances and joint ventures with private companies and other corporatized posts;
- To introduce greater institutional flexibility so that changes in basic rules (for example, universal service expectations) can be introduced administratively rather than legislatively; and
- To preserve long-term options for the government by creating an organizational framework that can be later adapted to either full privatization or conversion into an efficient Essential Governmental Service.

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[36] See Appendix T, *Overview of Selected Government Entities,* for more information.

Description

A commercialized Postal Service would need to operate more like a business. It would hire and reward managers and employees under more private sector rules, subcontract selected functions, invest in new facilities and services, and participate in partnerships and ventures with other commercial entities. A Commercial Government Enterprise may not pay taxes in return for a dividend paid to the government.

Under this model, the Postal Service would manage itself like a commercial enterprise, but would not alter its mission of universal service. The Postal Service might be responsible for the obligation by means of a contract between the government and the Postal Service (as in New Zealand), or a set of laws decreed by government and enforced by a regulator (as in Germany), or a set of conditions attached to a license (as in the United Kingdom and Sweden).[37] In principle, a Commercial Government Enterprise could be able to provide alternatives for services that are no longer, in its judgment, commercially attractive. Thus, for example, it might be envisioned that, as in other countries, the postal enterprise might close a significant number of nonperforming retail outlets and contract retail services with local businesses, and replace them with more efficient means of access. A commercialized Postal Service could earn a net income and might pay dividends to its owner, the government. A portion of its retained earnings could be reinvested in the business to support the universal service obligation and ensure business continuity. The Postal Service might also be free to borrow and invest in business alliances.

As a Commercial Government Enterprise, the Postal Service would have a dominant position in some markets, some of them protected by a legal monopoly. It may be anticipated that the regulator (the Postal Rate Commission) would be empowered to prevent the enterprise from extracting unreasonable profits from customers in noncompetitive markets and using monopoly profits to gain an unfair advantage in competitive markets. Regulatory controls could take the form of rule makings and review of complaints. In principle, a Commercial Government Enterprise should be able to set prices within broad parameters.[38]

Postal Service employees might be covered by private sector labor and employment laws, and craft employees would have the right to collective bargaining and other rights guaranteed by general legislation. Executive compensation might be structured to be competitive with comparable businesses without the existing federal salary cap.

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[37] See the Defining and Measuring the Postal Universal Service Obligation section in Appendix U, *Universal Service Obligation and the Postal Monopoly,* for more information.

[38] See Appendix H, *Postal Transformation — The International Experience,* for more information.

The table below summarizes possible attributes of the Postal Service as a Commercial Government Enterprise.

COMMERCIAL GOVERNMENT ENTERPRISE

Mission/Public Policy	Provide universal service at affordable cost
Ownership	Government
Corporate Governance	Board of Governors refocused on fiduciary duties
Regulation	Postal Rate Commission
Monopoly	Letter and mailbox monopoly
Universal Service Obligation	Negotiated with regulator
Retail Flexibility	Explicitly defined under USO
Product Development	Market based – cost/benefit model
Pricing	Flexibility within broad parameters, complaint-based review
Human Capital	Collective bargaining, Railway Labor Act model, some private sector laws, no salary cap
Financial Requirement	Reasonable net income; retained earnings
Ability to Invest	Business alliances
Access to Capital	Legislated debt ceiling; retained earnings
Earnings	Retained to support USO, capital and business continuity; dividends possible
Taxes	Determined through legislation
Security	Postal Inspection Service
Key Metrics	Business-based metrics

Consequences

For American citizens, mailers, and policymakers, the consequences of a Commercial Government Enterprise offer an ongoing commitment to providing self-funded universal service to America. Increased financial and pricing flexibility would allow the new Postal Service to find alternative sources of revenues if hard copy traditional mail volumes decline. Moreover, rate payers would most likely benefit from further development of value-added services that complement the existing products. Employees could have fewer federal safeguards, but a decreased potential for layoffs as new opportunities replace the decline of traditional workload.

A Commercial Government Enterprise would continue to be an asset of the federal government. As markets and consumer needs continue to evolve in the future, a government provided universal service may someday no longer be relevant. Commercialization would allow the Postal Service to ready itself for potential future privatization, safeguarding the value of the asset.

Selection of the Commercial Government Enterprise model may turn on reaching some of the following judgments:

- The model will induce greater efficiency and responsiveness to customer needs from the Postal Service in recognition that customer requirements have changed since passage of the Postal Reorganization Act of 1970.
- Policymakers will tolerate employee layoffs if required to make the Postal Service more affordable, although fewer layoffs may be required if additional sources of revenue are found.
- If the Postal Service essentially operates in a more commercial way, there still remain policy reasons to maintain government ownership.
- Customers prefer a stronger, more competitive Postal Service.
- The government favors a commercial post that preserves universal service or even pays dividends to the national treasury as an alternative to a potential return to government subsidies.
- Policymakers want a national post capable of competing against increasingly aggressive foreign posts both domestically and internationally.
- Policymakers and the American public will allow one of the largest businesses (by revenue) in the United States to compete and more fully partner with the private sector in its own and related markets even though it is owned by the government.
- While this model assumes a government-owned entity that may be a permanent structure, it also may be understood as a (potential) step toward future privatization; pressures toward privatization could continue if the Postal Service becomes a Commercial Government Enterprise.
- The government, as owner, will protect creditors as a last resort and may return to operating the Postal Service as a Government Agency to protect universal service, or privatize the organization if the business model breaks down.

Legislative, Structural, and Financial Implications

Some of the legislative, structural, and financial implications for the Commercial Government Enterprise model are as follows:

- Given the experience of other government organizations and transformed private bureaucracies, changing to a corporate culture could take a decade or longer. To ensure success of the organization, the monopoly protections should be retained as long as reasonably needed to facilitate this difficult transition.

- As a commercial enterprise, the Postal Service could be free to offer services in related markets where its core competencies provide the opportunity. Economic modeling indicates significant opportunities for a successful commercial entity.
- Legislation necessary to transform the Postal Service into a Commercial Government Enterprise will likely require compromise and a common vision for all stakeholders.
- Some commercial ventures fail; others succeed.

3.4 Universal Service

Any discussion of the future of the Postal Service must include consideration of the definition of universal service.[39] The ways by which that definition could be changed are nearly limitless. The combination of days of delivery, method of delivery, service commitments, access points, and other elements of universal service could be changed in any number of ways. Indeed, there have been numerous specific suggestions offered by stakeholders as to how USO could be defined differently. The Postal Service believes that the future definition of USO should be determined as a matter of public policy. This report, therefore, does not include a specific recommendation for change. However, to help frame the debate the Postal Service provides the following information relating to two commonly raised proposals, i.e., reducing the number of delivery days and changing the delivery method to a more centralized approach.

- Reducing the number of delivery days using volume- or revenue-based criteria has been suggested as a way of reducing costs. The Postal Service has conducted a preliminary study of the possibility of eliminating one day of delivery. Rough estimates of the gross savings possible from reducing the number of delivery days from six to five are in the range of $800 million to $1.1 billion. These savings could however, be offset by a loss of revenue since many Postal Service customers advised that they may opt to use alternative methods of delivery if delivery frequency were changed.
- Given the significant cost differences of the various delivery modes (door $0.81, curb $0.51, and centralized $0.37), it has been suggested that a mandated change to the current mix of delivery should be made. While the Postal Service has managed delivery costs over time by limiting new deliveries to curb or centralized modes, it has not done a study on the conversion of existing door delivery to a more cost effective method. Practical considerations, as well as public and political concerns, would have to be studied in great detail before the viability of this proposed change could be determined.

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[39] See appendix U, *Universal Service Obligation and the Postal Monopoly,* for more information.

3.5 Postal Service Perspective

Ultimately, the future business model of the Postal Service is a policy decision. In recent years, discussion and debate over the proper role for the Postal Service in the 21st century has been vigorous, and appropriately so, for important public policy questions are stake. After taking into account this public dialogue and stakeholder input, after weighing the implications of recent events, and after considering as well the enduring influence of the institution’s core values, vision, and mission, the Board of Governors and senior leadership of the Postal Service have formed an opinion on the most appropriate model for the Postal Service for the next few decades.

Government Agency

Postal leadership does not believe that devolution of the Postal Service into a Government Agency represents the best course for the future. While restructuring the organization as a Government Agency would continue support for its core values and mission, it would not provide stability for the nation’s delivery services network. The Postal Reorganization Act of 1970 rejected the government agency structure of the old Post Office Department because of volatility brought on by labor issues, capital shortfalls, and service problems. The risk of volatility will only increase if, as expected, First-Class Mail volume declines and the postal monopoly proves less able to fund the universal service obligation and other public policies. There is, moreover, little support for this model among stakeholders.

Privatized Corporation

Postal Service leadership likewise considers the Privatized Corporation an inappropriate, or at least premature, model for the Postal Service in the foreseeable future. Whether or not a privatized Postal Service would fully support the values and mission of the present institution is unclear. Corporate culture would inevitably change in a profit-driven organization even if public policy issues remain a factor in corporate decision making. Moreover, privatization is not a viable option at this time for financial reasons. There would likely be little investor interest in an initial public offering by a company operating in a potentially declining market. While the assets of the Postal Service are great, so are future retirement liabilities. Consideration of the privatization option would appear to be more timely after the Postal Service has further honed financial, pricing, and market skills. Most importantly, focus groups with the American public held during the Stakeholder Outreach effort yielded strong opposition to privatization. The American public wants its government to provide universal service, and Postal Service leadership hears them.

Commercial Government Enterprise

Postal Service leadership has concluded that the model of a Commercial Government Enterprise offers the best hope for transforming the Postal Service into an enterprise equipped to maintain universal service at affordable prices in the economy of the 21st century. The Postal Service's basic mission will not change. Its corporate vision will continue to embrace delivery and access for every American. Increased flexibilities inherent in the Commercial Government Enterprise will afford opportunities for growth and cost containment. Although the value of the monopoly is diminishing, transformation of the Postal Service as a Commercial Government Enterprise will equip it to control costs and adapt to changing markets while continuing to provide universal service.

3.6 Longer-Term Legislative Changes

Translation of a conceptual mode, the Commercial Government Enterprise, into a specific legislative framework will involve a wide array of choices. To be successful, transformational legislation must address deficiencies of the present model which make the current system too unwieldy. Transformation must arm the Postal Service to adapt quickly and responsively to change by freeing it from processes and restrictions that may support traditional governmental values but undercut business efficiency. To preserve universal service at affordable rates in the modern marketplace, the Postal Service will need the capacity to make the hard decisions presented by trade-offs between controlling costs and meeting customer demands.

In this section of the *Plan,* the Postal Service identifies the most significant issues that it believes would have to be addressed to transform the Postal Service along the Commercial Government Enterprise model. They encompass the following areas of 1) net income and retained earnings, 2) markets, 3) purchasing, 4) regulation, and 5) labor and employment. The Postal Service recognizes that various solutions may be possible in each area and that the entire postal community must be heard from in order to complete a satisfactory transformation.

1. Net Income and Retained Earnings

The Commercial Government Enterprise should have the goal of earning reasonable returns over the long term and have the ability to accumulate retained earnings. Retained earnings could provide two types of improvements:

First, the need to generate a net income for the owner (i.e., the government) could help instill in the entire organization an incentive to manage its resources as efficiently as possible. Resulting cost savings would benefit customers through lower postage bills and enhanced services.

Second, an earnings-based model should help resolve for the long term some of the deficiencies of the current financial model that are not fully addressed in the near-term, interim changes. Earnings would reduce the Postal Service's current dependence on issuing debt to finance capital spending. The current freeze on capital spending intensifies financial and competitive risks to the long-term viability of postal networks and services. To lessen the freeze, the Postal Service has requested from Congress

$957 million for services rendered in the past. Retained earnings would provide a more stable source of funding to assure that capital investments can be made on the basis of sound operating and financial policies and would help avoid reaching absolute borrowing limits. Similarly, retained earnings should enable the Postal Service to get through temporary economic slowdowns without always having to raise prices, allowing it to focus more on the longer term. Price increases could be scheduled to address market conditions. The Postal Service could also smooth the price effect of growth in longer-term liabilities such as retirement. Finally, the Postal Service would be better prepared financially to respond to unexpected events if the contingency built into existing rates proves inadequate, as it has in recent experience.

2. Markets

The postal enterprise should have the flexibility to explore service offerings in related markets in order to maintain the financial solvency of its postal network and to help fund continuing universal service responsibilities. New ventures could include overseas postal markets. Major foreign posts are now entering the U.S. market as they begin to compete globally. The U.S. postal enterprise should be able to compete globally as well.

Other global opportunities could include horizontal integration in such areas as logistics, printing, remittance, and scanning services. By leveraging its core competencies and knowledge through partnerships and contractual arrangements, a firm makes the most efficient use of its resources. For instance, the Postal Service could capitalize on its extensive logistics background by providing consulting help and maximizing usage of its assets. It could also increase use of its extensive retail network by providing sales outlets for other parties who do not have full-service outlets in particular locations. In addition, the Postal Service might allow broader downstream access, for a fee, to arguably its most valuable asset—its delivery network.

The Postal Service already partners with the private sector to accomplish many facets of its mission and, under this model, could continue to expand opportunities for the private sector. More scope for joint undertakings and investments with private partners should be permitted expressly. In today’s business world, strategic alliances and other ongoing business relationships often use shared equity as a way of managing a relationship and apportioning its risks and rewards. Many postal administrations make appropriate use of these kinds of transactions, as do other organizations with which the Postal Service does business regularly.

3. Purchasing

The postal enterprise should be free to enter into contracts to purchase goods and services, including transportation,[40] following the most effective commercial practices. A number of federal statutes should be reconsidered.[41] Like other service providers, the postal enterprise should be subject to purchasing statutes and obligations applicable

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[40] See Appendix M, *Efficiency-Based Strategies,* for more information on international air transportation deregulation, which is one example of purchasing freedoms.

[41] By way of illustration, some of the statutes that now impose added costs not required of the firms whose competing or substitute services may take increasing volume away from the postal system include the Contract Disputes Act (procedures for asserting and resolving claims in a specified court system); the Prompt Payment Act (payment of interest on delayed payments); the Davis Bacon Act (prevailing wage rate set by the Department of Labor for laborers); the Service Contract Act (payment of wages set by the Department of Labor under certain contracts); and the Javits-Wagner-O’Day Act (purchase of selected goods and services from workshops employing the blind or disabled).

to commercial organizations, such as the Uniform Commercial Code, which deals with many forms of commercial transactions (contracts to buy and sell goods). Also, a Commercial Governmental Enterprise may face some form of antitrust regulation.

4. Regulation

a. Pricing

A Commercial Government Enterprise would need pricing flexibility to participate effectively in the modern business environment and to provide its customers with moderate and predictable rate adjustments. If the postal monopoly is maintained to support universal service, however, some regulation of monopoly prices is likely to be considered appropriate to protect the public interest. However, the Postal Service should have authority to price its competitive services based on market principles. For customers using monopoly services, the Postal Rate Commission (PRC) and the Board of Governors would provide broad parameters to prevent cross-subsidy and undue discrimination. Within those broad parameters, the Postal Service would have the flexibility to adjust its prices promptly. Pricing and classification parameters should be enforced under a complaint process. Wherever the enterprise faces effective competition, the antitrust laws and fair competition laws should suffice to protect competition in the public interest.

b. Universal Service and Uniform Rates

Universal service should continue to be protected. The definition of universal service could specify general criteria on major service attributes such as days of delivery, but must be flexible and pragmatic, so that new methods of providing access to service are taken into account and networks and services are not unreasonably tied to historical conditions. Broad expectations should allow room for localized adjustments, such as differences in delivery days in some areas based on need and efficiency. Requirements for universal service should include a complaint process instead of prior review.

5. Labor and Employment

a. Collective Bargaining

An efficient postal enterprise should be accountable for its total performance, preferably including all cost-causing components. While the Postal Service currently negotiates with its bargaining unit employees over most conditions of employment, some employee benefits, including retirement and certain aspects of health benefits, are fixed by law. These statutory constraints distort the bargaining process because large elements of total employee cost are excluded from the bargaining table. This limitation on the bargaining process should be corrected so that the entire compensation package is on the table at the same time.

Additionally, cooling off and mediation procedures similar to those for essential services under the Railway Labor Act should be provided.[42] In the mediation stage, criteria for decision should be provided, similar to those under other models involving essential services, so that explicit consideration is given to the effect of labor contracts on the enterprise, its customers, and the public interest. Consistent with the Railway Labor Act, failure of the mediation process could lead to strikes and lockouts as in the private sector.

b. Employment Laws

Like other organizations in the mailing community, the Postal Service should be subject to private sector employment laws. Currently the Postal Service is under federal sector programs for workers' compensation, equal employment opportunity, and certain employee discipline procedures. On the other hand, the Postal Service has already been placed under private sector provisions regarding occupational safety and health and under the National Labor Relations Act for most aspects of collective bargaining. Employment laws applicable to a Commercial Government Enterprise should be made consistent with a similarly situated private business. For example, the current mixture of private and public employment laws permits dual filing of complaints by employees which drives up administrative costs and management expenses. Comparable private sector employers are not saddled with a similar burden. Postal customers should not have to bear costs of duplicative complaint systems.

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[42] See Appendix V, *Alternative Collective Bargaining Models,* for more information.

Conclusion

Section 4 — Conclusion

This report concludes that a fundamental transformation of the Postal Service into a truly commercial, efficient, and flexible institution has become a necessity, impelled by vast changes in the communications and delivery services markets since the last major restructuring of the nation's postal laws in 1970.

In preparing this report on postal transformation, the Postal Service has reviewed current operations and long-term trends. The views of all stakeholders have been solicited and considered. Experiences in other industrialized countries have been carefully studied. The Postal Service has heard the calls for modernization from members of Congress and the mailing industry.

From this review, postal leadership has concluded that fundamental transformation should begin as soon as possible. While the Postal Service does not presume to have all of the answers, this *Plan* offers a two-part approach for addressing the issues and opportunities facing the organization:

- **Meeting the Challenge.** Actions the Postal Service is taking now and the moderate changes to postal regulations and laws that will support these actions.
- **Preparing for the Future.** Enactment of a fundamentally new legislative framework for the Postal Service.

Meeting the Challenge defines the strategies the organization is pursuing to meet three commitments to its customers: 1) increasing the value of its products and services, 2) improving operational efficiency, and 3) fostering a performance-based culture. These strategies stretch across all functional areas. To increase the value of products and services and fuel growth, the Postal Service must both reshape how customers access products and services and improve the reliability, effectiveness, and convenience of the products and services themselves. To improve operational efficiency, the Postal Service must rethink all aspects of its logistics systems, from mail processing to material handling to network operations. To achieve a performance-based culture, the Postal Service must redesign incentives and workplace environments for its human capital, both managers and employees. Improved use of information technology, management of capital, and innovative purchasing strategies are also essential to support and facilitate improvement in all areas.

Moderate regulatory and legislative reforms, likewise, must be pursued to pave the way for transformation. These include regulatory or statutory changes needed to permit additional pricing flexibility, rationalize the postal retail network, resolve labor negotiation impasses, and pay market-based salaries.

Preparing for the Future describes options for long-term structural transformation. Three models are described to illustrate the range of possibilities that fundamental transformation could assume. Each model would require major legislative reform. The three models are:

- **Government Agency.** An agency focused on services not provided by the private sector.
- **Privatized Corporation.** A business entity with private shareholders.
- **Commercial Government Enterprise.** A government-owned enterprise operating more commercially in the market.

The Postal Service has concluded that the Commercial Government Enterprise model can provide the proper mix of commercial pressures and government ownership. It will allow the organization, even in the face of increasing competition, to continue achieving its mission—affordable, accessible delivery services for all Americans. As a commercialized entity, the Postal Service would provide core and market-based products and services, implement private sector employment incentives, and enhance financial management practices.

If such a commercial restructuring is approved by Congress, the Postal Service is confident that a transformed postal system can survive and thrive using the full range of managerial tools needed to create a performance-driven culture. Commercialization positions the organization to function in a dynamic marketplace as a stable, universal, integrated channel of the national economy.

Successful transformation will require strong and committed leadership from the Governors, the Postmaster General and all postal employees. Working together with its many stakeholders, including the executive and legislative branches of the federal government, the Postal Service will forge a new and modern business model for an institution that has served this country and evolved with changing times since 1789. The Postal Service recognizes its responsibility to take definitive action and to offer the citizens of America a clear and compelling view of current and planned actions, as well as a vision of where it is headed. At the same time the Postal Service wants and encourages all stakeholders to remain actively engaged in postal issues and the Postal Service’s future.

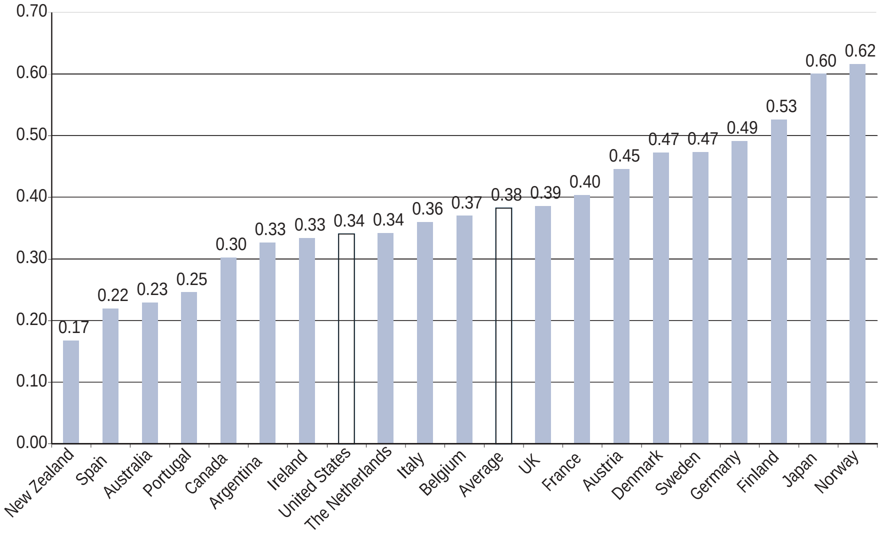
Postal Service leaders understand and embrace the pivotal role they must play in restoring the Postal Service to a sound footing, ensuring the continuation of affordable, universal letter mail service, and preparing the institution for the opportunities ahead. They are committed to leading the transformation of the institution and welcome the roles of Congress, postal customers, labor and management associations, and other stakeholders in this endeavor. These are truly challenging times, and the Postal Service pledges to take a leading and constructive part in the transformation of this vital American institution.

Appendix A

APPENDIX A — Charts, Graphs, and Tables

CHART 1: STANDARD LETTER RATES IN U.S. DOLLARS

The following chart depicts standard letter rates for twenty countries and highlights the standard U.S. rate, as well as the average rate for the countries listed. While the definition of a standard, or First-Class Mail[1] letter, varies between countries, this comparison includes prices for letters whose definition most closely resembles that of a First-Class Mail letter, weighing up to one ounce, with a basic price of $0.34.



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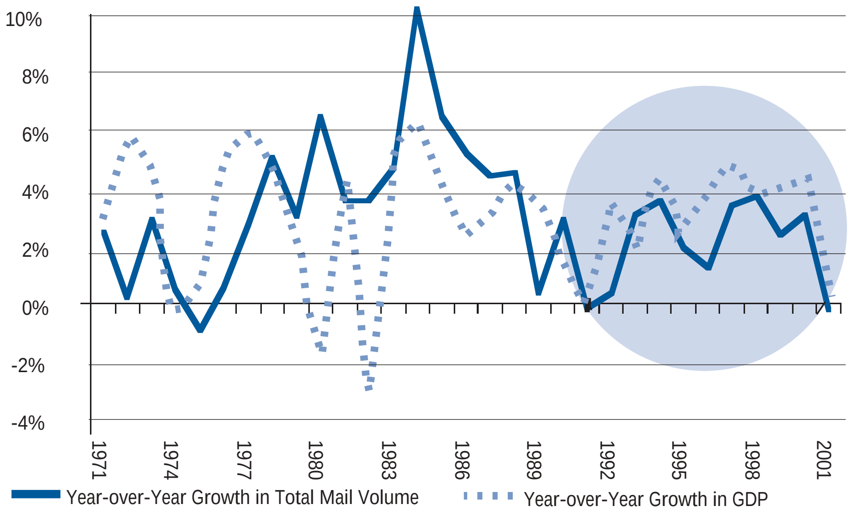
[1] First-Class Mail includes all personal correspondence, all bills and statements of accounts, all matter sealed or otherwise closed against inspection, and matter wholly or partly in writing or typewriting. Each piece must weigh 13 ounces or less. The minimum size for First-Class Mail is 5 inches long, 3-1/2 inches high, and 0.007 inch thick. The combined length and girth of a piece (i.e., the length of its longest side plus the distance around its thickest part) may not exceed 108 inches. Single-Piece Rates: first ounce: $0.34, each additional ounce: $0.23.

CHART 2A: MAIL VOLUME GROWTH SLOWS DURING RECESSIONS

Source: Bloomberg (GDP) data for last quarter of each fiscal year.

CHART 2B: MAIL VOLUMES FAIL TO KEEP PACE WITH THE ECONOMY



Note: Rates are based on foreign exchange rates as of February 12, 2002.

TABLE 1: POSTAL SERVICE SIZE, BY REVENUE, AMONG U.S. COMPANIES

Rank	Company	Revenues ($ billions)
1	Exxon Mobil	210.4
2	Wal-Mart Stores	193.3
3	General Motors	184.6
4	Ford Motor	180.6
5	General Electric	129.9
6	Citigroup	111.8
7	Enron	100.8
8	Intl. Business Machines	88.4
9	AT&T	65.9
10	Verizon Communications	64.7
11	**U.S. Postal Service**	**64.5**
12	Philip Morris	63.3
13	J.P. Morgan Chase	60.1
14	Bank of America Corp.	57.7
15	SBC Communications	51.5
16	Boeing	51.3
17	Texaco	51.1
18	Duke Energy	49.3
19	Kroger	49.0
20	Hewlett-Packard	48.8

Source: Company revenue rankings by *Fortune*, April 14, 2001; U.S. Postal Service revenue, 2000.

TABLE 3: POSTAL SERVICE SIZE, BY NUMBER OF EMPLOYEES, AMONG U.S. COMPANIES

Rank	Company	Employees
1	Wal-Mart Stores	1,244,000
2	**U.S. Postal Service**	**767,761**
3	General Motors	386,000
4	McDonald's	364,000
5	United Parcel Service	359,000
6	Ford Motor	345,991
7	General Electric	341,000
8	Sears Roebuck	323,000
9	Intl. Business Machines	316,303
10	Kroger	312,000
11	J.C. Penney	267,000
12	Verizon Communications	263,552
13	Kmart	252,000
14	Citigroup	237,500
15	Albertson's	235,000
16	Home Depot	230,000
17	SBC Communications	215,088
18	Delphi Automotive Systems	211,000
19	Boeing	198,000
20	Safeway	192,000

Source: Number of employees rankings by *Fortune*, April 14, 2001.

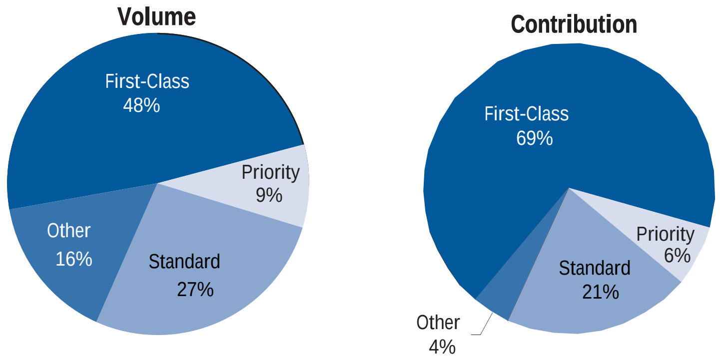
TABLE 2: POSTAL SERVICE SIZE, BY REVENUE, AMONG GLOBAL COMPANIES

Global 500 Rank	Company	Revenues ($ millions)
1	Exxon Mobil	210,392.0
2	Wal-Mart Stores	193,295.0
3	General Motors	184,632.0
4	Ford Motor	180,598.0
5	DaimlerChrysler	150,069.7
6	Royal Dutch/Shell Group	149,146.0
7	BP	148,062.0
8	General Electric	129,853.0
9	Mitsubishi	126,579.4
10	Toyota Motor	121,416.2
11	Mitsui	118,013.7
12	Citigroup	111,826.0
13	Itochu	109,756.5
14	Total Fina Elf	105,869.6
15	Nippon Telegraph & Telephone	103,234.7
16	Enron	100,789.0
17	AXA	92,781.6
18	Sumitomo	91,168.4
19	Intl. Business Machines	88,396.0
20	Marubeni	85,351.0
21	Volkswagen	78,851.9
22	Hitachi	76,126.8
23	Siemens	74,858.3
24	ING Group	71,195.9
25	Allianz	71,022.3
26	Matsushita Electric Industrial	69,475.3
27	E. ON	68,432.6
28	Nippon Life Insurance	68,054.8
29	Deutsche Bank	67,133.2
30	Sony	66,158.4
31	AT&T	65,981.0
32	Verizon Communications	64,707.0
33	**U.S. Postal Service**	**64,540.0**
34	Philip Morris	63,276.0
35	CGNU	61,498.7
36	J.P. Morgan Chase	60,065.0
37	Carrefour	59,887.8
38	Credit Suisse	59,315.5
39	Nissho Iwai	58,557.3
40	Honda Motor	58,461.6
41	Bank of America Corp.	57,747.0
42	BNP Paribas	57,611.6
43	Nissan Motor	55,077.1
44	Toshiba	53,826.6
45	PDVSA	53,680.0
46	Assicurazioni Generali	53,333.1
47	Fiat	53,190.4
48	Mizuho Holdings	52,068.5
49	SBC Communications	51,476.0
50	Boeing	51,321.0

Source: *Fortune*, July 23, 2001

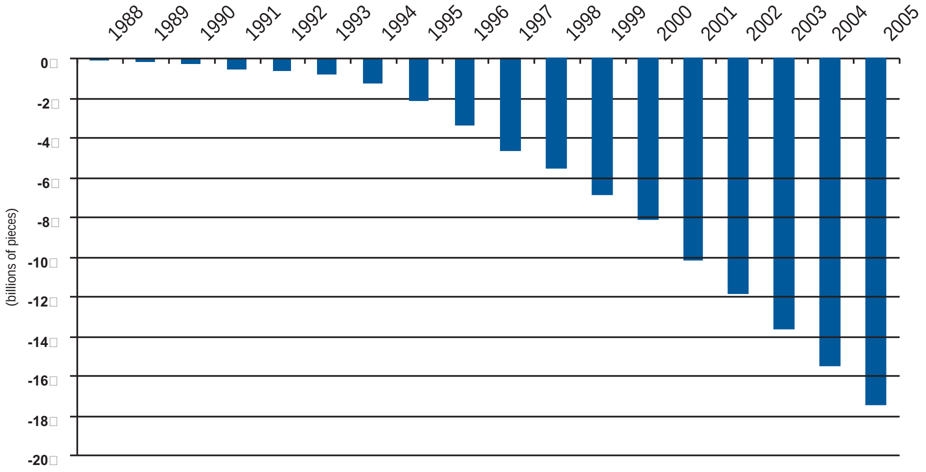
CHART 3: FIRST-CLASS MAIL IS A MAJOR FORCE

Contribution Per Piece - FY2000



Source: 2000 CRA

CHART 4: ANTICIPATED IMPACT OF INTERNET SERVICE PROVIDERS ON SINGLE-PIECE FIRST-CLASS MAIL LETTERS



Source: RCF Economic and Financial Consulting, Inc., Chicago, IL.

CHART 5: PROJECTED CHANGES TO HOUSEHOLD BILL PAYMENT METHODS

Method	2000 (actual)	2001 (projected)	2002 (projected)	2003 (projected)	2004 (projected)	2005 (projected)
Electronic	11.1%	13.7%	16.7%	20.3%	24.5%	29.2%
In-Person	9.5%	9.2%	8.9%	8.6%	8.3%	8.0%
By Mail	79.4%	77.1%	74.4%	71.1%	67.2%	62.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

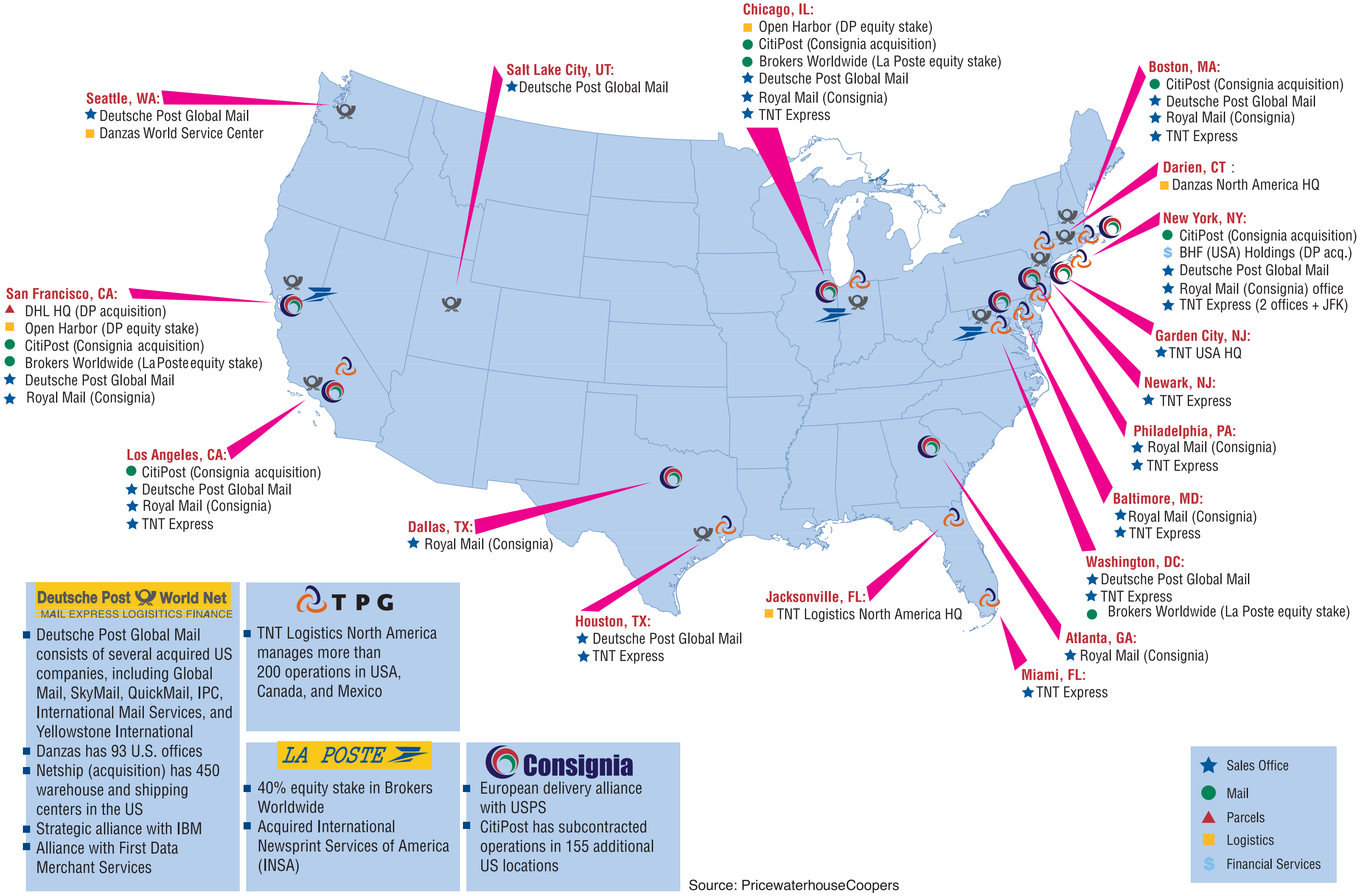
Source: RCF Economic and Financial Consulting, Inc., Chicago, IL.

CHART 6: 2000 COMPETITIVE MARKET SUMMARY

Market (USPS Revenue) 2000	**USPS Market Share Projections (2001 - 2005)**	**Major Competitors**	**Critical Competitive Issues**
Correspondence & Transactions ($35.5 Billion)	↓	Microsoft - First Data Resources CheckFree, Bank of America Mellon Bank, EBPP	Price Service Security
Advertising ($15.2 Billion)	↓	Broadcast Networks Newspapers, Alternate Delivery, Magazines	Price, Ease of Use, Service
Package Services ($7.7 Billion)	↓	Federal Express United Parcel Service Airborne	Service, Price, Ease of Use
Publications ($2.2 Billion)	↓	Internet (On Line Publications)	Service, Price, Ease of Use
Retail ($2.2 Billion)	↓	Mailboxes, Etc. Commercial Mail Receiving	Convenience, Service, Price
International ($1.7 Billion)	↓	Federal Express, UPS, DHL, TNT, Foreign Postal Admin. (Deutsche Post World Net)	Service, Price, Convenience

Source: RCF Economic and Financial Consulting, Inc., Chicago, IL.

CHART 7: SELECTED ACQUISITIONS, EQUITY STAKES, AND MAJOR OFFICES AS OF JANUARY 2002



Deutsche Post World Net
MAIL EXPRESS LOGISITICS FINANCE

- Deutsche Post Global Mail consists of several acquired US companies, including Global Mail, SkyMail, QuickMail, IPC, International Mail Services, and Yellowstone International
- Danzas has 93 U.S. offices
- Netship (acquisition) has 450 warehouse and shipping centers in the US
- Strategic alliance with IBM
- Alliance with First Data Merchant Services

TPG

- TNT Logistics North America manages more than 200 operations in USA, Canada, and Mexico

LA POSTE

- 40% equity stake in Brokers Worldwide
- Acquired International Newsprint Services of America (INSA)

Consignia

- European delivery alliance with USPS
- CitiPost has subcontracted operations in 155 additional US locations

Source: PricewaterhouseCoopers

Appendix B

APPENDIX B — Executive Summary of *Outline for Discussion: Concepts for Postal Transformation*, U.S. Postal Service, September 30, 2001

The United States Postal Service is one of America's most enduring institutions, an enormous communications network designed to "bind the nation together through the personal, educational, literary, and business correspondence of its people."[1] An independent entity of the federal government, it is directed by law to provide universal postal communications to all persons residing in the United States. It was established before the American Revolution and has functioned without interruption for 226 years. Today, with annual revenues approaching $68 billion, it is the eighth largest organization in the country, and, if included, would rank as the twenty-sixth largest enterprise on *Fortune* magazine's Global 500. It has a career workforce of nearly 800,000, which makes it one of the largest employers in the nation, and its diverse products and services anchor an $871 billion mailing industry, which in turn employs nearly 9 million Americans.

However, today's soft economy, changing global markets, new technologies, and the need to deliver mail to an ever-increasing number of addresses are combining to put the future of the Postal Service at risk. The Congress and the General Accounting Office have taken note of this and asked the Postal Service to produce a *Comprehensive Transformation Plan* by the end of the year that will address how the Postal Service proposes to meet these challenges. This document, *Outline for Discussion: Concepts for Postal Transformation,* is a progress report on the Postal Service's first steps toward transformation and an open invitation to stakeholders to join the discussion. The Postal Service is reaching out to the American public and policy makers and asking them to consider how the Postal Service can best serve them and the American economy in the 21st century.

The Postal Environment

While much of the previous decade was marked by financial success for the Postal Service, significant marketplace shifts – emerging alternative communications technologies, new competitors both domestic and international, and changing consumer attitudes and behaviors – have altered the landscape. Within the next decade technological innovations such as mobile commerce, broadband Internet access, interactive TV, data mining software, and new printing technologies will change the way businesses and consumers interact. Domestic delivery firms, such as United Parcel Service (UPS) and FedEx, and liberalized foreign posts, such as Deutsche Post World Net and TPG of the Netherlands, are aggressively competing in Postal Service markets. These drivers for change are moving rapidly and will continue to change the traditional postal business whether or not the Postal Service transforms.

Meanwhile, although the six major markets in which the Postal Service operates – retail, financial services, communications, advertising, logistics and delivery services – are expected to grow, the long-term role of the Postal Service in those markets is uncertain. Electronic billing and payments, pre-authorized debits to bank accounts and

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[1] Title 39, U.S. Code, Sec. 101 (a).

credit cards, and Internet-enabled Electronic Data Interchange will reduce the need for and use of paper bills and payments. Electronic communications will grow at a much more rapid pace than traditional hard-copy communications, particularly on the Internet. Using modern technology, advertising will be more targeted, personalized, and interactive. The logistics and delivery markets will use increasingly sophisticated information systems to provide integrated, supply chain management solutions to customers' needs. Global liberalized posts are acquiring logistics companies and other mail-related businesses both in and outside of the United States to position themselves as communications and logistics global conglomerates. The United States Postal Service, operating under current law, has not joined them.

Challenges

The current legal framework is but one of several challenges that has led the Postal Service and its stakeholders to seek change. Future challenges to success exist within postal operations, in the structure of postal finances, and in the necessity to find, train, and equip the workforce and its future leaders. Each of these areas requires attention in any discussion of the future. Among the specific issues to address is that possible reduced mail volume, when combined with cost increases for labor, employee health care and retirement costs, fuel, and facilities will drive a continuing gap between revenue and expense with severe financial implications for the Postal Service.

As the Postal Service nears its statutory $15 billion debt ceiling, it faces a critical challenge in terms of cash flow and capital investments. Capital investments have reduced costs through mail processing automation, but future productivity gains may be harder to find. Technology investments, likewise, are necessary to transform service offerings and prices to meet future customer requirements. The break-even requirement of the Postal Service and the uncertainty of the future economy will also make these investment needs difficult to fulfill.

Controlling the costs associated with the universal service obligation is another challenge. A transformed Postal Service must consider alternative methods of reducing these costs and providing universal service as mail volume growth declines and the delivery network expands. Network improvements will be considered in the *Transformation Plan* to reduce these costs. Challenges in the human capital arena include workforce planning and complement adjustments within the constraints of current labor agreements. Today's binding arbitration processes eliminate the threat of labor stoppage, but many believe that these processes could be improved. Postal Service compensation must also be reviewed, since today's salary caps drive some potential leaders as well as skilled, experienced executives to other organizations.

Taken together, these internal and external issues form a series of challenges that the Postal Service, as currently structured and regulated, must address. If a private corporation faced these same challenges, it might close facilities, reduce output or services, sell assets, abandon some unprofitable ventures, merge with another company, or even close its doors. These are not options for the Postal Service. It must continue to operate to fulfill its obligation to the nation. How it will do so and in what structure are the challenges of transformation.

Transformation Strategies

The *Outline for Discussion* proposes three phases of organizational transformation for consideration and, within each phase, discusses several strategies. The three parallel phases to be considered are:

- Incremental administrative and operational improvements possible under current law;
- Moderate legislative reforms; and,
- Fundamental structural transformation.

Current Postal Service actions to freeze capital expenditures, reduce the number of managerial employees, and take costs out of operations are examples of incremental administrative and operational transformation, and fall within the legal and public policy framework that exists today. Through administrative and operational action that is permitted under the current law, the Postal Service would continue to use existing authorities to reduce costs, increase efficiency and generate new revenues. The model for this phase is continuous improvement of the current Postal Service.

The objective of moderate legislative reform would be to improve the flexibility of the Postal Service and prepare it for the future. Key reforms could include more flexible pricing, allowing the Postal Service to make a profit, adoption of network improvements, and compensation changes. The options for legislative reform range from modest reforms that would enable streamlined rate-setting processes, to reforms that would grant the Postal Service greater commercial freedom. One aspect of this change might be structural separation between monopoly services and competitive services, a topic discussed for several years during debate over legislative reform.

Fundamental structural transformation would reconstruct the basic postal model based on a redefinition of a universal service obligation. This phase could entail transformation into a for-profit corporate enterprise, owned either by the government, Postal Service employees, or the public through an offering of stock. Still other fundamental structural reform models may be suggested by stakeholders in coming weeks. All would seek to achieve fundamental reform of the factors that contribute to postal costs and revenues and the basic business model of the Postal Service that has existed since 1970.

Stakeholder Input and Next Steps

A Steering Committee of senior executives selected by the Postmaster General will formulate the *Transformation Plan*. The Postal Service will coordinate stakeholder input and internal analysis of the transformation phases. Subject matter experts and specialists throughout the enterprise will develop strategies and analyze the impact of proposed changes. Specialists from other government agencies and the private sector will also be asked to focus on and address Postal Service transformation issues.

To obtain stakeholder participation in the development of the *Transformation Plan* the Postal Service has developed a two-step stakeholder engagement plan. Step One was designed to provide background for this *Outline for Discussion* and entailed a dozen informal meetings in August and September 2001. Postal Service executives and representatives of postal policy makers, unions, management associations, the Postal

Rate Commission, major mailers, and postal trade associations participated. Outreach during Step Two will include publication of the *Outline for Discussion* on the Postal Service's Strategic Direction web site at www.usps.com/strategicdirection. In addition, a special notice will be placed in the *Federal Register*, directing interested parties to the web site for their comments. Focus groups of small business owners and consumers will be convened, and postal employees will be reached through internal communications. Additional meetings will be conducted with representatives of postal unions, management associations, the Postal Rate Commission, major mailers, suppliers, competitors, critics and others. A summary and analysis of stakeholder comments will be incorporated in the *Comprehensive Transformation Plan* to be submitted at year end.

This *Outline for Discussion* is a "living document," the first step in a complex, ongoing process. The collected input, analysis, and conclusions will assist policy makers as they guide the future of the United States Postal Service. The basic questions that are raised in this document are:

- To best serve the needs of the American people and the American economy in the 21st century, what should America's postal system be like (or transform to) in the next decade?
- Should that postal system provide universal service and what should that entail?
- What should the "core" services of the future postal service be?
- How should the nation structure a future postal system to be as productive and efficient as possible and to ensure that consumers pay only what they wish to pay, for as much service as they can afford?
- Can the Postal Service continue to provide universal service under the current financial arrangements if volume slows or declines significantly? Are there other financing mechanisms needed?
- What steps should be taken today to anticipate the human capital requirements of the future postal system in a manner that embodies core values of respect, dignity and diversity while providing incentives to encourage continuous service improvement?
- Is it possible to design a government postal system in the United States that operates more commercially and still serves important social objectives including universal coverage?
- How would a privately owned postal entity or entities perform against public expectations for postal services? Are there other models that may do a better job for the American people?

Informal discussions with stakeholders and policy makers have reconfirmed that there is a lack of policy consensus about the answers to these questions and others. There may not be a need for all stakeholders to agree on every question. But it is expected that there may need to be a process of public policy discussion before issues can be resolved and a widely accepted transformation plan can be crafted. The purpose of this *Outline for Discussion* is to facilitate that process.

Appendix C

APPENDIX C — Overview of the Mailing Industry

The Role of the U.S. Postal Service in the Development of the Communications Marketplace

A businesslike Postal Service, focused on the needs of its customers, has helped to grow the U.S. economy. It is unlikely that the explosion of the direct mail medium, the opening and continued growth of the expedited package market, and the growth of the credit card financial sector would have occurred without the Postal Service's presence in the commercial marketplace since the early 1970s. Furthermore, the Postal Service is essential to the magazine industry and the nonprofit sector.

The Postal Service developed innovative pricing strategies, worked with the advertising community and mailing industry "partners," and invested in "address information technology" to create a dynamic and vital advertising channel that enables small businesses and local establishments to compete effectively with large national advertisers. Large and small businesses benefit from being able to increase awareness of their products or services and generate both increased store traffic (including visits to Web sites) and direct sales.

The Postal Service's investment in the development of the direct mail medium and associated investments in flats and package distribution systems supported the development of direct mail to the home sector, which, in turn, provided the infrastructure needed for the explosive growth of the mail order and publishing segments and established the consumer base for the new Internet marketplace.

The Postal Service, responding early in the 1970s to its banking customers who wanted an improved way to ship cancelled checks, developed the initial expedited package service, Express Mail®. Building upon its Airmail™ service, the Postal Service developed the operating concept to provide overnight service between banks and the financial depositories. This new service created the recognition on the part of commercial customers of the value and use of an expedited form of package transportation. This opened the expedited marketplace to UPS, Federal Express, and other expedited competitors. Despite the existence of these competitors, the Postal Service is still the primary delivery service for packages going into the home.

Through the development of the various worksharing programs, the implementation of the advanced automated processing capital programs, and extensive service improvement programs, the Postal Service has contributed significantly to the financial service infrastructure of the nation. Use of First-Class Mail for the billing and remittance return processing has allowed the financial service industry to extend its presence throughout the economy and create a convenient and flexible financial marketplace. The distribution of a major new method of payment–credit cards–was only made possible by the availability of a reliable and secure infrastructure.

Most magazines are dependent upon the Postal Service for the delivery of the bulk of their subscription copies. The Postal Service provides a national and global market to large circulation publications, special interest magazines, educational and professional journals, newsletters, out-of-town newspapers and other printed material. Many nonprofit organizations depend on low-cost mailings to generate the majority of their funding.

All of these mailers are supported by a mailing industry that provides data (such as mailing lists), design, production and distribution services, processing equipment, and supplies. Envelope manufacturers and paper companies are also part of this key industry.

The Mailing Industry[1]

The mailing industry is composed of a complex set of interconnected businesses performing various functions that intersect around mail-driven applications to move money, messages, and merchandise among businesses and consumers worldwide. Mail is a critical component of a total value chain that links businesses to consumers and other businesses, and consumers to other consumers and businesses. At the core of this value chain is the Postal Service, its business partners, direct competitors, and associated businesses whose combined annual commercial impact is approximately $871 billion. Associated firms include direct marketers, nonprofits, magazines, financial services, newspapers, remittance mailers and catalog companies, and the sectors which support corporate advertising, communications and distribution processes – advertising agencies, addressing software firms, financial transaction processors, and mail printing and preparation processors. These firms together represent an estimated nine million U.S. jobs.

If an additional tier is added–firms such as envelope and paper manufacturers, providers of mailing equipment and supplies, transportation firms, and others involved in some way with the mailing process–the global value of the participants in this chain is nearly $2 trillion. The strength or weakness of the value chain in the mail channel could have a direct affect both on the viability of the total trillion-dollar industry and this substantial workforce.

The Mailing Industry Value Chain

The mailing industry can be defined in terms of a value chain. The mailing industry value chain supports business mailer activities such as customer acquisition, service delivery and customer retention. Mailing services participants–working on behalf of a manufacturer or retailer–might include a creative design agency, an address manager, a service bureau responsible for processing a mail piece, a printer, a letter shop, a presort bureau, and a shipper, all of whom play roles designed to get a mailing into the postal network. Equipment manufacturers, software vendors, retail outlets, and other stakeholders support and share interests with these players. And benefiting from the Mailing Industry Value Chain are key customer segments whose business models depend upon customer access through the mail channel.

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[1] The following material has been adapted from *Seizing Opportunity: The Report of the 2001 Mailing Industry Taskforce,* October 15, 2001, www.usps.com/stratgicdirection/mitf.htm.

Economic Value of the Core Mailing Industry

There are two tiers of stakeholders in what can be described as the Core Mailing Industry, aligned with each other through their dependency on the postal network for revenues, customer relationship management, and realization of business objectives. In the first tier are the postal and package stakeholders, including the providers of direct and indirect mailing services and the U.S. Postal Service, with total annual revenues estimated at $636 billion. A second tier–customer segments whose business models intensively depend on the mail for service fulfillment, customer acquisition, customer retention or a combination of all three–accounts for another $235 billion. Industry segments in this tier include catalog companies, printers and magazine publishers. This core mailing industry, generating an estimated $871 billion in commerce annually, employs nearly 9 million workers. The mail's economic impact on a state-by-state basis is substantial, ranging from $372 million in Wyoming to more than $62 billion in California. The annual impact is less than $1 billion in only two states. By comparison, the smallest Fortune 500 company has revenues of $3.2 billion. For most states, the mailing industry has an economic effect equivalent to one or more Fortune 500 companies.

The Changing Mix and Drivers of Change

Commercial customers create the vast majority of mail to both businesses and consumers. Volume trends indicate that the use of mail is increasing in the business-to-business market, while the consumer-to-consumer market is showing no growth. The sender-receiver loop between businesses and consumers represents about one-half of all mail volume and business-to-consumer mail volume continues to grow moderately. However, mail sent by consumers to businesses is declining.

There have been shifts in the proportion of First-Class Mail to Ad Mail (Standard Mail) in terms of revenues generated. Since 1980, Standard Mail has nearly doubled in terms of its contribution to overall postal revenue, rising from 12.5 percent of the annual total to 2000's 23.5 percent. At the same time, First-Class Mail has increased from 52.7 percent to 54.9 percent in revenue contribution, but has experienced an interim decline over the past decade, dropping five points from 1990's 59.9 percent. Over these two decades, Standard Mail has joined First-Class Mail to become the mailstream's two dominant classes. In 1980, they accounted for 65.2 percent of postal revenues; in 2000, they combined to produce 78.4 percent of postal revenues.

The rise in work-shared mail is even more dramatic. The Postal Service and the mailing industry developed a series of discounts to permit mailers to take advantage of cost savings by preparing the mail in ways that avoided postal operations in order to provide for a lower total mailing cost. Twenty years ago, work-shared mail generated 16.8 percent of postal revenues. Today it accounts for 43.9 percent. Its share of volume is even greater, amounting to 66.6 percent of all mail in 2000, a rise of more than 30 percent in the past two decades, and 11 percent over the last ten years.

The transformation of the mailstream is driven by several factors: changing consumer behavior, technological integration with other channels (particularly the Internet), increasing emphasis on "one-to-one" marketing by businesses, and raised expectations on the part of both sender and receiver for richer information and higher levels of service. The Institute for the Future, in a study titled “Posts: Inside the New Web of Communications,” recently concluded that fundamental mail volume shifts will occur over the next decade. Financial statements, direct mail sent to broad populations and general purpose catalogs will either decrease or experience significantly slowing growth. That research suggests Web-generated customer contact mail and merchandise, and individualized catalogs and one-to-one marketing-inspired mailings will rise.

Studies of the “Intelligent Document” and the “Print on Demand Initiative” (PODi) demonstrate that there are opportunities for technological innovations to documents, envelopes and packages, and mail handling operations that would transform the mailstream. These innovations would provide postal managers and customers with data that will increase security, safety, and create new applications for mail.

From a postal revenue and contribution perspective, current data indicate that financial statements, bills, and payments represent the most valuable segment of mail channel volume, generating about $17 billion of the $34 billion in First-Class Mail revenue, and that this segment is at serious risk. For example, Bank of America, one of the largest mailers of bills and statements, is positioning itself as an industry leader in electronic services by starting a two-year, $45 million campaign to promote online banking and electronic bill payment. The total dollar value of Bank of America customer payments processed electronically grew 36 percent in 2000. In March 2001, Bank of America reported 3.6 million electronic bill payments, totaling $1.2 billion. The bank recently polled its online customers and reported that 90 percent of those surveyed said that they knew about the service. About 75 percent of banks are expected to provide online banking services by 2003, up from 61 percent in 2000.

The Transformation of Expectation

A growing number of today’s consumers share the following characteristics: information sophistication, discretionary income, and access to information technology. These new consumers use some form of information technology at work and at home. In 1980, only 20 percent of adults 25 and older could be characterized as new consumers. Twenty years later, 45 percent fell into the category. The Institute for the Future projects that the percentage will be above 50 percent by 2010.

New consumer demands will lead to greater personalization, access and control of the mail channel by customers, the Institute concluded. Mail and the Internet will be integrated, and used for increased targeting and personalization. Already 61 percent of purchases made on the Web are in response to mailed ads.

“The customer must be the focus,” notes the International Post Corporation’s 2001-2003 global strategic assessment. “Customers are developing sophisticated techniques for assessing which supplier should win their business. In response, supply chain management and logistics service providers are implementing Customer Relationship Management (CRM) strategies.”

One-to-one marketing is an integral part of this trend, and CRM investments generate a need for direct marketing tools that offer more effective targeting and improve the ability of companies to maintain relevant communications on an ongoing basis and across channels. An example is the use of follow-up postcards from sales associates. While challenging traditional direct mail by requiring lower volume mailings, one-to-one marketing is expected to generate new opportunities for the mailing industry.

Industry Transformation

The structure of the mailing industry value chain, and the services delivered through it, have also been transformed. Technologies ranging from affordable computers, to recognition and sorting technology, to automation, to printing and logistics are "blurring" the segment boundaries as intermediaries gain the ability to provide more services. Mail processing– made cheaper and more efficient by technology– is being brought in-house by some originators, and wholly outsourced by others.

Research conducted by Arthur D. Little indicates that large intermediaries grow postage revenues at a faster pace than the channel's overall growth. The major players now dominate a competitive landscape that five years ago was shared more or less equally by businesses of varying sizes.

Within the industry segments, there is also sweeping change. Non-traditional users of address data – such as the health care industry and Fortune 500 firms – are increasing expenditures on list company services, which in turn are major customers of the Postal Service for that information. The trend toward outsourcing supports growth of data processing and service bureaus. Consolidation in the printing industry results in a smaller number of "mega-printers." Eighty percent of all lettershop volume now comes from 20 percent of the country's mailers. Half of the automated mail processed by the Postal Service is sorted by presort bureaus. Consolidators and third-party logistics companies are an emerging, rapidly growing component of the shipping industry.

Postal markets are becoming increasingly global, and sophisticated transnational postal organizations are competing with traditional national postal administrations. These foreign postal administrations have entered the United States and are competing with the U.S. Postal Service.

These shifts mandate that the nature and operation of the current postal network must change to focus on where customers place value.

The Value of the "Mail Moment"

Research from a variety of sources, conducted for the Postal Service and others, confirms that the "mail moment"–the daily collection and review of household mail delivered to a mailbox–remains an important daily ritual for which consumers have positive attitudes toward mail. The arrival of mail in a household is a meaningful, valued "moment." The mail, the data indicate, plays three major roles–as a tool with which to manage household finances, as a provider of aspirational information with which to improve one's lifestyle, and as entertainment. Another survey concluded "Americans prefer U.S. mail to e-mail as a means of transmitting sensitive information, as U.S. mail is viewed as more reliable, private and secure." A third study found that consumers said they trusted the mail channel and the "post office" more than any other institution, enjoyed sending and receiving mail, and tended to save what came to them through the channel. The 2001 data found more than half of the people surveyed could access e-mail at home. This suggests that mail maintains its value in the face of e-mail's popularity and prevalence. Of those, almost 62 percent preferred regular mail to e-mail to receive documents, letters, and messages. Related research on consumer behavior concludes that consumers use their mail daily as a catalyst for household decisions. Mail is perceived as relevant to managing household business, unwinding life's pressures, and bettering self and home life. Without mail, participants said they would not be able to keep in touch, stay up-to-date and stay on top of things. The research shows a strong emotional bond between consumers and mail.

Of concern, however, were data indicating dependence on mail eroded as the age of the consumer dropped. Sixty percent of consumers over sixty years of age found that they "really depend on mail and would be lost without it," compared with 41 percent of those under forty years of age. This sentiment held regardless of whether the consumer expected a mailbox delivery to contain personal correspondence or not, surveyors found. In fact this study indicated that 57 percent said they did not expect personal correspondence in their next mail delivery, and nine in ten said they did anticipate bills and statements. Seventy-four percent expected flyers, circulars and ad mail. This research suggests that the mail channel–for many–is a media portal connecting consumers with businesses, and has relevance as long as it helps them with the business of living.

Consumer behavior research also suggests that mail "reaches real-life shoppers in places where consumer plans are made." Data showed that typically one person in the home is the "mail manager" who often is also the principal household shopper and financial manager. Being able to target such an individual by mail enhances the channel's value to business mailers, the research implies. Other study data suggest that mail's portability is an asset, with magazines and catalogs studied in comfortable surroundings, while bills and flyers were reviewed in household workspaces–a kitchen, for example, or a study.

Households receiving the most mail are more technologically adept (as are younger consumers), but that familiarity with the Internet did not–according to the research–affect how the mail was used in the household. Surveys suggest the Internet is raising expectations of what the mailing industry needs to do to thrive, particularly in terms of the integration of electronic and hard-copy media.

Public Policy Challenges

There are a number of public policy challenges regarding reform of the Postal Service, use of consumer information and liberalization of the postal marketplace. Recent developments regarding legislation that restricts use of consumer information pose challenges. Research assembled by the Direct Marketing Association (DMA) indicates that privacy and the sharing of consumer data remains both an opportunity for and obstacle to the growth of mail. "Ultimately, data restrictions, such as a general 'opt-in' model currently being debated in Congress and in the states," notes a July 2001 report released by the DMA's Information Services Executive Council, "would cause mail to become a less efficient medium for marketing relative to competitive media." Direct marketers, suggests the DMA study, might shift a substantial portion of the $45 billion spent on direct mail advertising in 2000, to other media in response to the enactment of restrictive privacy legislation.

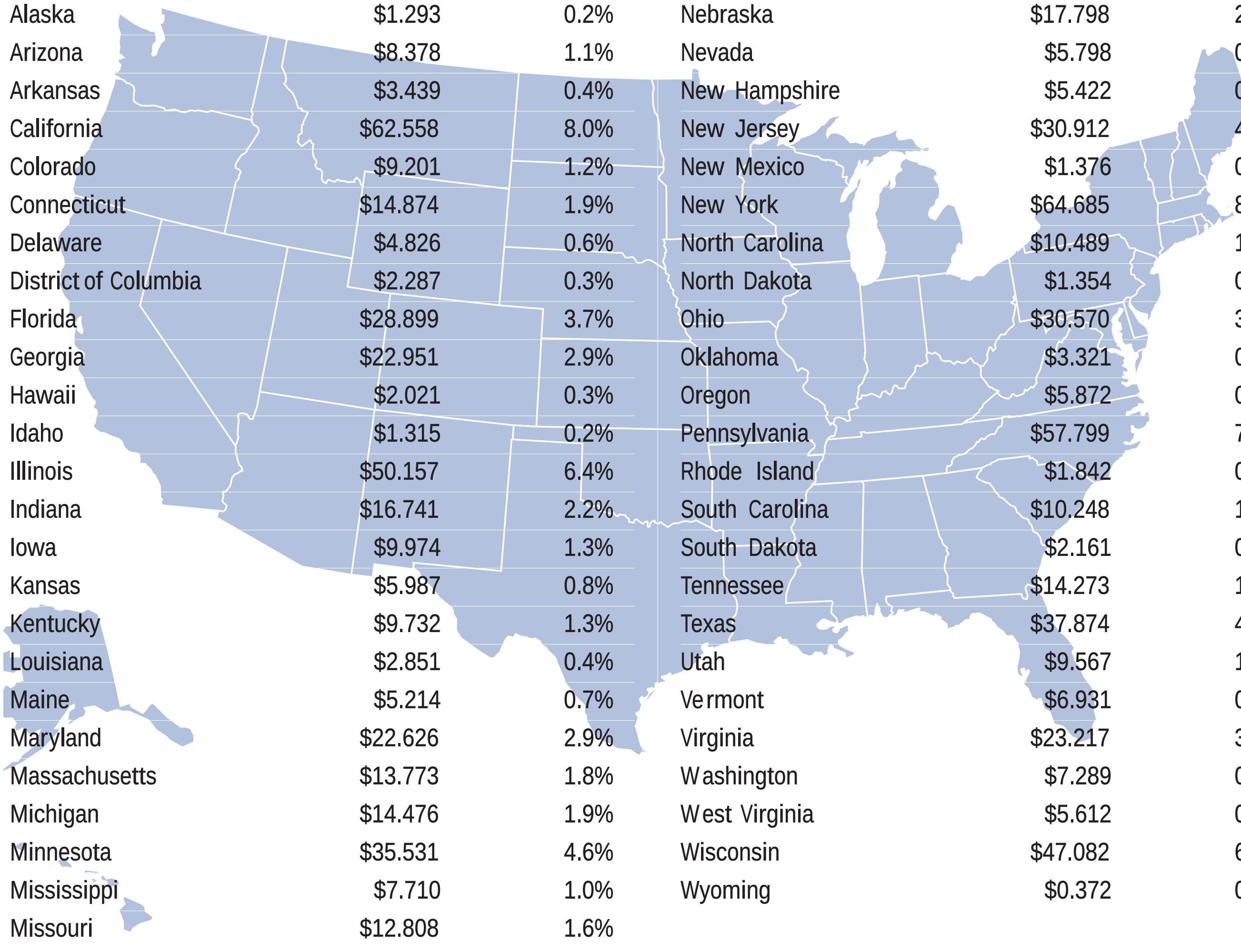
At the same time, another study confirms that Internet based shopping is still being held back by a lack of trust and privacy concerns around that channel. The data suggest the Postal Service brand–as that of a trusted third party–can be leveraged by the mailing industry to enhance the integration of the “mail moment” and the Internet.

While the study reinforces the notion of the “mail moment” and its importance in daily life, a cautionary note was struck by research indicating that mail not requested or targeted to established customer preferences reduces the consumer response for mail. Those who see mail as mostly irrelevant are less likely to sort through the mail, browse through catalogs, or look at advertising material than those who find the mail interesting. Customers expect value from everything, even a bill, the research states. Retailer Nordstrom, for example, now provides consumer information on its bills.

The research indicates that mail becomes more efficient and relevant through the targeted and thoughtful and secure use of personal information. Studies show that consumers want communications to be more relevant and specific to their needs. The paradox lies in consumers voicing concerns about privacy, which research suggests have been heightened with the more visible, immediate interactivity of the Internet. Of specific concern are the collection, protection and use of personal information, particularly sensitive data relating to health, finances and family.

The need for privacy of personal information and its use to meet the needs of consumers, as they desire more personally relevant and useful communications, remains an issue. Personal information is the key component of effective targeting. Indeed, according to the DMA’s Information Services Executive Council, annual aggregate revenues from direct marketing postal campaigns have continually increased in the last ten to fifteen years, while expenditures associated with these campaigns have simultaneously leveled off. The result has been an appreciable growth in the return on investment for postal direct marketers during this period. Given the data documenting privacy issues for both the commercial mailer and the consumer, achieving both personal information protections and benefits will be key to maintaining direct mail’s valuable position within the competitive media set.

MAIL: ECONOMIC IMPACT STATE-BY-STATE

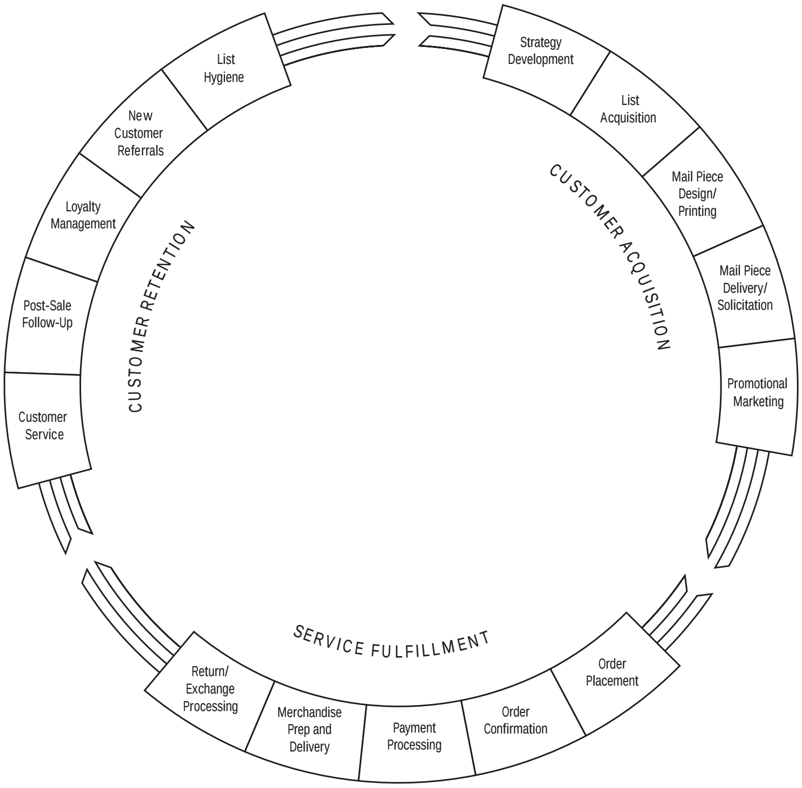


State	Total ($ Billions)	Total %
Alabama	$6.145	0.8%
Alaska	$1.293	0.2%
Arizona	$8.378	1.1%
Arkansas	$3.439	0.4%
California	$62.558	8.0%
Colorado	$9.201	1.2%
Connecticut	$14.874	1.9%
Delaware	$4.826	0.6%
District of Columbia	$2.287	0.3%
Florida	$28.899	3.7%
Georgia	$22.951	2.9%
Hawaii	$2.021	0.3%
Idaho	$1.315	0.2%
Illinois	$50.157	6.4%
Indiana	$16.741	2.2%
Iowa	$9.974	1.3%
Kansas	$5.987	0.8%
Kentucky	$9.732	1.3%
Louisiana	$2.851	0.4%
Maine	$5.214	0.7%
Maryland	$22.626	2.9%
Massachusetts	$13.773	1.8%
Michigan	$14.476	1.9%
Minnesota	$35.531	4.6%
Mississippi	$7.710	1.0%
Missouri	$12.808	1.6%
Montana	$0.630	0.1%
Nebraska	$17.798	2.3%
Nevada	$5.798	0.7%
New Hampshire	$5.422	0.7%
New Jersey	$30.912	4.0%
New Mexico	$1.376	0.2%
New York	$64.685	8.3%
North Carolina	$10.489	1.3%
North Dakota	$1.354	0.2%
Ohio	$30.570	3.9%
Oklahoma	$3.321	0.4%
Oregon	$5.872	0.8%
Pennsylvania	$57.799	7.4%
Rhode Island	$1.842	0.2%
South Carolina	$10.248	1.3%
South Dakota	$2.161	0.3%
Tennessee	$14.273	1.8%
Texas	$37.874	4.9%
Utah	$9.567	1.2%
Vermont	$6.931	0.9%
Virginia	$23.217	3.0%
Washington	$7.289	0.9%
West Virginia	$5.612	0.7%
Wisconsin	$47.082	6.0%
Wyoming	$0.372	0.0%
Total	$778.261	100.0%

Source: United States Postal Service, *The Report of the 2001 Mailing Industry Task Force*

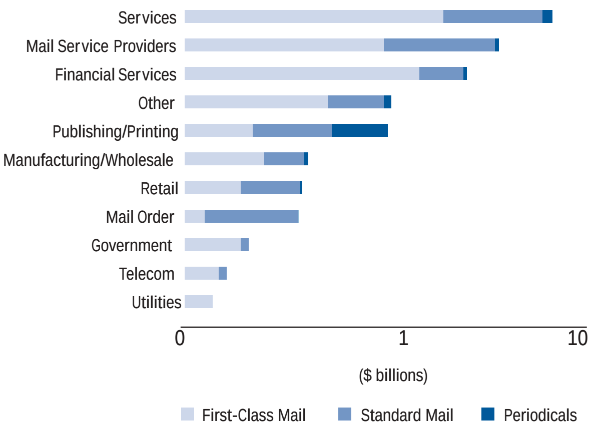
Note: The state-by-state economic impact is augmented by nearly $100 billion in commerce from international posts, totaling $871 billion for the global industry.

THE CUSTOMER VALUE CHAIN



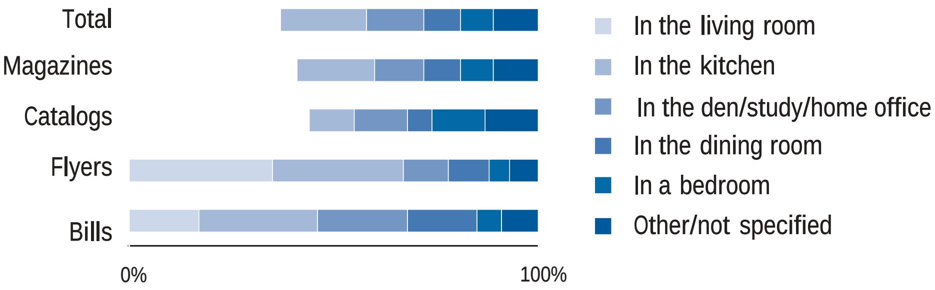
Source: U.S. Postal Service

MAIL REVENUE BY INDUSTRY SEGMENT



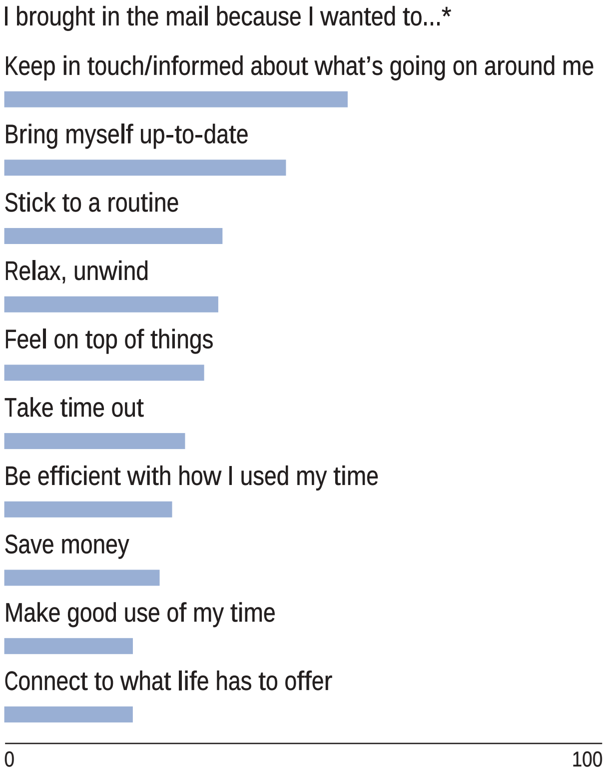
Source: U.S. Postal Service

THE MAIL MOMENT



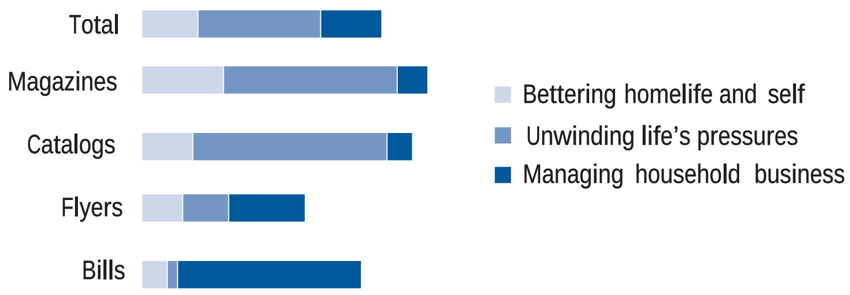
Source: U.S. Postal Service, Gateway to the Household Research

TOP TEN REASONS FOR BRINGING IN THE MAIL



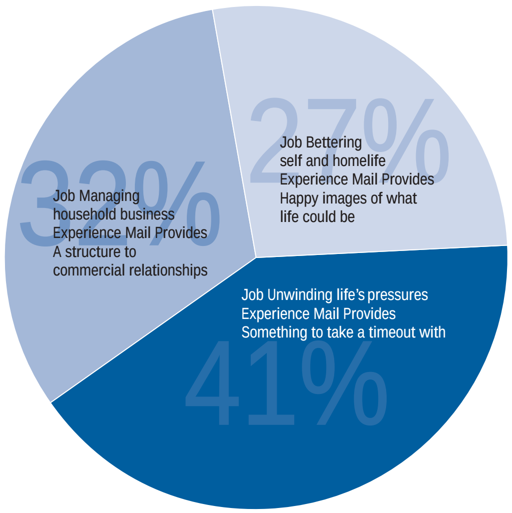
Source: U.S. Postal Service, Gateway to the Household Research

HOW FOUR TYPES OF MAIL ARE USED



Source: U.S. Postal Service, Gateway to the Household Research

THREE JOBS CONSUMERS USE MAIL FOR



Source: U.S. Postal Service, Gateway to the Household Research

MAJOR SHIFTS IN THE NORTH ATLANTIC MAIL STREAM: SIX INDUSTRY TOTALS (AVERAGE ANNUAL RATE OF CHANGE)

	1990-1998	1999-2010
2000		
RISING		
Letter mail: relationship	2.7	6.0
Letter mail: responses and confirmations	2.7	7.0
Catalogs: targeted	5.0	5.0
parcels	1.0	7.0
FALLING		
Financial Statements	3.4	-1.5
Direct ad mail: mass/segmented	3.8	2.0
Catalogs: general purpose	3.5	2.5

Note: the six communications-intensive, heavy mail using industries include retail, catalog/consumer direct, financial services, printing/publishing, telecommunications, and utilities.

Source: IFTF; Historical numbers from the national Posts

MAJOR SHIFTS IN SHARES OF MAIL: SIX INDUSTRY TOTALS (PERCENT OF SIX INDUSTRIES' TOTAL VOLUME)

	1990-1998	1999-2010
RISING		
Letter mail: responses and confirmations	10	16
Letter mail: relationship	12	18
Catalogs: targeted	4	5
parcels	2	3
FALLING		
Financial Statements	20	12
Direct ad mail: mass/segmented	40	34
Catalogs: general purpose	12	12

Note: the six communications-intensive, heavy mail using industries include retail,catalog/consumer direct, financial services, printing/publishing, telecommunications, and utilities.

Source: IFTF; Historical numbers from the national Posts

Appendix D

APPENDIX D — Escalating Retirement Costs

Issue

Postal Service retirement costs will continue to escalate during the next ten plus years due to the overlap in funding requirements under the retirement systems that cover current employees and postal annuitants.

Background

Postal Service employees are covered under either the Civil Service Retirement System (CSRS), the Dual System, or the Federal Employees Retirement System (FERS). Coverage is based upon the starting date of employment with the Postal Service. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan.

Civil Service Retirement System. Under the Postal Reorganization Act, career employees are covered by the Civil Service Retirement System, which provides a basic annuity, at a minimum retirement age of 55, determined by the combination of years of service and high-three years average salary. The CSRS covers substantially all employees hired before January 1, 1984.

Dual Civil Service Retirement System (Dual System)/Social Security System. Employees with prior U.S. government service who were hired between January 1, 1984 and January 1, 1987 are covered by the Dual Civil Service Retirement System/Social Security System.

Federal Employees' Retirement System. Effective January 1, 1987, career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees' Retirement System. This system provides a basic annuity, at a minimum retirement age of 62, determined by the combination of years of service and high-three years average salary. An additional annuity in the form of Social Security benefits is also received, as well as benefits from the Thrift Savings Plan. Only under the FERS plan does the Postal Service contribute to the Thrift Savings Plan. A minimum contribution of 1 percent per year of basic pay is made. Employee voluntary contributions up to 3 percent of basic pay are matched, as well as 50 percent of contributions between 3 percent and 5 percent of basic pay, for a possible match of up to 5 percent.

Funding. While different benefit levels are provided under these three programs, the primary difference in these plans relates to how they are funded. Under CSRS, funding is made during an employee's years of service, as well as during retirement and after death (pay later funding). Funding is based on a percentage of basic pay during employment and is paid by both the employee and the Postal Service. Additional funding is required for general pay increases and for cost-of-living adjustments received after retirement. These costs are paid for by the Postal Service. With FERS, full funding is provided during an employee's years of service and is based on a percentage of an employee's basic pay during employment. It is paid by both the employee and the Postal Service (*pay now* funding). Employee contributions for the basic annuity and Social Security are fixed at 7 percent of basic pay under each plan. The Postal Service contributions on basic pay are as follows:

	CSRS	FERS	Dual
Annuity	7.0%	10.7%	7.0%
Social Security	n/a	6.2%	6.2%
TSP	n/a	1.0% to 5.0%	n/a
Total	7.0%	17.9% to 21.9%	13.2%

The number of employees covered by each of the retirement plans at the end of the last three years are as follows:

	2001	2000	1999
CSRS	248,347	263,383	281,062
Dual	11,440	12,021	12,598
FERS	514,870	510,509	503,233

These numbers reflect the natural reduction of the number of employees covered under CSRS as older employees retire and the increase in the number of employees covered under FERS as new employees are hired.

Deferred Retirement Costs – Civil Service Retirement System. Because the percentage funding of basic pay under CSRS does not provide for general pay increases, additional funding is required when general pay increases are provided. Each general pay increase creates a deferred retirement liability. Each $1 increase in basic pay in 2001 created a $4.279 deferred retirement liability. This amount is amortized and paid in 30 equal annual installments, which include interest computed at a rate of 5 percent per year. The first payment is made at the end of the year in which the general pay increase is granted.

Deferred Retirement Liability – CSRS Retirees' and Survivor Cost-of-Living Adjustments (COLAs). Similar to general pay increases, the percentage funding of basic pay under CSRS does not provide for increases in annuities after retirement. The Omnibus Budget Reconciliation Act of 1990 made the Postal Service liable for its share of cost-of-living adjustments granted to those retirees and their survivors, retiring on or after July 1, 1971. The Postal Service is not responsible for any costs due to federal civilian service before that date. Each year the Office of Personnel Management determines the estimated increase in the Postal Service retirement liability for COLA increases granted by Congress to CSRS annuitants. This amount is amortized and paid in 15 equal annual installments, which include interest computed at a rate of 5 percent per year. The increase in deferred retirement liability for retiree COLAs was $1,668 million in FY 2001.

The deferred retirement liability at the end of the last two years is as follows:

	2001	2000
CSRS basic pay increases	$24,843	$25,857
CSRS retiree and survivor COLAs	7,180	6,326
Total	$32,023	$32,183

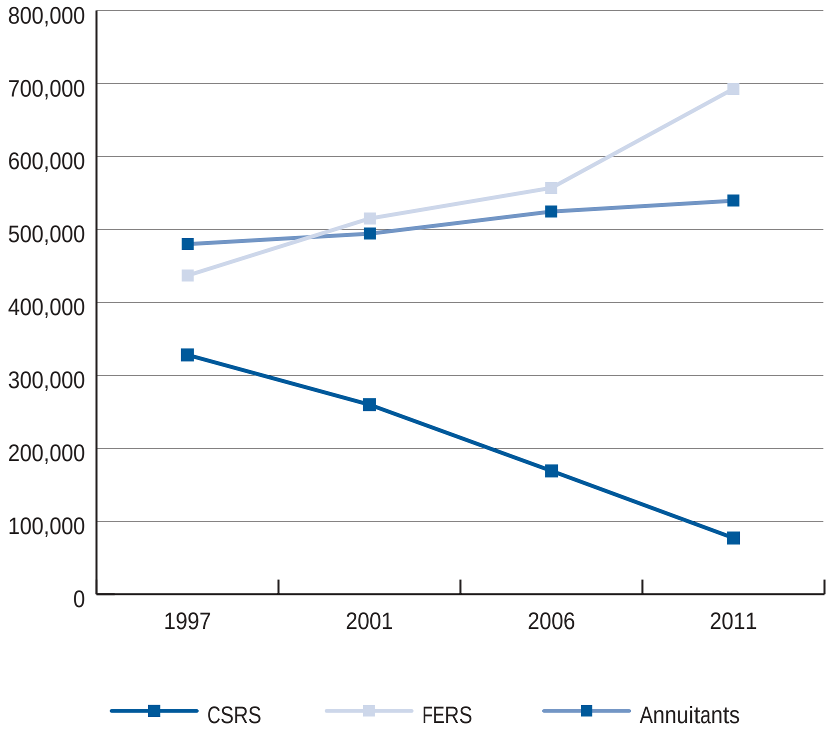
It should be noted that the cost of the annual payment on these deferred retirement costs, $3,750 million in FY 2001, is included in current postal prices.

Problem

The creation of the FERS *pay now* retirement system provides full funding of retirement costs during an employee's years of service. As employees retire under the CSRS *pay later* retirement system, they are replaced by *pay now* or higher current retirement cost FERS employees. The divergence of these retirement systems has created ever increasing retirement costs, since the postal work force is now comprised of more FERS employees while the number of CSRS annuitants continues to increase. The following graph depicts the change in employment levels under each of these retirement systems, as well as the number of CSRS annuitants.

This changing demographic profile of postal employees and CSRS annuitants is causing postal retirement costs to escalate. The following table provides the major components of retirement costs. It reflects the essential stabilization of the *pay later* CSRS costs as the number of CSRS employees decreases and combines with descending CSRS pay increase deferred retirement costs. These declining costs offset the increasing CSRS annuitant COLA costs. However, this stabilization does little to offset the increasing costs of the *pay now* FERS retirement system.

EMPLOYEES AND CSRS ANNUITANTS



MAJOR COMPONENTS OF RETIREMENT COSTS

($ millions)	**1997**	**2001**	**2006**	**2011**
CSRS	$870	$769	$582	$308
CSRS Pay Increase	2,396	2,624	2,465	2,235
CSRS Annuitant COLA	817	1,126	1,504	2,004
Dual	36	33	25	13
Total CSRS	**$4,119**	**$ 4,552**	**$ 4,576**	**$4,560**
FERS & TSP	2,142	2,835	3,567	5,162
Social Security	1,162	1,498	1,885	2,727
Total FERS	**$3,304**	**$ 4,333**	**$ 5,452**	**$7,889**
Total Retirement	**$7,423**	**$8,885**	**$10,028**	**$12,449**
Annuitant Health Benefits	548	858	1,725	3,325
Total	**$7,971**	**$9,743**	**$11,753**	**$15,774**

Options

Escalating retirement costs will exceed inflation rates in the near future, placing additional pressure on the Postal Service to find new ways to reduce costs.

One direct option to mitigate these escalating costs other than through productivity improvement relates to investment of CSRS and FERS retirement fund assets currently managed by the Office of Personnel Management.

Investment Options. The investment of retirement fund assets in other than federal securities at higher rates of returns could increase income generation and minimize the increase in CSRS deferred retirement costs. Private sector, state, and local government pension funds diversify investments to maximize investment return and minimize risk. Investments are made in a combination of fixed income securities, common stocks, real estate, etc. In fact, the federal retirement systems of the Tennessee Valley Authority and the Federal Reserve Board are not required by law to be invested in federal securities. Legislative change will be required to implement this option.

Appendix E

APPENDIX E — Electronic Diversion of Mail Volumes[†]

The “new economy” has been extensively discussed in the popular and academic press. How the Internet will revolutionize everyday life and lead to dramatic changes in business practices, particularly between businesses and households, has been the key topic. Depending upon how communications are transformed by the Internet, the Postal Service could see significant losses in revenue, which could ultimately threaten the Postal Service’s ability to meet its universal service obligation.

The Internet creates both opportunities and threats to the Postal Service. The opportunities come in the form of increased markets for mail products, such as increased package volumes resulting from online retail sales. In addition, recent advances in computing and communications technologies have made the mail an even more efficient medium for direct marketing, as a result of significant improvements in database collection and management.

The threats come in the form of electronic diversion of mail volumes. The term electronic diversion is usually used to characterize the reduction in mail volumes resulting from the use of new electronic alternatives facilitated by the Internet, for example, electronic funds transfer, e-mail, and electronic data interchange instead of the mail. Some electronic diversion of mail volumes to these new media has already occurred. For example, Social Security checks that were previously mailed are now automatically deposited to the recipients’ bank accounts, and electronic filing of tax returns and online bill payments are becoming increasingly popular.

The ultimate effects of the Internet and other new electronic messaging media, such as electronic funds transfer and electronic data interchange, on Postal Service volumes and revenues are still difficult to determine, even though some of these ‘new’ media have been in use for more than a decade. Analysts do not always agree on the timing or level of impact of these new media. Notwithstanding recent fluctuations in e-commerce activity, most analysts do agree, though, that the question is not whether the Internet will have an impact on Postal Service volumes and revenues, but rather when. Even if overall volumes remain at current levels, a change in distribution of mail volumes across classes due to electronic diversion could have a significant impact on the Postal Service’s ability to meet its universal service obligation. According to many analysts, significant electronic diversion could occur within the next five years.

Electronic Diversion Has Already Affected the Postal Service

Throughout its history, the Postal Service has faced competitive threats from many alternative messaging media. Earlier alternatives include the telegraph, the telephone, and the facsimile machine. More recently, alternatives include electronic data interchanges, automatic teller machines, electronic funds transfer, and e-mail, with many of these recent alternatives being supported by the Internet. For nearly a decade, e-mail has been used as an alternative for some business and personal

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[†] This appendix was prepared for the United States Postal Service by Laurits R. Christensen Associates, Inc., an economics consulting firm in Madison, WI, that specializes in regulated industries, including natural gas, electricity, telecommunications, transportation, and postal services.

correspondence, as well as for advertising. Adoption rates for alternative bill payment methods such as pay by phone, by credit card, and by electronic funds transfer have slowly but steadily increased. Federal and state governments have contributed to electronic diversion of mail volumes by encouraging the electronic filing of tax returns and the use of electronic funds transfer for tax payments and refunds. The Paperwork Reduction Act of 1995 resulted in significant diversion of First-Class Mail volumes, including the loss of monthly volumes of Social Security checks, which are now automatically deposited in the recipient's bank accounts.

In spite of the introduction of these competitive messaging media, and a noticeable amount of electronic diversion in recent years, mail volumes have continued to grow over time. However, mail volume growth has slowed in recent years. The official Postal Service data that tracks Revenue, Pieces, and Weight (the RPW Report) shows that volume declined 0.2 percent in Government Fiscal Year (GFY) 2001[1], and growth rates have been steadily declining since 1997. First-Class Mail single piece volumes fell 2.7 percent in GFY 2001, the fourth straight year of declines for this mail category, which includes bill payments. In evaluating the separate factors that affect mail volumes, the official Postal Service forecasting model shows that electronic diversion was one of the principal factors responsible for declines in this mail category. Single-piece First-Class Mail letter volume declined by 3.8 percent over the five-year period ending in the third quarter of 2001, but over the same period electronic diversion is estimated to have caused these volumes to decline by 8.6 percent,[2] thereby more than offsetting any positive effect of economic growth and growth in the number of households.

Total mail volume fell by 5.5 percent in the first quarter of postal fiscal year 2002 over the first quarter of 2001's level, although this decline cannot be attributed to electronic diversion. It will not be known for some time how the events of September and October of 2001 have changed mail volumes in the long run, but these events could be the driving force that leads businesses and consumers to make permanent changes in the way they use the mail.

One indication that the Internet economy is expected to become more important in the future is the fact that the U.S. Department of Commerce now maintains separate statistics on the Internet economy. In addition, research centers have been established at several leading academic institutions to study issues related to the Internet economy. One Internet site compiling links to research centers indicates that there are almost 40 academic research centers now studying these issues.[3]

How Does Internet Activity Affect Postal Mail Volumes?

The Postal Service provides products and services to market segments defined, in part, by specific customer applications. These market segments are:

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[1] GFY 2001 ended on September 30, 2001, so this volume decline includes any transitory effects on mail volume resulting from the September 11th attacks. For Postal Fiscal Year 2001, which ended September 7, 2001, total mail volume grew 1.0 percent.

[2] See Docket No. R2001-1, USPS-T-7 (Testimony of George Tolley), page 37.

[3] www.internetpolicy.org/research/directory.html.

- Bills, statements, and payments (money);
- Business and personal communications (messages);
- Publication delivery (news);
- Advertising (marketing); and
- Package delivery (merchandise).

Within each market segment the demand for various products and services is further differentiated by the relationship between sender and recipient. Communications between businesses differ from communications between businesses and households, which differ from communications between households. Table 1, *Postal Market Segments*, provides a breakdown of the competitive threats and opportunities for the Postal Service by market segment.

While it is relatively easy to identify which Internet activities could affect various mail volumes, the actual impact is difficult to determine at this point in time. For example, one might assume that online catalogs will substitute for the mailed version, thus resulting in lost mail volume. However, consumer surveys show that this is not necessarily the case. Many consumers order from online catalog sites only after having researched products in traditional catalogs. Consumers also request to be added to the mailing lists for offline catalogs from catalog companies they discover during online searches or from online ads, thereby increasing mail volume. This behavior is driven in part by tastes and habits (e.g., some consumers prefer printed catalogs because they are familiar with them, or because they can easily share them with friends). This behavior is also driven in part by technology. Consumers who access the Internet by a dial-up modem may find that online catalog pages download too slow. Future usage of online catalogs is likely to be driven in part by the penetration rates for high-speed modems, cable modems, and home printers.

Another example of the complicated effects the Internet has on mail volumes can be seen with Periodicals mail volumes. Increased usage of e-mail newsletters, online magazines, and online news sources could lead to lower Periodicals and First-Class Mail volumes. Web sites for offline publications can also lead to declining mail volume, in that online subscription signups can lead to a decrease in business reply mail volumes. However, Web sites for offline publications can lead to new subscriptions, and therefore increased mail volume, as new audiences are introduced to the publications through Web searches, pop-up ads, and free trial subscriptions.

TABLE 1: POSTAL MARKET SEGMENTS

Market Segment	Customer Applications	Class/Subclass	Competition/Threat*	Opportunity*
Bills, Statements, and Payments	Bills, bank statements, financial statements, other account information	Presorted First-Class Mail	Online billing, electronic funds transfer, e-mail, electronic data interchange	Increased number of accounts per household
	Bill payments	Single-Piece First-Class Mail	Online billing, electronic funds transfer, electronic data interchange, automated teller machines, payment by credit card, payment in person	Increased number of accounts per household
	Government transfers, including Social Security	First-Class, government	Direct deposit	
Business Communication and Personal Correspondence	Business communications	Single-Piece First-Class Mail, Presorted First-Class Mail; Priority Mail, Express Mail	E-mail, Internet, facsimile, telephone, in person, local couriers, FedEx, UPS, Airborne Express, enhanced electronic data interchange and automated clearing house transactions	Internet (requests for more info, free samples on Web sites), online data (permission-based marketing)
	Other business (e.g., proxy votes, product registrations)	Single-Piece First-Class Mail, Presorted First-Class Mail; Business Reply Mail	E-mail, Internet, facsimile, telephone, in person, local couriers, FedEx, UPS, Airborne Express	
	Personal communications	Single-Piece First-Class Mail, Priority Mail, Express Mail	E-mail, Internet, facsimile, telephone, in person, local couriers, FedEx, UPS, Airborne Express, electronic greeting cards	
	Other (e.g., tax returns, tax payments, tax refunds)	Single-Piece First-Class Mail	E-mail, Internet, facsimile, telephone, in person, local couriers, FedEx, UPS, Airborne Express, direct deposit/debit	
Publications Delivery	Magazines, professional journals, newspapers, newsletters	Periodicals, Standard Mail, First-Class Mail (orders/renewal)	E-mail, alternative delivery services, online magazines/newsletters, Internet news services, TV & radio; online ordering and renewal	Internet subscriptions/free trial offers; online data (permission-based marketing)
Advertising	Direct ad mail	Standard Mail, First-Class Mail, Periodicals (indirect)	E-mail, alternative delivery services, Internet ads, online catalogs	Online data (permission-based marketing); online businesses as mailers
	Catalogs	Standard Mail, Bound Printed Matter	E-mail, alternative delivery services, Internet ads, online catalogs	Online retail sites (can sign up to get catalog mailed); online data (permission-based marketing); online businesses as mailers
Package Delivery	Packages	First-Class Mail, Priority Mail, Express Mail, Standard Mail, Parcel Post	Alternate delivery (UPS, FedEx, Airborne, Express, local couriers)	Online retail sales; online data (permission-based marketing); online auctions

*Effects on all market segments: changes in tastes, economic growth, industry concentration/level of competitiveness, number of households, cost of paper, postal rates

The effects of e-mail on ad mail will depend in part on how the Internet is employed, especially in terms of targeted mailings. Permission-based marketing, where consumers agree to provide information about their interests, buying habits, income, and education levels in exchange for product information, sales notices, and even discounts or coupons, has received much higher response rates (i.e. customer sales and inquiries) on the Internet than the first generation of Internet ads (pop-up ads and banner ads) and unrequested e-mails. Permission-based e-mails achieve response rates as high as 30 percent, while unsolicited e-mails, pop-ups, and banners generally only have response rates of 1 to 2 percent.[4]

The effects of electronic billing on mail volume also depends upon the way the Internet is employed. Some online bill payments still involve bill presentment by mail, and only the bill payment is diverted. Other online billing services and automated payments by electronic funds transfer and credit card usually involve the loss of two mail pieces—the bill presentment/statement and the bill payment, although in the short run billers or payment processors may still mail a statement or payment confirmation in order to attract customers to the electronic alternative.

Secondary effects further complicate the effort of forecasting the effects of alternative messaging media on mail volumes. The impact of these secondary effects is often difficult to predict or quantify. For example, as online retail sales increase, package mail volume is likely to increase[5], and there may also be related increases in catalog mailings and ad mail, if the online purchase results in the placement of the consumer's name on a mailing list. However, permission-based marketing could negatively affect mail volumes, if companies use it for more targeted advertising (online or offline) instead of mass advertising.

The relationship between Internet-based companies and traditional messaging media, including the Postal Service, is also a complicated one. For example, America Online facilitates billions of e-mail messages, but it is also a major user of direct mail, and Amazon.com uses ad mail in addition to e-mail to contact existing customers about sales and to send coupons.

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4 Sources: The Institute for the Future, *The Posts in an Interactive World,* 2001; and Bob Tedeschi, "E-Commerce Report," *New York Times*, August 9, 1999.

5 In a recent Media Metrix study of the top fourteen online retail sales categories, twelve involved the physical shipping of goods (travel services, clothing/apparel, auction, computer hardware/peripherals, books, electronics, computer software, music, health/beauty, home and garden, flowers/gifts/cards, video, fitness/sports equipment, and toys), as opposed to the downloading of music or software.

FIGURE 1: MAIL VOLUMES IN THE ELECTRONIC ECONOMY

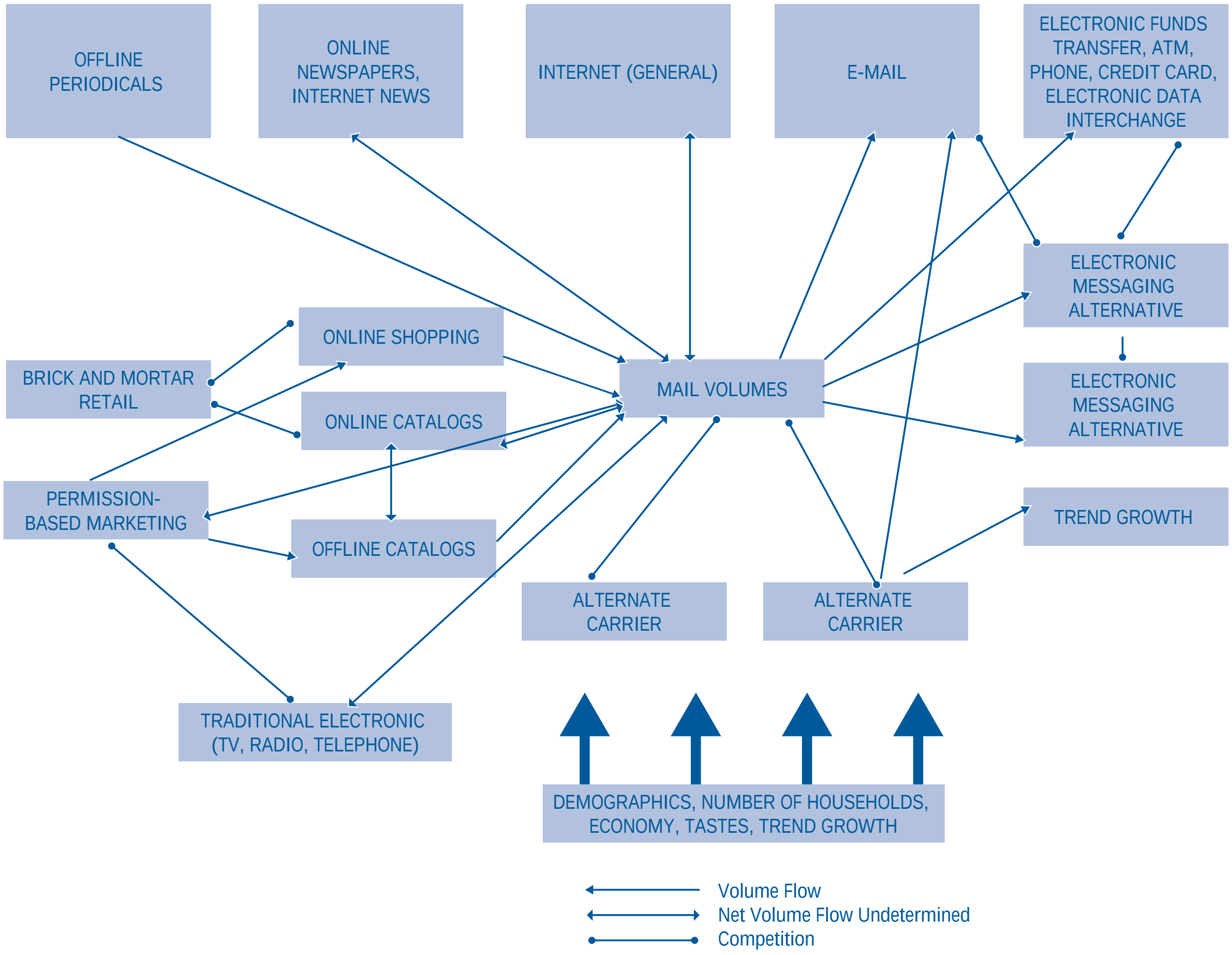

Figure 1, *Mail Volumes in the Electronic Economy*, illustrates the complexity of the interactions between the Postal Service, its competitors, alternative messaging media, and various factors affecting mail volumes, and why it is difficult to determine the effects electronic diversion will ultimately have on the Postal Service.

Forecasts of Electronic Diversion

The Postal Service is constrained in its ability to develop strategies to deal with electronic diversion because of the difficulties in forecasting when and to what degree mail volumes will be diverted. Since these alternative messaging media represent new technologies, historical data do not provide the information needed to develop rigorous forecasts of their use or impact on existing media. There were many cases recently where this failure to forecast the impact of the new technologies was evident. In the mid-1990s, many predicted that the Internet would lead to immediate declines in First-Class Mail volumes, as households and businesses switched from the mail to online alternatives for correspondence, bill presentments and payments, and advertising. For example, the Yankee Group predicted 13.8 million households would pay bills online by 2000, while in fact only 3.4 million people paid bills online by 2000 (Time Magazine-Digital, April 2000).

While there has been some diversion to date, the persistence of personal habits, uncertainty about the security of the Internet, the lack of financial incentives, and competition among electronic alternatives have led to a lower than expected adoption of electronic services by consumers. Furthermore, the high rate of economic growth, increased advertising by bank card issuers, and increased use of direct mail advertising have all led to increases in mail volume until very recently. One must note, however, that changes in these underlying factors, including more widespread adoption of the Internet, could lead to a trend of declining mail volume.

Uncertainty concerning the timing and the degree of the effects of the new economy on mail volumes and revenues stems, in part, from the unpredictable nature of change, especially as it relates to human behavior and habit formation. Postal Service products are well-established and highly valued tools for both businesses and consumers. Survey results show that customers like the ease of use, security, and reliability of Postal Service products. Surveys also show that the primary reasons why households have been reluctant to adopt electronic services like online billing are concerns about security and privacy, as well as control over the timing of bill payments. In addition, there are start-up costs associated with learning how to use online billing systems, and to date most households do not perceive any financial incentive in making the change. Bill payment by mail is a firmly entrenched habit among most bill payers.

Predicting if or when these attitudes will change is difficult. One source for this change is generational differences. Younger adults are more likely to have experience with the Internet and other new media at a younger age than their parents, and therefore are more likely to feel secure making financial transactions online. The Census Bureau found that in 2001 the rate of use of online bill payments was highest for the 25 to 34 age group. These generational differences have implications for future mail volumes, as the degree to which consumers are aware of and feel secure with financial transactions over the Internet is directly related to the level of online experience. As Internet services evolve, financial incentives, technological innovations, customer service improvements, and security improvements will determine, in part, the degree of migration to electronic messaging media.

One must also recognize that the Internet is a new, rapidly developing, and still evolving technology. Many businesses and consumers do not want to make the investment in adopting an Internet service like online billing until a dominant technology is established. Payment processors have driven costs from traditional processing technologies and will be reluctant to change to Internet technologies until the financial incentive to do so is clear. Some businesses have also indicated a reluctance to adopt online billing because of the perceived lack of control over customer contact and customer service with current electronic billing methods.

Current forecasts of online billing adoption are more modest than the forecasts of a few years ago, but still represent significant challenges for the Postal Service. Two consulting groups have projected that approximately 40 percent of households will be paying bills online by 2004.[6] This level of diversion would substantially impact Postal Service mail volume and net revenues.

By 2004, most billers and payment processors will be capable of meeting any demand for online bill payment—by year-end 2000, nearly half of all high-volume U.S. consumer billers were already capable of presenting consumer bills on the Internet. Households will also have the technical capability to use Internet services. According to the Census Bureau, in 2001 over half of all households had access to the Internet.[7] Not only will this percentage increase in the near future, but more households will also have substantially faster access to the Internet. Jupiter Media Metrix forecasts that 71 percent of the population (210.8 million people) will have online access by 2006, and more than thirty million households will have broadband access to the Internet by 2005. However, there is still a question as to whether households will embrace the new technology for bill payments. The Institute for the Future found in 2001 that 65 percent of North American consumers indicated that they were uncomfortable with electronic billing and less than 10 percent of consumers were using online bill-paying services.

Surveys show that a household’s comfort level with the security of the Internet for financial transactions is directly related to the level of experience with other Internet activities. Households are increasingly using the Internet for services beyond e-mail and information searches. In the last half of 2000, Nielsen/NetRatings found that 74 percent of online users in the United States browsed for products online, and 30 percent purchased products online. Jupiter Media Metrix forecasts that online retail sales will reach $104 billion in 2005, and $130 billion by 2006. In a March 2001 survey, Jupiter Media Metrix found that online buyers are increasingly less hesitant to register and give out personal information to retailers. Seventy percent register to receive e-mail for new products and special offers, 68 percent register prior to making a purchase, 50 percent register to store personal information on the site, and 41 percent register to receive mail via the Postal Service on products and special offers.

Electronic Diversion May Lead to Higher Rates and Reductions in Service Even if Overall Mail Volume Continues to Increase

In the Postal Service, there are substantial costs that are not related to the volume of mail delivered. For example, the costs associated with sending carriers on their delivery routes do not increase or decrease in proportion to mail volume fluctuations. In the Postal Service rate-setting environment, markups over volume-related costs are used to develop rates so that revenues cover non volume-related costs. The markups for First-Class Mail volumes are higher than for other mail classes, so First-Class Mail makes a larger contribution to covering the non volume-related costs than other mail classes.

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[6] The Gartner Group assigns a 60 percent probability to this forecast. Jupiter Media Metrix forecasts a similar adoption rate for online billing (40.2 million households), but by 2005.

[7] According to the results of the September 2001 Current Population Survey, as reported in “A Nation Online: How Americans are Expanding Their Use of the Internet,” compiled by the National Telecommunications and Information Administration and the Economics and Statistics Administration.

The mailstream most vulnerable to electronic diversion is First-Class Mail letters. In Government Fiscal Year 2001, First-Class Mail letters and cards accounted for 46 percent of all mail volume, 47 percent of all revenue from mail (excluding services like Certified Mail), and 66 percent of contribution to cover non-volume costs. The contribution per piece for First-Class Mail letters was $0.177, and, in contrast, was only $0.061 for Standard Mail. This difference in contribution per piece is what makes the change in mail mix so important to the Postal Service. When one piece of First-Class Mail letter mail is diverted, but total volume stays the same because there is one additional piece of Standard Mail, contribution falls by almost $0.12.

Because of these differences in contribution per piece, a substantial change in the mail mix involving a decrease in First-Class Mail volumes, even if an increase in Standard Mail volumes leads to overall mail volume growth, will threaten the Postal Service's ability to cover non volume-related costs.

The Postal Service, the Internet and the Future

As is often witnessed during the early stages of technological innovation, change seems to take longer than those who are promoting the change would like, which makes forecasting difficult. For example, the electrical dynamo was supposed to be the breakthrough of the 19th century, when it was introduced. However, it took decades before the use of electricity became widespread. There were lags in the diffusion of electricity in the production economy, even though it was a superior production input. As Barua, et al. state, "It wasn't enough that visionaries could see the potential of new technological breakthrough."[8] Electricity gained widespread acceptance only after organizations re-engineered their business processes to suit the new technology and after a generation of workers learned how to use the new technology (i.e., when complementary innovations were made). This history provides some insight into the process by which the Internet may come to affect the economy in the future.

The new economy will continue to evolve—further changes in the scope and nature of e-commerce transactions are expected because electronic business methods permit the players to change their roles relatively easily and they will increasingly do so (e.g., manufacturers and wholesalers selling directly to consumers over the Internet).[9] The focus, however, is starting to shift from one of technology to one of information. Two years ago, a survey of marketing managers found that problems with online marketing were related to processing payments, getting page-download times under seven seconds, preventing fraud, and having an easy checkout process. Recently, this ongoing survey showed that the problems cited by marketing managers are now personalization, assorted ad formats, and rich media e-mail.[10] This indicates that there is a shift in focus from making Internet services possible to making their adoption probable. Service providers on the Internet are progressing to the point of fine-tuning their services, indicating that more diversion of mail volumes is likely.

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8 Barua, et al., "Measuring the Internet Economy: An Exploratory Study," Working paper, Center for Research in Electronic Commerce, University of Texas at Austin, 1999; Paul A. David, "The Dynamo and the Computer: An Historical Perspective on the Modern Productivity Paradox," *American Economic Review*, May 1990, 355-361; Robert J. Gordon, "Does the 'New Economy' Measure Up to the Great Inventions of the Past?" *Journal of Economic Perspectives*, Fall 2000.

9 Mesenbourg, Thomas L. "Measuring Electronic Business: Definitions, Underlying Concepts, and Measurement Plans." www.census.gov/epcd/www/ebusines.htm (1999).

10 Alexis D. Gutzman, "The Biggest Problem in Online Marketing," Ebusiness Illuminator (http://ecommerce.internet.com/news/insights/ebiz/print/0,,10379_805821,00.html) July 20, 2001.

Some would point to continued use of printing and writing paper and consumers' revealed preference for paper as indicators that the Postal Service is not facing significant electronic diversion. However, in early phases of new technology adoption, there are typically transition periods where both old and new technologies are used concurrently before a full transition to the new technology takes place.

It is important to note that Internet growth and the resultant changes in business practices are not necessarily a foregone conclusion. Paul Romer, professor of economics at the Stanford Graduate School of Business and an expert in economic growth theory, warns against a *technological determinism*, that is, a belief that technological progress will continue along a given trajectory regardless of the choices people make. Not only will the Internet shape society, according to Romer, but society will reshape the Internet through its decisions about taxation, antitrust policy, support for new types of standards organization, privacy and intellectual property rights protection, and regulation of bandwidth connectivity.[11]

The ability of the Postal Service to help shape its own future in this regard, either through cost reduction, productivity improvement, new product development, or through partnerships with online businesses, will depend in large part on the regulatory structure in place in the future. The Internet is bringing significant changes to the way businesses operate and compete, and flexibility is needed to respond to these changes. Likewise, the mailing industry can continue to have a hand in shaping business and personal communications, not only through the products and services provided, but also through emphasizing and reminding customers of its strengths—the reliable, secure, private, and timely provision of information services in a form consumers prefer, and especially the joy provided by personal communications. What happens with First-Class Mail volume trends will depend, in part, on how tastes change over time, and whether the mailing industry can do anything to affect tastes. Even with this effort, the Postal Service is likely to face significant challenges in the near future in determining how to respond to further electronic diversion while meeting its universal service obligations.

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11 George J. Church, "The Economy of the Future?" in *Time*, November 29, 1999.

Appendix F

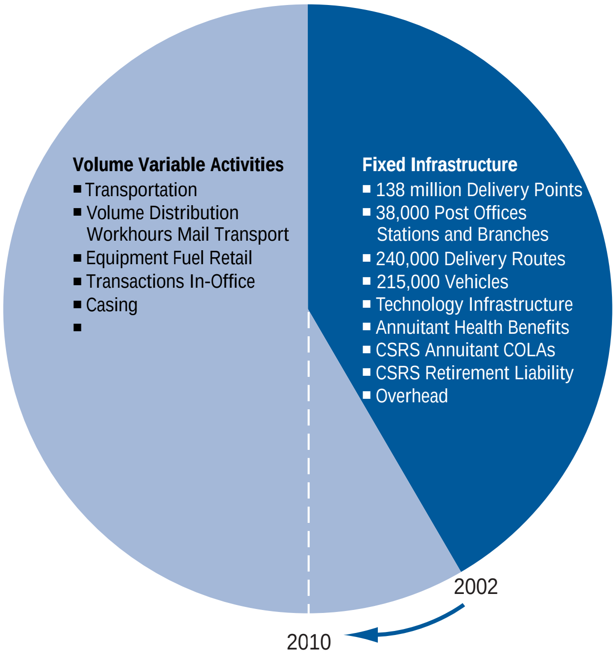
APPENDIX F — Fixed Versus Variable Costs

The universal service obligation requires a significant infrastructure investment. Almost one-half of total postal costs are spent on fixed costs. Examples include most of the cost related to more than 38,000 post offices, stations and branches; 240,000 delivery routes to service over 137 million delivery addresses; 215,000 vehicles and significant annuitant retirement costs. Technology infrastructure and other overhead costs are also mostly fixed.

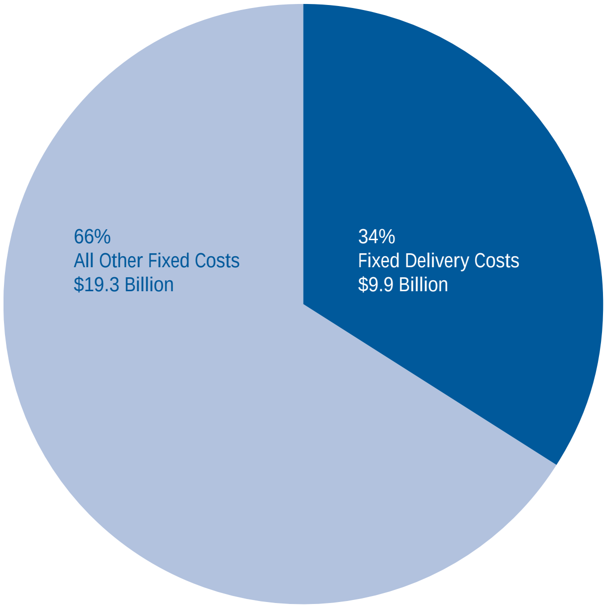
The “every day” portion of the universal service obligation contributes significantly to these fixed costs. A significant portion of postal costs is spent on fixed resources and does not increase or decrease when volume changes. Letter carriers travel their complete routes, making over 500 million new delivery stops annually; trucks transport mail between facilities each day to meet service commitments, and retail facilities are open each business day no matter what level of activity occurs. Nearly one-half of all postal costs are fixed and their proportion of total cost will continue to increase. Of these fixed costs, $10 billion is directly related to the Postal Service’s delivery obligation.

As indicated in Appendix D, the Postal Service faces significant future costs due to payment of deferred retirement costs, CSRS annuitant COLAs and annuitant health benefits. The Civil Service Retirement System costs for retired or soon to be retired employees, will have to be paid, regardless of future volume growth or volume decline. Because much of this cost is fixed and growing, it will continue to be a significant cost.

The increasing proportion of fixed costs also exposes the Postal Service to the danger of rising unit prices. Postal prices must cover both fixed and variable costs. If volume remains constant or declines, a rising pool of fixed costs will have to be covered by a constant or lower volume base. In addition, as discussed in Appendix E, there is a real danger of possible volume declines. This would lead to more fixed costs per piece and higher overall unit prices.



FIXED VS. VARIABLE COSTS



TOTAL FIXED COSTS

Appendix G

APPENDIX G — Global Postal Competitors in the United States[†]

The U.S. Postal Service delivers more than 200 billion pieces of mail each year, accounting for over 40 percent of the world's mail, making the United States the largest national market for parcel, express, and direct mail services. As international postal competition intensifies, global postal operators are looking to the U.S. market as one of the most attractive opportunities for business expansion.

Several global postal operators now enjoy extensive commercial freedoms. They are rapidly gaining global market share by way of numerous acquisitions. They have the financial ability, commercial ambition, and international presence needed to go after the U.S. postal market. In fact, many of these players are already here.

Exhibit 1 highlights key financial data and strategic observations for Deutsche Post World Net (Germany), TNT Post Group (TPG) (The Netherlands), Consignia (United Kingdom), and the U.S. Postal Service. A second exhibit lists selected acquisitions, equity stakes, and alliances for seven international postal competitors, and a third exhibit illustrates the broad presence of key foreign posts in the United States.

[†] This appendix was prepared for the United States Postal Service by PricewaterhouseCoopers' Mail, Package, and Freight industry group, Washington, DC.

EXHIBIT 1: KEY FINANCIAL DATA AND STRATEGIC OBSERVATIONS

	Deutsche Post World Net	**TNT Post Group**	**Consignia**	**U.S. Postal Service**
2000 Revenue	$29.4 B	$8.9 B	$10.8 B	$64.5 B
Average Annual Revenue Growth Rate	27% 1996 to 2000	16% 1996 to 2000	6% 1997 to 2001	3% 1996 to 2000
2000 Revenue by Division	Mail: 34.5% Express: 17.7% Financial: 23.5% Logistics: 24.3%	Mail: 36.9% Express: 41.3% Logistics: 21.8%	Mail: 85.8% Counters: 15.5% Other: 3.5% Sales between segments: -4.8%	Mail: 96.6% Special Services: 3.4%
Cumulative 5-Year Net Income	$3,747 M 1996 to 2000	$1,657 M 1996 to 2000	$2,468 M 1997 to 2001	$3,545 M 1996 to 2000
Average Annual Net Income Growth Rate	58% 1996 to 2000	22% 1996 to 2000	2% 1997 to 2001	-66% 1996 to 2000
2000 Net Income by Division	Mail: 74.3% Express: 2.8% Financial: 18.7% Logistics: 4.2%	Mail: 69.5% Express: 19.2% Logistics: 11.3%	Mail[1]: 75.3% Counters[1]: 12.1% Other[1]: 12.6%	
Other	▪ Has established a Political Action Committee in the United States	▪ Consignia/TPG/Singapore Post alliance: Reposition Royal Mail and TNT International Mail brands in United States as: “Spring”	▪ Consignia/TPG/Singapore Post alliance: Reposition Royal Mail/TNT Intl. Mail brands in U.S. as: “Spring” ▪ USPS/Consignia Outbound deal	▪ USPS/DHL Global Priority Mail Guaranteed partnership ▪ USPS/Consignia Outbound deal
Possible Next Steps	▪ Buy competitor? ▪ Alliance/merger with parcel/mail consolidator ▪ Alliance/merger w/ parcel/express competitor ▪ Extend relations with South Am. posts.	▪ Buy competitor? ▪ Alliance/merger with parcel/mail consolidator ▪ Alliance/merger with parcel/express competitor		

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[1] Consignia Profit by Division is before “exceptional items.”

Source: Annual reports from USPS, Deutsche Post World Net, TNT Post Group, and Consignia. 1996 – 2001.
Note: Revenue and net income data is based on varying national accounting standards.
Note: Revenue and net income data is based on 12/13/2001 foreign exchange rates.

Global Postal Market Leaders

The global postal/parcel/express market is evolving rapidly. As recent trends continue, anticipating further acquisitions and alliances would be prudent. Because acquisitions and alliances are generally kept confidential until consummated, this overview can only suggest logical possibilities based on past developments and known tendencies. As such, the opinions presented below are proposed simply as educated guesses based on historical industry observations and are not based on partial or substantial facts.

TNT Post Group (TPG)

The Dutch postal operator, TPG, is the second largest express company in the world and a global player present in more than two hundred countries, largely due to its 1996 acquisition of global courier company TNT. Today, TNT Post Group—publicly traded on the New York, London, Frankfurt, and Amsterdam stock exchanges—is one of the largest global postal operators. It has experienced an average revenue growth rate of 16 percent from 1996 through 2000. Domestic mail represents 36.9 percent of its revenues and as much as 69.5 percent of its profits. TPG has experienced an average profit growth rate of 22 percent from 1996 through 2000, as a result of its prolific acquisition activity during the same period, illustrated in Exhibit 2. TPG is the dominant partner in a three-way alliance with Consignia and Singapore Post called *Spring*, which bills itself as “the world’s largest business mailing partnership.” Currently, this alliance is present in the United States through the TNT International Mail and Royal Mail services, but these brands will be replaced with the Spring moniker over the course of 2002.

EXHIBIT 2: SELECTED LIST OF ACQUISITIONS, EQUITY STAKES, AND ALLIANCES BY REGION

EUROPE

Deutsche Post World Net

Acquisitions

A Post A/S, DK
Ascoli, IT
ASG, SE
Correct Express, NL
Danzas, CH
Deutsche Postbank, DE
Deutsche Telekom, DE
DHL International, BE
Ducros, FR
Herald International Mailings, UK
ITG Internationale Spedition, DE
McPaper Aktiengesellschaft, DE
Merkur Direktwerbeges, DE
Nedlloyd ETD, NL
Pakedienst GP Paketlogistik, CH
Qualipac, CH
Trans-o-flex, HU
SAV, IT
Schnell-Lieferdienst, AT
Selektvracht, NL
Servisco, PL
Van Gend & Loos, NL
Vindo Logistik, AT
VOP Colli-Service, BE

Equity Stake

GFT Technologies, DE
Global Freight Exchange, UK
Guipuzaoana, ES
MIT, IT
Narrondo Desarrollo, ES
Securicor, UK
zouk Holding Ltd, UK

Alliances

Amazon.de, DE
BPD, AT
Bright Station/Sparza, UK
Cardo Door, SE
Deutsche BA, DE
Fiat Auto, IT
GMX, DE
Hapag-Lloyd Group, DE
Lufthansa Cargo, DE
Nexgo, DE
Ricardo, DE
Scandinavian Garment Service, DK
TOMORROW Internet, DE

TPG

Acquisitions

Advanced Logistics Services, IT
ASE Transport, IT
ATOS/ Direct Marketing, BE
Barlatier, FR
BBR, IT
Bleckmann Group, NL
Broos Fouya, FR
Cargotech, TR
Convoi, NL
Datus/CAK, NL
Florentia, ADRA, Bologna & Modena, IT
Genova Sprint, IT
GFW, AT
GMA Verwaltungs, DE
Go Express, IT
Goldair Super Express, GR
Great Glen, IE
Holland Districare, NL
IVA Data Entry Services, NL
Jet Services, FR
Lason UK Group, UK
Logistics Taylor Barnard, UK
Mendy, FR
Motomail, IT
Olaf Jepsen, DE
Omnidata, NL
Pony Express, IT
Rinaldi, IT
Romcargo, RO
Schrader Group, DE
Spedimacc, IT
Taylor Barnard, UK
Tecnologistica, IT
Tesselaar Marketing Services, NL
Tranjato, PT
Treviso & Patavina, IT

Equity Stake

CD Marketing Services Group, UK

Alliances

Consignia, UK
Hermes Versand Service, NL
Koc Group, TR
P&T LU, LU
Poste Italiane, IT
Styria Medien, AT
Swiss Post, CH
VNU and Sanoma Uitgevers, NL

Consignia

Acquisitions

Crie Group, FR
City & Financial Intl, UK
Der Kurier, DE
Direzione Gruppo Executive, IT
Domberger Paket Dienst, DE
Extand, FR
Nederlandse Pakket Dienst, NL
Pakke-Trans A/S, DK
Williames Group, IE

Equity Stake

General Parcel, DE
Stafetten, DK
Szybka Paczka Spolka, PL

Alliances

Opus Trust, UK
Selektvracht, NL
TPG, NL

La Poste

Acquisitions

Ae’ropostale, FR
Caisses d’Epargne, FR
Denkhaus, DE
Deutscher Paket Dienst, DE
DPD, FR
Geodis, FR
INSA, FR
Interlink Express, IE
Mikros, IT
Mayne Nickless Europe, AU
Parceline, UK
Soge’poste, FR

Equity Stake

CNP, FR
Modeus, FR
Moneo, FR

Alliances

Caisse des De’pots et Consignations, FR
BNP Paribas, FR
Post eCS, FR
Poste Italiane, IT
SAGEM, FR

USPS

Alliances

Consignia, UK
Lynx Express, UK

EXHIBIT 2: CONTINUED

NORTH AMERICA

Deutsche Post World Net

Acquisitions
Air Express Intl, US
BHF Holdings, US
Global Mail, US
Skymail International, US
QuickMAIL, US
Yellowstone International, US

Equity Stakes
DHL International Ltd, BM
Open Harbor, US

Alliances
Amazon.com, US
First Data Merchant Svcs, US
IBM, US
Netship, US

TPG

Acquisitions
Classic Cold, CA
CTI Logistx, US

La Poste

Acquisitions
INSA, US

Equity Stake
Brokers Worldwide, US

Alliances
FedEx, US

Consignia

Acquisitions
CitiPost, US

Alliances
USPS, US

Canada Post

Acquisitions
Progistix-Solutions, CA
Purolator, CA

Alliances
Bank of Montreal, CA
BigOrangeBOB.com, CA
Cebra, CA
Clic.net Telecom, CA
Deloitte & Touche, CA
Desjardins, CA
MSN.ca, CA
Planet411, CA
Post eCS, CA
Postlinx, CA
SAP CA, CA
Scotia Bank, CA
Silanis Tech, CA
USPS, US

USPS

Alliances
AT&T, US
Airborne, US
CA Post Corporation, CA
CheckFree, US
DHL Airways, US
FedEx, US
IBM, US
Imagitas, US
Mailboxes Etc, US
Overnite Express, US
Post eCS, US
Returns Online, US
Swift Rivers Inc, US
Switchboard Inc, US
Warner Brothers, US
Youraccounts.com, US

REST OF WORLD

Deutsche Post World Net

Acquisitions
Letterbox AUtralia, AU
Skymail AUtralia, AU

Alliances
AEI Maruzen, JP
OCA, AR

TPG

Acquisitions
Ansett Air Freight, AU
Caxton Distributors, HK
PQR Delivery Services, SG
T.E.I., TH
TNT, AU

Alliances
Shanghai Automotive Industry Corporation, CN
Kintetsu World Express, JP
Singapore Post, SG
Korea Post, KR

Consignia

Alliances
Singapore Post, SG

Australia Post

Alliances
AUtrapay, AU
Coles Online, AU
Commonwealth Bank, AU
Corprocure, AU
ninemsn, AU
Royal & Sun Alliance, AU
SmartBuy, AU
Tandy Electronics, AU
Telstra, AU
Transpoint, US
Unysis PSL, AU
Western Power, AU

New Zealand Post

Acquisitions
Couriers Please, NZ
Message Media, NZ

Equity Stake
Datacom NZ, NZ
Dawson Group, NZ
Electronic Commerce Network, NZ
Infolink, NZ
PacStream, AU
Silent One, NZ
TEDIS, AU
Viatx, NZ

Alliances
CheckFree, US
Synergy International, NZ
Whitcoulls & Bennetts, NZ

Spring is making increased use of a number of “extraterritorial offices of exchange” in the United States—offices where foreign postage is applied to outbound international mail acquired in the United States. (For further information on “extraterritorial office of excharge” see Appendix I, Overview of Universal Postal Union.) Most of these offices can be found in Exhibit 3.

TPG is clearly interested in the North American market. Through the acquisition of CTI Logistx in 2000, TPG has established TNT Logistics North America. Calling itself an “innovative leader in global third-party logistics,” TNT Logistics North America offers supply chain and Internet-based solutions as well as operations-centric, back-end fulfillment. It is reported to cover North America by way of two hundred “operations” in the United States, Canada, and Mexico. In the future, further penetration into the U.S. market by TPG should be expected.

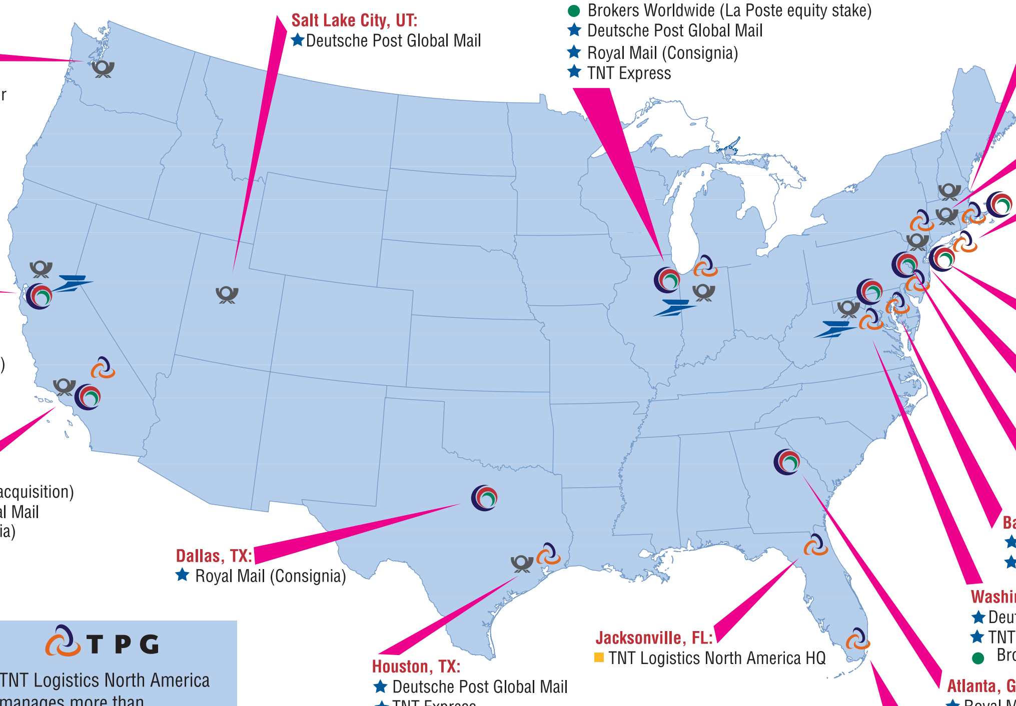
TPG has a history of remail activities. An alliance between TPG and a large mail preparation company such as RR Donnelly or Quad Graphics seems plausible. Similarly, an alliance or merger between TPG and FedEx appears plausible because the two companies appear to complement each other. A UPS–TPG merger is likewise a possibility, especially if the Dutch government loses its right to veto such arrangements (an issue now under investigation by European competition authorities). Still another remote possibility is a TPG purchase of Airborne Express. In 1987, as the single largest shareholder, it was reported that TNT attempted a hostile takeover of Airborne Express, having bought approximately 15 percent of the company. TNT courted Airborne Express for an additional four years, before it divested its shares in 1991.

Deutsche Post World Net (DP)

German national postal operator, DP, has invested more than $4 billion over the last five years on numerous acquisitions around the world as listed in Exhibit 2, including a 72 percent stake in DHL and a takeover of logistics company, Danzas. DP focuses on four key business areas: mail, express, financial, and logistics. DP is listed on all eight German stock exchanges, including the primary stock exchange in Frankfurt. In 2000, only 34.5 percent of its revenues were derived from its mail business with remaining revenues split evenly between the other three business units. DP has rapidly increased its international revenue share to 29.2 percent. Of that revenue, $1.3 billion or 14.7 percent is derived from the Americas (North and South).

EXHIBIT 3: PRESENCE OF FOREIGN POSTS IN THE UNITED STATES

Selected Acquisitions, Equity Stakes, and Major Offices as of January 2002



Seattle, WA:
★ Deutsche Post Global Mail
■ Danzas World Service Center

San Francisco, CA:
▲ DHL HQ (DP acquisition)
■ Open Harbor (DP equity stake)
● CitiPost (Consignia acquisition)
● Brokers Worldwide (La Poste equity stake)
★ Deutsche Post Global Mail
★ Royal Mail (Consignia)

Los Angeles, CA:
● CitiPost (Consignia acquisition)
★ Deutsche Post Global Mail
★ Royal Mail (Consignia)
★ TNT Express

Salt Lake City, UT:
★ Deutsche Post Global Mail

Dallas, TX:
★ Royal Mail (Consignia)

Houston, TX:
★ Deutsche Post Global Mail
★ TNT Express

Chicago, IL:
■ Open Harbor (DP equity stake)
● CitiPost (Consignia acquisition)
● Brokers Worldwide (La Poste equity stake)
★ Deutsche Post Global Mail
★ Royal Mail (Consignia)
★ TNT Express

Jacksonville, FL:
■ TNT Logistics North America HQ

Boston, MA:
● CitiPost (Consignia acquisition)
★ Deutsche Post Global Mail
★ Royal Mail (Consignia)
★ TNT Express

Darien, CT :
■ Danzas North America HQ

New York, NY:
● CitiPost (Consignia acquisition)
$ BHF (USA) Holdings (DP acq.)
★ Deutsche Post Global Mail
★ Royal Mail (Consignia) office
★ TNT Express (2 offices + JFK)

Garden City, NJ:
★ TNT USA HQ

Newark, NJ:
★ TNT Express

Philadelphia, PA:
★ Royal Mail (Consignia)
★ TNT Express

Baltimore, MD:
★ Royal Mail (Consignia)
★ TNT Express

Washington, DC:
★ Deutsche Post Global Mail
★ TNT Express
● Brokers Worldwide (La Poste equity stake)

Atlanta, GA:
★ Royal Mail (Consignia)

Miami, FL:
★ TNT Express

Deutsche Post World Net
MAIL EXPRESS LOGISITICS FINANCE

- Deutsche Post Global Mail consists of several acquired US companies, including Global Mail, SkyMail, QuickMail, IPC, International Mail Services, and Yellowstone International
- Danzas has 93 U.S. offices
- Netship (acquisition) has 450 warehouse and shipping centers in the US
- Strategic alliance with IBM
- Alliance with First Data Merchant Services

TPG

- TNT Logistics North America manages more than 200 operations in USA, Canada, and Mexico

LA POSTE

- 40% equity stake in Brokers Worldwide
- Acquired International Newsprint Services of America (INSA)

Consignia

- European delivery alliance with USPS
- CitiPost has subcontracted operations in 155 additional US locations

Source: PricewaterhouseCoopers

★ Sales Office
● Mail
▲ Parcels
■ Logistics
$ Financial Services

Consequently, 4.3 percent of its total revenue is derived from the Americas. Its mail business is clearly the most lucrative business unit with a 74.5 percent share of overall profits. DP has experienced an average revenue growth rate of 27 percent from 1996 through 2000 and a 58 percent profit growth rate over the same period—largely due to its significant acquisition activity mentioned earlier.

DP initially focused on (1) consolidating its European parcel organization and (2) developing its global express/freight services. More recently, DP has stepped up its activities in the U.S. market with acquisitions under the Deutsche Post Global Mail brand such as: Global Mail, Yellowstone International, QuickMail, and SkyMail. Deutsche Post Global Mail—focusing on international mail services, direct mail, press, and merchandise distribution—has established a substantial sales presence in the United States, as depicted in Exhibit 3, and now claims to be the second largest exporter of mail from the United States (after the Postal Service). Moreover, DP's Danzas North America has solid traction in the growing U.S. logistics market with 93 offices spread throughout the United States. Further, through its financial services subsidiary Deutsche Postbank, DP has acquired BHF Holdings, a New York-based bank focusing on corporate financing and commercial real estate loans. With this acquisition DP has obtained a strategic financial platform to support U.S. and worldwide logistics operations.

Consignia

Another global postal operator vying for international postal markets is Consignia, the recently corporatized British postal operator. While Consignia only attained the commercial freedoms it was seeking in 2000—later than it wished, as many prime candidates had already been acquired—its competitive ambitions clearly include the international and global postal markets. Consequently, Consignia has expanded its market reach providing international mail services under the Royal Mail brand in the United States, France, Germany, the Netherlands, Belgium, and Spain. Consignia operates nine sales offices throughout the United States under the Royal Mail brand, all listed in Exhibit 3. In spite of its recent international activity, Consignia's international strategy is strained due to its late arrival on the international scene. Consignia is now playing catch-up in a game with rules set by the likes of TPG and DP. While Consignia has acquired more than a dozen private parcel carriers since 1999, 96.6 percent of its revenues are still derived from its mail business, as are 75.3 percent of its profits. When compared to TPG and DP, Consignia has experienced a relatively modest average revenue growth rate of 6 percent from 1997 through 2001 and a 2 percent profit growth rate over the same period.

FedEx and UPS

The global postal ambitions of UPS and FedEx should not be overlooked. UPS grew its average daily package volume for international operations by 3 percent from 1998 to 1999 and by 14 percent from 1999 to 2000. UPS and FedEx, building on a strong domestic presence, are growing their international business. Both offer their customers much more than package delivery. Aside from their core services, they both offer supply chain solutions such as fulfillment and logistics support, and both have a sophisticated suite of e-business offerings.

UPS in particular has stepped up its presence in the U.S. mail market by expanding its portfolio to include a number of mail-specific services. These new services are marketed as an extension of UPS' strategy to enable global commerce. UPS cites expedited delivery times, production efficiencies, and cost savings as key benefits of these new mail services. Currently, these services are for First-Class Mail and standard mail and include: Hybrid mail – letters are electronically sent, then printed and inserted into the U.S. postal system at the point nearest to the final destination. Flats—UPS has acquired Reno, NV-based RMX in order to offer flats pre-sort services. Presort—a daily mail pick-up service, specifically for small-and medium-sized businesses. UPS Presort was initially piloted in Georgia and has been expanded to include the Dallas/Fort Worth area.

This broader set of services enables UPS to effectively "sweep the mailroom," that is, fulfill demand from business customers for both express and mail services. With a national distribution network already in place, UPS is well positioned to selectively compete for the most profitable segments of the mail market. As such, UPS seems to be well prepared for a potential liberalization of the U.S. mail market.

Implications for the U.S. Postal Service

Global postal market leaders such as DP and TPG are eyeing the U.S. parcel and express markets, threatening the position of the U.S. Postal Service in the two segments that will be increasingly important to the U.S. Postal Service if the First-Class Mail letter business declines.

These global postal market leaders have been supported by their national governments through liberalization, deregulation, and commercial freedoms and, short of antitrust restrictions, are not restrained from any regional or international expansion. Further, major domestic delivery companies, such as UPS, are expanding their services in the U.S. mail market. Indeed, these companies would surely look seriously at commercial prospects arising from deregulation of the U.S. postal markets. DP and TPG are already reaping the benefits of legislative and organizational transformation.

Should these competitors be given broader market access as a result of deregulation, they are already positioned to build a credible threat to the U.S. Postal Service. If the U.S. Postal Service is not given more commercial freedom, it will be unable to respond to today's competitive market, either domestically or globally. It is not a question of *if* this will happen, but *how* and *when* it will happen.

Appendix H

APPENDIX H — Postal Transformation — The International Experience[†]

Executive Summary

The regulatory and competitive landscape of the postal sector in most of the industrialized world has changed irreversibly over the past fifteen years. As postal operators have become corporatized, even privatized, and national postal monopolies have been reduced or repealed, the old industry atmosphere of cozy cooperation has given way to one of fierce competition of regional and global scale. Over the next decade, regulatory reforms and an expansion of competitive freedoms will likely continue. Successful privatization of the Dutch and German postal services will exert a powerful influence on debates in other countries about appropriate models for postal transformation.

Although there are significant differences across countries and postal operators, most postal transformation efforts have followed similar paths and depended on three fundamental elements—corporatization, a reduction in the scope of the letter mail monopoly, and independent regulation.

Corporatization. Six of the seven postal operators included in this study have been transformed into postal corporations. The seventh, Japan's Postal Services Agency (PSA), is due to be corporatized by 2003, although details are undecided. Corporatization has allowed postal operators to use many traditional private sector management tools to improve productivity and profitability, while fulfilling their universal service obligations. By taking steps, ranging from the reduction of job protection to pay-for-performance programs, corporatized postal operators have been able to improve productivity dramatically. Similarly, the freedom to employ competitive pricing practices or to divest unprofitable business units or outlets has materially improved the bottom-line for many operators.

With corporatization has come an increasing opportunity for postal operators to leverage their assets and experience to expand product and service offerings. All the postal operators discussed, except Canada Post Corporation (CPC) and the PSA, are able to borrow private capital without government approval; and all except the PSA are free to participate in joint ventures and form subsidiaries.

Reduction in the scope of the letter mail monopoly. Monopoly reduction has been a key element of transformation. Governments in most of the countries included in this study have reduced the postal monopoly; three (the United Kingdom, Sweden, and New Zealand) have abolished the postal monopoly.

Independent regulation. Each government in this study has continued to regulate the postal market, usually through an independent regulator, to ensure a level playing field in markets previously dominated by an incumbent postal operator.

[†] This appendix was prepared for the United States Postal Service by PricewaterhouseCoopers' Mail, Package, and Freight industry group, Washington, DC.

In response to corporatization and changes in postal regulation many postal operators have expanded both their geographical presence and service offerings. They have done so while improving operational efficiency and maintaining a universal service obligation.

Strategic reexamination. The most successful transformation stories have been initiated by a major strategic reexamination and subsequently marked by committed adherence to resulting long-term strategic plans. In this respect, Deutsche Post World Net (DPWN) and TNT Post Group (TPG) represent particularly successful examples of reform.

Regional/Global expansion. Through aggressive acquisition strategies, DPWN and TPG have expanded internationally to become dominant regional and global logistics operators. Sweden Post (SP) and Consignia are also looking to expand their logistics presence.

Service diversification. SP has explored financial services and e-commerce activities. While not corporatized, the PSA operates the world's largest savings bank and Japan's largest life insurance company. Both CPC and New Zealand Post (NZP) provide postal consulting services internationally.

Cost reduction. Cost reduction has been a significant factor in transformation. Common means of reducing costs include automation of operations, as found most conspicuously at CPC, DPWN, NZP, and TPG, and staff reductions, as experienced at CPC, DPWN, NZP, SP, and TPG. Most of the postal operators discussed have been largely successful in avoiding conflict with organized labor (CPC and Consignia being notable exceptions). By working closely with labor through the transformation process, NZP reduced its workforce by 40 percent with minimal disruption, SP by 30 percent, and DPWN by 38 percent—primarily through attrition.

Transformational changes, as described above, have dramatically altered the legal and commercial environment for a number of postal operators. As evidenced by examples such as DPWN and TPG, it appears that postal operators who prepared for change have gained the most from postal transformation.

Objective and Scope of Study

The objective of this study is to describe the transformation paths taken by seven postal operators: Canada Post Corporation, Consignia (United Kingdom), Deutsche Post World Net (Germany), New Zealand Post, Sweden Post, The Postal Services Agency (Japan), and TNT Post Group (The Netherlands). The report discusses nine aspects of structural change: legislation and transformation, finance, universal services, regulation, reserved services, products and services, pricing, operations, and human capital.

Approach

Data collected for this study are based on secondary research, confirmed by PwC consultants and/or postal employees in each country. Transformation highlights for each operator are graphically depicted in the Legislation and Transformation section. The seven postal operators are presented in alphabetical order. All figures are in U.S. dollars unless otherwise stated. Exhibit A on the following page summarizes key findings.

EXHIBIT A – TRANSFORMATION OVERVIEW

	Canada Post Corp.	Consignia (UK)	Deutsche Post World Net (Germany)	New Zealand Post	Sweden Post	The Postal Services Agency (Japan)	TNT Post Group (The Netherlands)
Revenue [1,2,3]	$3.7B	$11.7B	$29.4B	$412M	$2.5B	$17.9B	$10.1B
Net Income	$53M	$95M	$1.4B	$9M	$-136M	$-80M	$500M
Year of Last Major Reform	1981	2000	1997	1998	1997	2001	1998
Corporatized	Yes	Yes	Yes	Yes	Yes	No	Yes
Owner	Government	Government	Private and Government	Government	Government	Government	Private and Government
Borrows Private Capital Without Government Approval	No	Yes	Yes	Yes	Yes	No	Yes
Pays Federal Income Tax	Yes	Yes	Yes	Yes	Yes	No	Yes
Joint Ventures	Yes	Yes	Yes	Yes	Yes	No	Yes
Subsidiaries	Yes	Yes	Yes	Yes	Yes	No	Yes
Financial Mandate	Profit	Profit	Profit	Profit	Profit	Break-even	Profit
Scope of Monopoly	3 x standard rate, 1.8	No monopoly [4]	Exclusive license replaces monopoly [5]	No monopoly	No monopoly	Mail delivery services [6]	3 x standard rate, 3.5 oz.
Price Cap – Reserved Area	Yes	No [7]	No	Yes	Yes	No	Yes
Mail Box Monopoly	No	No	No	No	No	No	No
Right to Strike	Yes	Yes	Yes	Yes	Yes	No	Yes

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1 Revenue and net income data are most recent available. 2001 data are presented for Canada Post Corporation, Consignia, New Zealand Post, and TNT Post Group. 2000 data are presented for Deutsche Post World Net, Sweden Post, and The Postal Services Agency.

2 Throughout the document, conversions of financial data to U.S. dollars are based on foreign exchange rates as of 12/13/2001.

3 Revenue and net income data are based on varying national accounting standards.

4 Universal service is ensured by administration of a “licensed area.” No person may operate a business for delivery of “letters” without a license unless, for each letter transported: 1) the price of service is at least £ 1.00 ($ 1.44); or 2) the weight of the letter is at least 350 grams. The new regulator has issued a number of postal licenses, including to Consignia.

5 In 1997 a licensed area replaced the postal monopoly. Deutsche Post was granted an exclusive license for a portion of the licensed area until the end of 2002. The exclusive license was later extended to 2007.

6 There is no monopoly on parcel services.

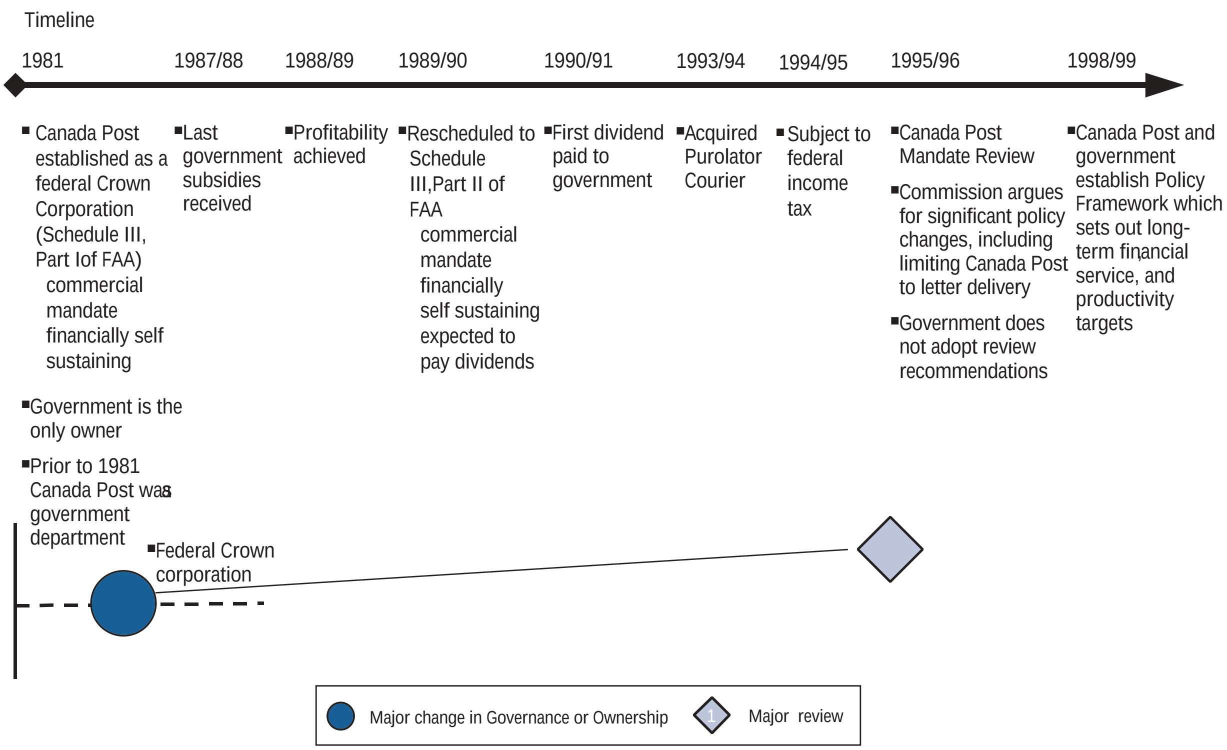
7 The application of a potential price-cap system is pending a 2002 review by Postcomm, the UK postal regulator.

Canada Post Corporation

Legislation and Transformation

Canada Post Corporation (CPC) is a federal Crown corporation whose only shareholder is the government of Canada. In 1981, the Canada Post Corporation Act created CPC, replacing the former Post Office Department and its government administration with today's corporatized entity. CPC retains its universal service obligation and monopoly protection, but only for basic letter services. The figure below highlights transformational events since 1981.

CANADA POST TRANSFORMATION HIGHLIGHTS



CPC reported its first annual profit in 1989 and paid its first dividend to the government in 1990. In 1993, CPC purchased 75 percent of Purolator Courier, the largest overnight delivery company in the country.

In 1995, the government of Canada launched a review of CPC's mandate, hiring an independent reviewer to recommend long-term transformation strategies for the postal service. The resulting report recommended a fundamental reorientation of CPC. CPC was to focus on its public policy mission, withdraw from most competitive services, return to a break-even financial mandate, and significantly reduce its labor force. The report also recommended that the government consider implementing general taxes and specific levies on courier companies to offset the resultant lost postal revenues.

After much debate, and strong objections from CPC, the government rejected this approach to postal transformation. Instead, the Minister of Public Works and Government Services reiterated Canada Post's current status as a government owned corporation with a public policy mission. The Minister confirmed that CPC would:

- Continue to have a mission to provide affordable universal service for all Canadians;
- Remain a federal Crown corporation and not be privatized as long as it fulfilled a public policy role;
- Maintain its primary focus on letter service;
- Continue to earn profits, pay dividends, and compete in delivery services markets;
- Retain its ownership of Purolator;
- Not be subsidized by taxpayers;
- Continue the moratorium on closing rural post offices; and,
- Withdraw from the delivery of unaddressed advertising mail where alternate capability exists.

The government also called for creation of a multiyear Policy Framework defining CPC's financial, service, and productivity targets and a formula for determining future increases in the basic letter mail rates. In December 1998, this framework was established. It defined business targets for operating income, return on equity, dividend payments, and capital structure and leverage. The framework also defined the price-cap formula, which limits increases to the basic domestic letter mail rate to two-thirds the rate of inflation as measured by the Consumer Price Index.

CPC continues to compete aggressively in nonmonopoly markets. As CPC has gained share in some markets, competitors have complained about a possible cross subsidy. Government and antitrust authorities' inquiries have rejected these complaints.

Today, CPC's mission remains to maintain the universal service obligation (USO), broadly defined, "to establish and operate a postal service for the collection, transmission and delivery of messages, information, funds and goods both within Canada and between Canada and places outside Canada." CPC has explicit authority to "extend its products and services in the light of developments in the field of communications." There are no plans to revise the postal monopoly or change CPC's business model.

Finance

CPC has received no direct government funding since 1988, has paid a dividend since 1990, and has paid federal income tax since 1994. CPC is required to prepare annual reports and to adhere to generally accepted accounting principles as if it were a publicly traded company. In 2001, CPC experienced its sixth straight year of profitability, with increasing profits for the past four years.

In 2000/2001, CPC's financial objectives were operating profits of C$104 million ($65.5 million), a Return on Equity (ROE) of 4 percent, productivity of 98.2 percent, a debt to capital ratio of 12 percent, and a dividend payout ratio of 25 percent.[8] The corporation achieved its ROE, productivity, and debt to capital objectives and paid its 25 percent dividend to the government but missed the operating profit target.[9]

Universal Services

CPC is responsible for providing universal postal service under the direction of the government. Universal service is not strictly defined, but is understood to mean nondiscriminatory service. Some addressees (approximately 35 percent in 2001) receive mail at community mailboxes or other centralized points while the rest receive mail at their residences.

Regulation

Canadian law does not provide for a third-party regulator for CPC or for the delivery services sector generally; however, CPC is subject to direct government supervision. Compared to the United States, there is no organization in Canada with the role and responsibilities of the Postal Rate Commission. CPC is managed by a Board consisting of nine directors appointed by the Deputy Prime Minister and Minister of Infrastructure and Crown Corporations (Minister), and a Chairman and President who are appointed by the Governor in Council. CPC is subject to such directives as the Minister deems appropriate.

As a federal Crown corporation, CPC is subject to the provisions of the Financial Administration Act (FAA). Under the FAA, CPC is obligated to submit annually to the Governor in Council, for approval, a five-year corporate plan and a one-year capital budget. CPC also submits its operating budget for review. The Treasury Board is a specialized committee of the cabinet that administers the FAA. The Treasury Board scrutinizes the corporate plans submitted by CPC and considers the reasonableness of the plans and business strategies. CPC's borrowings are subject to the approval of the Minister of Finance and the Treasury Board. Approval by the Treasury Board of CPC's corporate plans and budgets is typically subject to explicit conditions.

CPC is subject to the Competition Act, Canada's antitrust law. The Act is administered and enforced by the Bureau of Competition Policy.

Reserved Services

CPC has a monopoly over "collecting, transmitting and delivering letters to the addressee thereof within Canada." There are several exceptions. The most important exception permits private carriage for all letters charged more than three times the domestic postage rate for a 50-gram (1.8 ounce) letter. There is no mailbox monopoly.

Products and Services

CPC provides products and services in four principal markets: communications, physical distribution, advertising, and publications, respectively accounting for 52 percent, 21 percent, 14 percent, and four percent of sales in 2001.[10] In addition, CPC generates revenue from other sources including terminal dues from incoming international mail,

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8 2000/01 to 2004/05 Corporate Plan Summary, Canada Post Corporation.
9 2000/2001 Annual Report, Canada Post Corporation.
10 Ibid.

money orders, retail and philatelic products, and consulting. CPC provides worldwide postal consulting services through a wholly owned subsidiary, Canada Post International Limited (CPIL). More than one hundred projects have been completed in fifty countries since CPIL was established in 1990. CPIL has, for example, a five-year contract for the administration and operation of postal services in Guatemala, a twelve-year contract to rebuild and operate Lebanon's post, and a strategic alliance with the government of the Dutch Antilles for the transformation of its postal system.

In 1991, CPC, along with the postal operators of France, Germany, the Netherlands, and Sweden, formed a joint venture, GD Express Worldwide, to purchase one half of TNT, a worldwide courier service. In 1993, CPC acquired Purolator Courier to provide domestic express service. The post has also formed several alliances to develop hybrid and e-commerce services. In 1998, CPC launched Electronic Bill Payment through epost, an Internet-based secure electronic messaging service. epost recently concluded agreements with Yahoo.ca and msn.ca, two of Canada's leading Internet portals, to broaden access to its services. In partnership with certain Canadian banks, CPC offers financial services to customers living in remote areas and in specific locations where no financial institution currently operates. CPC plans to invest in areas of significant potential growth, particularly distribution, integrated logistics, and e-commerce.[11] In 2001, CPC acquired a majority interest in Progistix-Solutions, Inc. and Intelcom Courier Canada, Inc.

Pricing

CPC is not subject to direct price regulation as is the case in the United States. It must, however, demonstrate that revenues from monopoly products are not subsidizing competitive services. In 1989, CPC's unaddressed advertising mail services were deregulated, allowing for new and flexible rate structures, like volume discounts. By 1996, CPC was granted authority to set prices for all products and services except letter mail and some publications.[12] Prices for monopoly products (50 percent of CPC revenues) may only be increased once a year. The basic letter rate is subject to a price cap equal to two-thirds the rate of inflation. Through its annual submission of a five-year corporate plan, CPC advises the government of its rate plans for all mail services.

Operations

In the late 1980s and early 1990s, CPC sought to increase efficiency through greater mechanization, automation and cost-cutting measures. It invested significant capital in mail processing equipment. CPC also introduced community mailboxes to service new suburban housing developments. It adopted independent auditing and quarterly public reporting of its letter mail delivery performance. It cut back rural mail service, closing unprofitable post offices and shifting services to outlets in retail stores.[13] (However, in 1994 the government imposed a moratorium on CPC's program of converting corporate rural post offices to franchised outlets; this moratorium continues today). By 1996, many non core operations were outsourced, including long-distance transportation and information technology.[14] In 1996, CPC built a national control center

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[11] 2000/2001 Annual Report, Canada Post Corporation.

[12] Congressional Testimony, "Changes in Foreign Postal Service," Michael E. Motley, 01/25/1996.

[13] Christian Science Monitor, "Profits May Bring Other Problems to Canada's Post Office," Fred Langan, et. al., 06/28/1990.

that allowed postal executives to monitor the condition of the network and the movement of mail through the network.

Human Capital

Including wages and benefits, labor costs accounted for 64 percent of CPC's operating costs in 2000-2001, up from 62.4 percent in 1999-2000.[15] CPC has a history of difficult labor relations with its unionized staff (95 percent of the workforce in 2001). Since 1967, CPC has experienced twelve national postal strikes—an average of one every two and two-thirds years.[16] However, over the past five years, CPC has been virtually strike-free. Mediation, arbitration and back-to-work legislation have been imposed to help resolve labor disputes.

To improve the work culture and productivity, CPC increased training for its employees significantly in the 1990s, tripling the training budget between 1994 and 1996. CPC funded the Canada Post Learning Institute, a 'virtual' university for training courses. CPC is also working with its largest union to develop a more competitive operating model for collection and delivery activities.

Consignia (United Kingdom)

Legislation and Transformation

Postal reform in the United Kingdom followed an eight-year public discussion. In June 1994, after two years of study and public debate, the Conservative government published a "green paper" on postal services that proposed reductions in the monopoly and privatization of 51 percent of The Post Office. Although supported by The Post Office, this proposal was narrowly defeated by postal unions and by parliamentary "backbenchers" concerned over the future of rural retail and delivery services. In July 1999, as highlighted in the graphic below, the new Labour government published a white paper proposing a modified plan for postal modernization, followed by draft legislation announced the following January.

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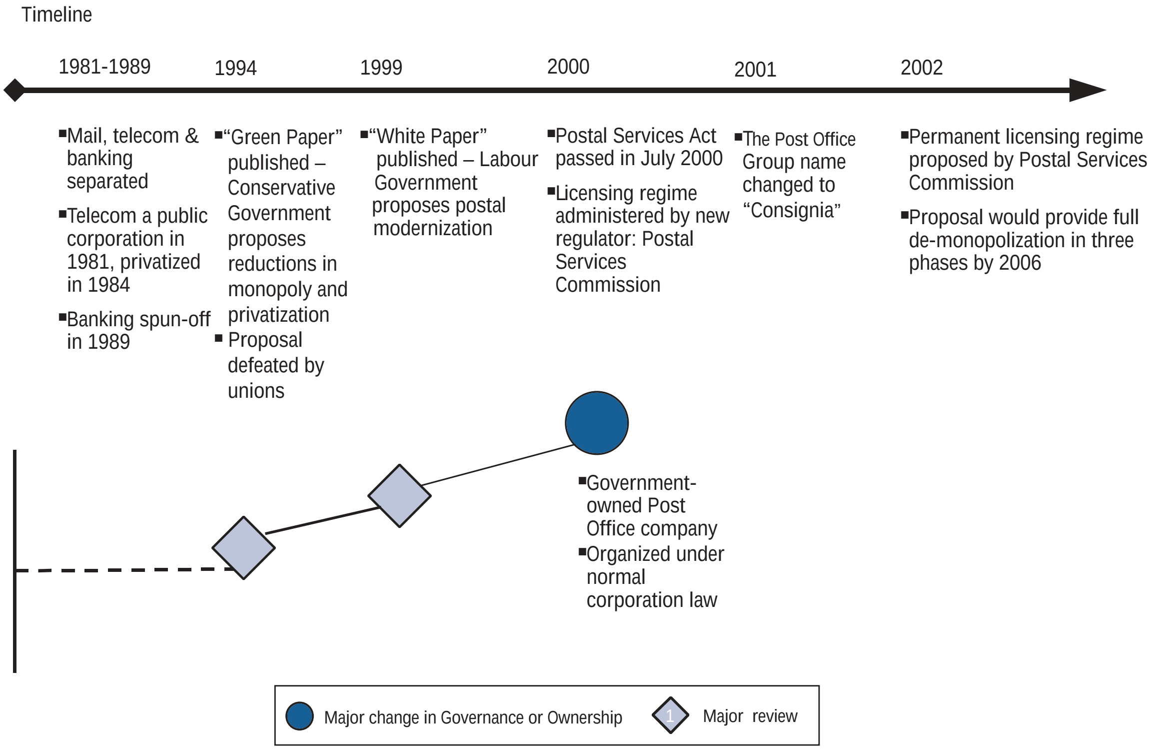
14 Congressional Testimony, "Changes in Foreign Postal Service," Georges C. Clermont, 01/25/1996.
15 2000/2001 Annual Report, Canada Post Corporation.
16 USPS Future Vision, "Review of Eight Progressive Postal Administrations," PricewaterhouseCoopers Report, 10/15/1998.

CONSIGNIA TRANSFORMATION HIGHLIGHTS



1981-1989
- Mail, telecom & banking separated
- Telecom a public corporation in 1981, privatized in 1984
- Banking spun-off in 1989

1994
- "Green Paper" published – Conservative Government proposes reductions in monopoly and privatization
- Proposal defeated by unions

1999
- "White Paper" published – Labour Government proposes postal modernization

2000
- Postal Services Act passed in July 2000
- Licensing regime administered by new regulator: Postal Services Commission
- Government-owned Post Office company
- Organized under normal corporation law

2001
- The Post Office Group name changed to "Consignia"

2002
- Permanent licensing regime proposed by Postal Services Commission
- Proposal would provide full de-monopolization in three phases by 2006

In July 2000, the Postal Services Act 2000 was enacted. The Act dissolved The Post Office and transferred its assets to a government-owned postal company organized under normal corporation law. The postal monopoly was replaced by a licensing regime administered by a new regulator, the Postal Services Commission (Postcomm). Responsibility to ensure universal service was transferred to Postcomm, which is authorized to attach conditions to licenses to accomplish three goals: maintenance of universal service, promotion of competition, and promotion of efficiency, in that order of importance.

In March 2001, The Post Office Group changed its name to Consignia but maintained its existing business brands—Royal Mail for letter services, Parcelforce Worldwide for parcel services, and Post Office for the retail network.

Since its creation, Postcomm has issued seven licenses, including one to Consignia. To date, these have produced only limited competition. In January 2002, Postcomm proposed a permanent licensing regime that would provide for complete phase-out of the monopoly in three stages by March 2006:

- Phase one, April 2002 – March 2004: Eliminate the monopoly on bulk mail above 4,000 items per shipment, consolidation services, and certain niche services—around 30 percent of Consignia's market by value.
- Phase two, April 2004 – March 2006: Open up a further 30 percent of the market by lowering the bulk mail threshold as appropriate—probably between 500 and 1,000

items per mailing. Plus a review of restrictions on consolidation licenses with a view to enabling consolidators to tender destination entry mail to delivery providers other than Royal Mail.

- Phase three, no later than March 31, 2006: All restrictions on market entry abolished.[17]

Finance

By 1995, The Post Office was obligated to pay taxes. In addition, the government relaxed limits on capital spending and the level of government scrutiny on individual investment projects and gave The Post Office greater scope to enter new markets, for example, through joint ventures. The Post Office was also required to prepare financial statements equivalent to those of a commercial company.

During the 1990s, the Post Office felt burdened by long-standing agreements with the government to return a large percentage of its profits to the Treasury. The Post Office has taken the position that it was thus deprived of capital for much-needed investments. Up to 80 percent of the post's annual profits have been diverted to the Treasury. In 2000, the government reduced The Post Office's annual Treasury payments to 40 percent of post-tax profits and approved acquisitions totaling £600 million ($864 million). With corporatization in 2000, Consignia won greater commercial freedom but the state remains its single shareholder and the Treasury still exercises tight control over its balance sheet and borrowings.[18] Consignia has asked that dividends paid to the government be waived for 2002, but that decision remains solely in the hands of the government.[19] Consignia cannot make large acquisitions or borrow more than £75 million ($108 million) without government consent.

From the mid-1970s through the late 1990s, The Post Office earned surpluses each year. In 1998–1999, The Post Office earned £493 million ($710 million)—its 24th consecutive year of profit.[20] In the fiscal year ending March 25, 2001 The Post Office returned a post-tax profit of £66 million ($95 million) on revenues of £8.1 billion ($11.7 billion), reversing the previous year's losses of £264 million ($380 million), but earnings before taxes and exceptional items declined from £474 million ($682 million) to £103 million ($148 million). It appears, however, that Consignia returned a profit in 2000/2001 only because it received £106 million ($153 million) in interest on previous dividends held by the government.

Universal Services

The Postal Services Act defines universal service to mean delivery each working day of "relevant postal packets" to each address in the country except in "exceptional circumstances." Service must be provided at "affordable prices determined in accordance with a public tariff which is uniform throughout the United Kingdom." "Relevant postal packets" refers to documents and parcels weighing up to twenty kilograms.

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[17] Postcomm press release, 01/2002.
[18] The Guardian, "It's deliver or die time…," David Gow, 04/12/2001.
[19] The Sunday Telegraph, "Last Post for Consignia?" Mary Fagan, 12/16/2001.
[20] The Guardian, "Out of sorts," Andy Beckett, 01/23/2002.

To ensure universal service, Postcomm has made continuation of universal service a condition of Consignia's license. In March 2001, Postcomm issued the first postal license to Consignia. Twenty conditions are attached, addressing issues such as prices, universal service obligations, standards of service, complaint handling, free services for the blind, provision of information to users, integrity of mail, access to postal facilities, prohibitions against unfair commercial advantage, mergers, accounting rules, financial resources, and reports to Postcomm.

The universal service obligations set out in the Consignia license are detailed. For example, Consignia must make delivery to each address point at least once each working day. It must establish collection boxes so that "in each postcode area where the delivery point density is not less than two hundred delivery points per square kilometer not less than 99 percent of users or potential users of postal services are within five hundred meters of a post office letter box." Postcomm has required Consignia to make its address database available to all operators. Postcomm will review which of Consignia's products should be considered universal services before the summer of 2002.[21]

Regulation

The basic task of Postcomm is to ensure continued provision of universal service by administration of a "licensed area." Under the act, no person may operate a business for delivery of "letters" without a license unless, for each letter transported: 1) the price of service is at least £1.00 ($1.44), or 2) the weight of the letter is at least 350 grams.

Postcomm is obliged to grant licenses to serve the "licensed area" pursuant to three goals. First, Postcomm is directed to exercise its discretion "in a manner which it considers best calculated to ensure the provision of universal service." Second, subject to the first goal, Postcomm is directed to "further the interests of users of postal services, where appropriate by promoting effective competition between postal operators". Third, subject to the first two goals, Postcomm is directed to "promote efficiency and economy on the part of the postal operators". To accomplish these goals, Postcomm is authorized to grant licenses for service in the licensed area, and to attach virtually any type of condition. In order to enforce conditions attached to a license, Postcomm may seek a judicial injunction, or levy a fine. It may also, with concurrence of the Competition Commission, modify a license to cure an anticompetitive practice. Postcomm is authorized to request searches and seizure of private property by competent police authorities. The regulator also has broad responsibility to keep under review all aspects of the postal services sector in the United Kingdom and around the world. Postcomm has no regulatory jurisdiction over service providers operating wholly outside the licensed area.

In addition to Postcomm, the Postal Services Act establishes a regulatory role for three other bodies: 1) the Secretary, 2) the Consumer Council for Postal Services ("Postwatch"), and 3) the Competition Commission. The Secretary is authorized to modify the list of exemptions from the licensed area on recommendation of Postcomm. The Secretary may also designate one or more postal operators as "universal service

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[21] Postcomm Web site, www.postcomm.co.uk, "Competition and Regulation Framework".

providers" if they provide all or part of the universal service. Designation as a "universal service provider" gives the designee certain rights, including: 1) protection from defacement of post offices and letter collection boxes, 2) protection from obstruction of activities, 3) exemption from tort liability, and 4) authority to require carriage by ship or aircraft.

The Consumer Council for Postal Services (CCPS) is a users group appointed by the Secretary on terms established by the Secretary. The CCPS is authorized to advise Postcomm, the Secretary, and others on postal issues, and to investigate complaints. In its duties, the CCPS is authorized to use legal process to obtain information.

The Competition Commission is a separate regulatory body whose advice and concurrence is required before Postcomm can modify a license.

Reserved Services

The 2000 Postal Act did not provide a reserved service area, ending the 340-year old British postal monopoly law. Initially, Postcomm has been cautious about granting licenses for activities that would compete with Consignia's main business. It has issued seven temporary licenses (including the license for Consignia), which resulted in only limited competition. However, as mentioned earlier, in January 2002, Postcomm proposed a permanent licensing regime that would provide for full de-monopolization by March 2006.

Based on figures from Consignia's 2001 Annual Report, it is estimated that the market open for competition from April 2002 accounts for as much as 34 percent of Consignia's revenue.[22] There is no mailbox monopoly.

Key Products and Services

Consignia's core services are mail and parcels, through Royal Mail and Parcelforce. In addition, Consignia provides counter services through its post office network, and is working to expand its global distribution services.[23] Until 1994, The Post Office could not implement even small changes in services without government approval. Beginning in 1995, the government permitted The Post Office greater commercial flexibility, and it began to pursue non core products, such as hybrid mail, wire transfer services, travel insurance, and currency exchange. While expanding its product range, The Post Office also sought to improve efficiency of retail operations by installing an automated system for welfare disbursement. This plan, however, was stopped by the government and was the major cause of losses in 1999–2000. In 1997, The Post Office entered the insurance market. During 1999 and 2000, The Post Office made thirteen acquisitions, most involving express parcels operators and international mail firms, including two in the United States.[24]

Pricing

Consignia is required to maintain a tariff for relevant postal packets that is "a public tariff that is uniform throughout the United Kingdom." Prices for letter services within the licensed area (about 66 percent of revenues) may not be increased without approval by

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22 Postcomm Forward Work Programme and Business Plan, January 30, 2002.
23 Annual Report 2000-2001, Consignia.
24 Traffic World, "Applying Postal Breaks," John Parker, 01/08/2001.

Postcomm. Prices for postal services outside the licensed area but lacking effective competition (about 24 percent of revenues) may not be increased more than inflation.

To increase prices, Consignia must demonstrate to Postcom that its ability to finance its licensed activities will be jeopardized without the price increase.[25] It must also demonstrate that no other course of action, for example improving efficiency, will work. Postcomm will judge the necessity of the price increase in accordance with criteria in Consignia's license and, if necessary, will consult with all interested parties before deciding whether to allow all, part, or none of the requested price increase.[26] Consignia's license imposes controls on the prices it can charge for most of its products and services. [27]

Postcomm was not able to complete a detailed price and efficiency review by March 26, 2001, and has therefore adopted a relatively neutral stance towards Consignia's prices pending results of such a review. The review will consider the interrelationship between prices and service standards and will in particular examine price cap regimes. Postcomm intends to complete this review by the summer of 2002 and have a full price control regime in effect by April 2003.[28]

Operations

In 2001, all but 600 of Great Britain's 17,500 post offices were privately owned franchises, paid by Consignia for the volume of work they handled. The network of post offices has recently been operating at a loss, due to increases in operating costs.

Consignia is now developing plans to save £1.2 billion ($1.73 billion) through measures such as contracting out support services including vehicle maintenance, construction, and information technology; reducing the workforce by up to 15 percent; and stopping the second daily delivery to households.[29] Consignia has also shaken up its management team, replacing senior level executives with executives that have private sector experience, and has plans to increase the proportion of middle management from the private sector to 10 percent. Consignia hopes the new managers will be catalysts for change.

Human Capital

Labor relations remain difficult for Consignia. More days are lost through strike action at Consignia than at any other company in Europe. Wildcat strikes are still called without ballot, and branch union officers still wield a great deal of power. In 2000, there were 340 individual strikes, accounting for 63,000 lost days.

In 2001, Royal Mail and the Communication Workers Union, which represents most postal workers, commissioned an independent review of labor relations. The report concluded that "(t)he perception of Royal Mail as strike ridden and unreliable makes it deeply vulnerable to competitors and to action by the regulator." Further, the report stated, "(w)e have no doubt that unless the problem of industrial action, and the

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[25] Financial Times, "Consignia withdraws request for stamp price rise," Alan Pike, 06/20/2001.
[26] M2 Presswire, "Consignia's application for a price increase," 04/11/2001.
[27] Ibid.
[28] Postcomm Forward Work Program and Business Plan, January 30, 2002
[29] Sunday Times-London, "Consignia to cut 30,000 jobs in drive for mail efficiency," John Waples and Rory Godson, 01/13/2002.

underlying state of industrial relations which it reflects, is effectively resolved there is little hope for the future success of Royal Mail." The report recommended adoption of alternative dispute-resolution methods, including the creation of a special arbitration panel to provide a rapid ruling to help resolve disputes.[30]

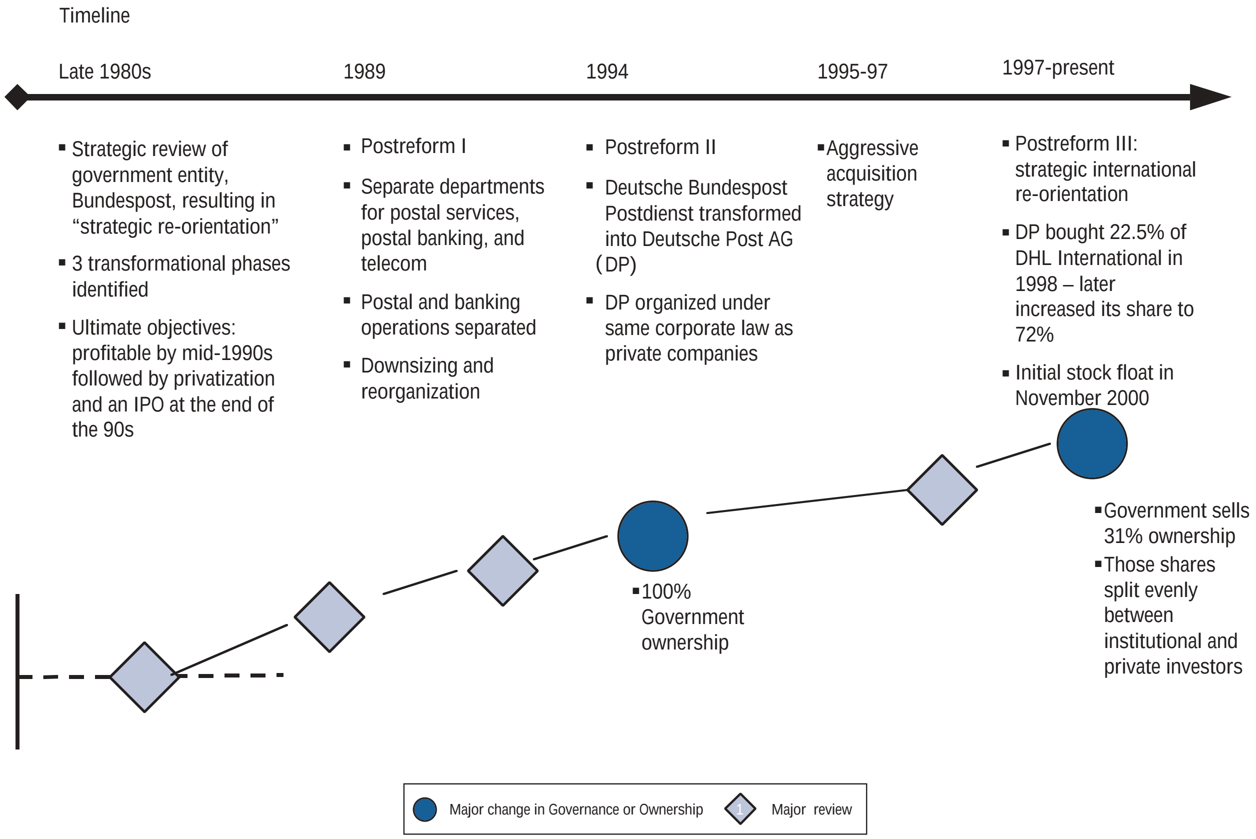
In 2001, approximately 70 percent of Consignia's costs were for in-house labor.[31] It has recently announced plans to cut up to 30,000 workers, 15 percent of the workforce, through a variety of outsourcing and productivity-enhancing initiatives.[32]

Deutsche Post World Net (Germany)

Legislation and Transformation

Germany reformed its postal market in three legislative stages, all highlighted in the graphic below.

DEUTSCHE POST WORLD NET TRANSFORMATION HIGHLIGHTS



Timeline

Late 1980s
- Strategic review of government entity, Bundespost, resulting in "strategic re-orientation"
- 3 transformational phases identified
- Ultimate objectives: profitable by mid-1990s followed by privatization and an IPO at the end of the 90s

1989
- Postreform I
- Separate departments for postal services, postal banking, and telecom
- Postal and banking operations separated
- Downsizing and reorganization

1994
- Postreform II
- Deutsche Bundespost Postdienst transformed into Deutsche Post AG (DP)
- DP organized under same corporate law as private companies
- 100% Government ownership

1995-97
- Aggressive acquisition strategy

1997-present
- Postreform III: strategic international re-orientation
- DP bought 22.5% of DHL International in 1998 – later increased its share to 72%
- Initial stock float in November 2000
- Government sells 31% ownership
- Those shares split evenly between institutional and private investors

● Major change in Governance or Ownership ◆ Major review

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30 UK Communication Workers Union website, www.cwu.org: Independent Review of Industrial Relations between Royal mail and The CWU.
31 The Sunday Telegraph, "Last Post for Consignia?" Mary Fagan, 12/16/2001.
32 Ibid.

In 1989, "Postreform I" created separate departments for postal services, postal banking, and telecommunications within the Ministry for Posts and Telecommunications. A new Board of Directors introduced a greater degree of private sector management and accounting practices. The Deutsche Bundespost Postdienst was reorganized into four business sectors: letters, parcels/express, post offices, and new business segments.

In 1994, "Postreform II" transformed Deutsche Bundespost Postdienst into Deutsche Post AG, a company organized under the same corporate law as private companies and having the government as the sole shareholder. At the same time, the German Constitution was amended to make explicit a governmental obligation to ensure maintenance of "appropriate and adequate" universal postal services offered on a private enterprise basis by Deutsche Post AG and private operators.

In 1997, "Postreform III" substituted a licensed area for the postal monopoly and granted Deutsche Post AG (DP) an exclusive license for a portion of the licensed area until the end of 2002. Responsibility for maintenance of universal service and regulation of the postal sector was committed to the telecommunications regulator, Reg TP. At the start of 1999, Deutsche Post AG began to operate under the name Deutsche Post World Net (DPWN). Recently, the government extended the exclusive license to the end of 2007, delaying total de-monopolization.

Over the last five years DPWN has made numerous acquisitions around the world, including a 72 percent stake in the largest global courier company, DHL, and a takeover of one of the largest global logistics companies, Danzas. On November 11, 2000, the German government sold 31 percent of the ownership of DPWN to the public. The company is listed on all eight German stock exchanges, including the primary stock exchange in Frankfurt. Further sales are planned, but no date has been set.

Finance

Since 1995, DP has been able to act as though it were a private company, in terms of procurement, mergers, and acquisitions, although most of these freedoms were not utilized immediately by the organization. Beginning in about 1997, DP began an aggressive buying spree, making acquisitions in all the main European markets and in all of the big postal sectors. Prior to its Initial Public Offering in 2000, DP raised capital, independent of the government, in order to finance its assertive acquisition strategy. DP spent €5.8 billion ($5.2 billion) on acquisitions during 1999 and 2000—€5 billion ($4.5 billion) of that during 1999 alone.

In accordance with European and German legislation, DP is exempt from paying Value Added Tax on revenue generated in the universal service area. The justification for the exemption is that universal service is intended to serve the common good and should therefore not be made more expensive through taxation.[33]

In 2000, DP achieved revenues of €32.7 billion ($29.4 billion), up from €22.4 billion

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[33] Deutsche Post website, www.deutschepost.de, Press Release, "Deutsche Post World Net Response To Handelsblatt Article "Deutsche Post Faces Threat Of Higher Tax Bill," January 24, 2002

($20.1 billion) in 1999, representing a 46 percent increase. Net income for 2000 increased 48 percent to €1.5 billion ($1.4 billion), up from €1 billion ($926 million) in 1999. In 2000, DP's largely domestic mail business, including its first class letter monopoly, provided 74 percent of the profits, while accounting for 35 percent of revenues. Remaining revenues were split approximately evenly between DP's three other business units: logistics, express, and financial services. International revenues in 2000 were €9.6 billion ($8.6 billion), equal to 29 percent of total revenue.[34]

Universal Services

The Postal Act guarantees provision of universal service defined as "provision throughout the Federal Republic of Germany of basic postal services (universal service) at affordable prices." The term "postal services" is defined to include for-profit delivery services for: 1) "letter post" items, 2) addressed parcels up to twenty kilograms, and 3) books, catalogues, newspapers or magazines, insofar as such conveyance is provided by companies providing letter post or addressed parcel services. "Letter post" items are, in turn, defined to mean "addressed written communications."

The definition of universal service is further refined in the Postal Universal Service Ordinance. The Ordinance specifies, for example, the maximum level of stamp prices (real price on December 31, 1987), minimum quality of service (80 percent of letter post items shall be delivered one day after posting), the minimum number of post offices (12,000 of which 5,000 shall be operated by company staff), and the rules on letter box location (no more than one kilometer from any urban resident), and delivery frequency (once per working day). The Universal Service Ordinance also requires DP to maintain a uniform tariff for nonbulk licensed services.

Regulation

The Postal Act designates the regulatory authority for the telecommunications sector, Reg TP, as regulator of the postal sector. Reg TP is an agency within the Ministry of Economics. Its presiding committee is composed of three members designated by the government on proposal of a committee composed of members of the German Parliament. Reg TP may hold hearings and compel production of evidence. Responsibility for ensuring universal postal services is vested in Reg TP. To accomplish this objective, Reg TP is authorized to administer a licensing scheme for certain postal services and to impose certain standards on all providers of postal services.

Under the Postal Act, no person may, without a license, operate a business for delivery of "letter post items" weighing up to one kilogram. The 1997 Postal Act provided that, until the end of 2002 (recently extended to 2007), DP shall have an exclusive license for a portion of the licensed area (see Reserved Services, on the following page).

Regulation is imposed most strictly on licensed operators with a "dominant position." All rates in the licensed area by a licensee with a dominant position are subject to prior approval by Reg TP. Rates must be based on "the costs of efficient service." A licensee with dominant position is also generally obliged to provide users and other operators of

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34 Deutsche Post Annual Reports, 1998, 1999, 2000.

postal services access to “downstream” delivery services and post office boxes at cost-based rates and, in case of disagreement, such rates may be imposed by Reg TP.

After expiration of DP’s exclusive license, Reg TP may, if it deems universal service to be inadequate in a given area, require licensed operators with “dominant position” to provide the necessary universal services, subject to compensation for losses incurred. Large licensed operators, having annual licensed revenues greater than Deutsche Marks 1 million ($460,000), may be required to contribute to a universal service fund to compensate licensed providers obliged by Reg TP to provide universal services.

Reg TP may also require a provider of postal services outside the licensed area to respect certain principles of fair competition if that provider has a “dominant position” in the market.

Reserved Services

The Postal Act does not provide for reserved services per se. However, until December 31, 2007, the Postal Act grants DP an exclusive license to provide licensed services for letter post items and catalogs which: 1) weigh not more than two hundred grams each (fifty grams for identical printed items sent in batches of fifty or more), and 2) cost not more than five times the basic stamp price on December 31, 1997. The exclusive license applies only if both conditions are met. In return for the exclusive license, the Postal Act provides that Reg TP may impose the obligation to provide universal service on DP and only DP until the end of the exclusive license. No such obligation has been imposed yet.

There are other exemptions from the exclusive license. In particular, the exclusive license does not apply to document exchanges nor to “special services,” that is, “services distinct from universal services, having special features and higher quality.” Reg TP has issued more than 2,500 special services licenses to about 630 licensees. DP sued Reg TP and competitors in more than 600 cases to block these special services licenses. German courts have ruled that the majority of the suits were unfounded. Nevertheless, legal action delayed new market entry, helping DP retain almost 100 percent of the market.[35]

Products and Services

Much of DP’s product and service expansion has come through an aggressive global acquisition strategy based on three objectives: 1) development of a European parcel network, 2) acquisition of an international express system, and 3) development of logistics and value-added freight services.[36] DP entered the financial services market through the purchase of Postbank. While DP continues to pursue acquisitions and alliances, in 2001 it shifted its focus to global integration of its many recent acquisitions. This period of integration is designed to “leverage the full potential within the group” and realize DP’s stated goal of becoming “the number one global player” in its markets.[37] DP has been active in e-business, focusing on the development of e-commerce, electronic communications, digital franking, and on line brokerage services.

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35 OECD Economic Surveys – Germany, “A review of progress in structural reforms,” 05/01/2001.
36 Congressional Testimony, “International Postal Policy,” Uwe R. Doerken, 03/09/2000.
37 Deutsche Post Annual Report, 2000.

DP is viewed as being ahead of most of its EU peers in planning for a phase-out of its monopoly, as evidenced by its balanced portfolio of products and services. In 1997, mail accounted for 75 percent of DP's revenue, with express parcels making up the rest. In 2000, mail accounted for only 35 percent of revenue and express parcels accounted for 18 percent. The rest–almost half–was split between the logistics and financial services divisions. As stated earlier, however, the majority of DP's profits (74 percent) come from its mail business. In 2001, DP held a two-thirds share of the domestic postal market, with 50 percent in those segments open to competition and 98 percent in the letter market.[38]

Pricing

DP has limited ability to set its prices for letter mail within the licensed area.[39] Rate increases must be vetted with Reg TP.[40] In fact, Reg TP is responsible for setting the stamp price, but the Ministry of Economics plays a role in such changes. Recent studies by the German Association of Post Customers (DVPT) and Reg TP have compared postage rates for standard letters in Germany with rates in other countries. After allowing for differences in products and service levels, these studies have concluded that DP's tariffs are among the highest in industrialized countries.

After 1994, DP began to offer discounts to its biggest parcel shippers. This practice has resulted in numerous lawsuits under European competition law. In 2001, one was decided against DP when European competition authorities ruled that DP had "abused its dominant position" and "engaged in predatory pricing in the market for business parcel services." As a result the European Union fined DP $21.8 million and ordered it to separate its private parcel business from its letter monopoly.[41]

Operations

In 1990, the German post office was a money-losing service with little in the way of marketing or sales departments. Seventy-five percent of all letters were sorted by hand. After reunification, the post office had to absorb the postal system of the former East Germany – a system so archaic that its conveyors were actually designed for Russian coalmines.[42]

In response, DP instituted a series of radical initiatives and changes. DP reorganized into four groups: letters, freight, post offices, and new business segments, and reclassified products to simplify letter service offerings. The BRIEF2000 program was launched, aimed at dramatically improving the distribution and processing of letter mail. In 1992, DP began building a parcel network to consolidate hundreds of small sorting stations at train stations into thirty-three mammoth distribution centers located near airports and highways.[43] DP also appointed a Board of Directors with members from the private sector to initiate movement toward financial accountability, with private sector management and accounting practices.

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38 OECD Economic Surveys – Germany, "A review of progress in structural reforms," 05/01/2001.
39 The Financial News, "Deutsche Post IPO scoops a clear win," 01/01/2001.
40 Wall Street Journal Europe, "Deutsche Post Aims to Raise the Price of 1st-Class Stamps…," Alfred Kueppers, 03/21/2000.
41 Economic Strategy Institute, "Dealing with Deutsche Post's Well-funded Foray into the U.S. Express Delivery Market, 04/2001.
42 Wall Street Journal Europe, "Deutsche Post Delivers a Message About Capitalism," Neal E. Boudette, 11/20/2000.
43 Ibid.

The BRIEF2000 program oversaw the closure of more than 1,000 postal depots by 1998, replacing them with eighty-three high-tech sorting centers that operate twenty-four hours a day. As a result, at least 12,000 of DP's 26,000 post offices were closed. The results have included substantial cost savings and service improvements. In 1994, 83 percent of domestic letters were delivered the next day; by 2000, that number had increased to 95 percent.[44]

Human Capital

DP has faced many human capital challenges on the road to privatization. Initially, culture was a problem due to inherent differences between the former East and West German postal workers.

A hurdle that Germany was required to overcome in order to develop postal sector privatization plans was the issue of DP's unfunded pension liability, estimated in 1995 at over DM 60 billion ($28 billion). As a solution to this problem, DP was required to contribute payments to the pension fund at a rate comparable to those found in the private sector; the government agreed to fund any shortfall.

In 1997, DP agreed with the postal union to bar forced redundancies until 2001 in exchange for a reduction of breaks for employees. The agreement allowed DP to renegotiate job protection if competition from expected liberalization became too intense. At the time, DP employed 262,000 persons but expected to eliminate 110,000 jobs as a result of liberalization and to shed another 13,500 through attrition.[45] In all, the workforce was reduced from 379,000 in 1990 to 235,500 in 1999 (a decrease of 143,500) without layoffs.[46]

New Zealand Post

Legislation and Transformation

In late 1986, the New Zealand government initiated a two-year review of the long-term future of the New Zealand Post Office. As first steps towards reform, the 1986 State-Owned Enterprises Act and the Postal Service Act of 1987 transformed the Post Office into a "State-Owned Enterprise," New Zealand Post (NZP). The 1987 act limited the postal monopoly to letters weighing 500 grams or less and transported for NZ$ 1.75 ($0.74) or less.

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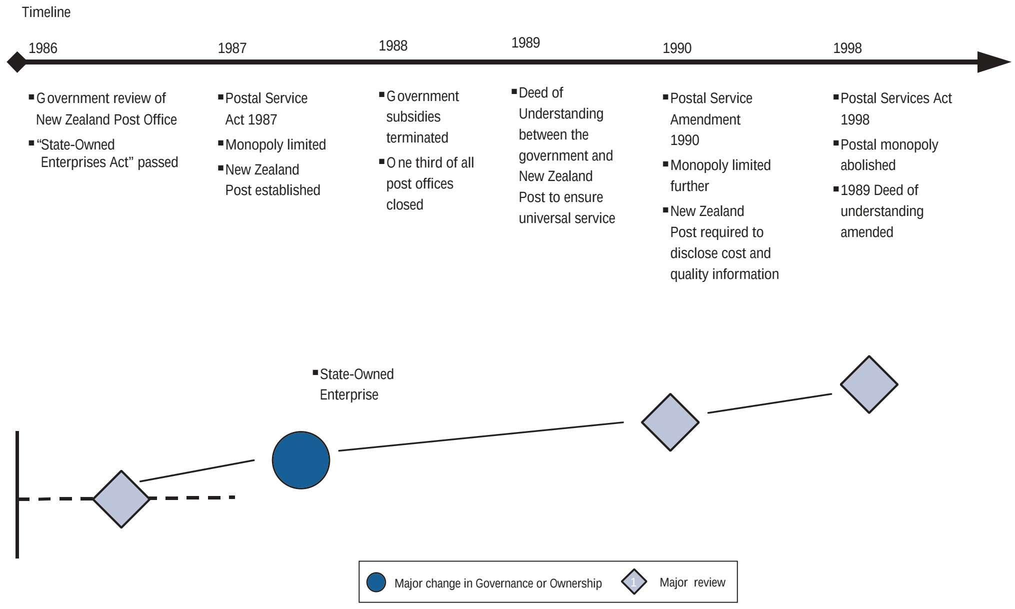
44 Forbes, "The Yellow Machine," Christopher Watts, 09/18/2000
45 AFX News, "Deutsche Post union agree to bar forced redundancies until 2001," 12/23/97
46 Congressional Testimony, "International Postal Policy," Uwe R. Doerken, 03/09/2000

NEW ZEALAND POST TRANSFORMATION HIGHLIGHTS



Timeline

1986
- Government review of New Zealand Post Office
- "State-Owned Enterprises Act" passed

1987
- Postal Service Act 1987
- Monopoly limited
- New Zealand Post established

1988
- Government subsidies terminated
- One third of all post offices closed

1989
- Deed of Understanding between the government and New Zealand Post to ensure universal service

1990
- Postal Service Amendment 1990
- Monopoly limited further
- New Zealand Post required to disclose cost and quality information

1998
- Postal Services Act 1998
- Postal monopoly abolished
- 1989 Deed of understanding amended

The 1987 act also terminated the government subsidy for the Post Office after one year.

Faced with an end to its subsidy and the likelihood of competition, in February 1988 NZP closed one-third of its post offices and increased its annual fee for rural delivery. A public outcry followed, but a Parliamentary inquiry concluded the only major problem posed by the closures was difficulty in maintaining rural banking services and recommended non postal remedies.

In November 1988, a committee of senior officials studying the long-term future of the post office recommended repeal of the postal monopoly despite strong opposition from NZP. In October 1989, the government moved to ensure continuation of public services by means of a contractual agreement with NZP called a "Deed of Understanding," which is subject to review every three years. A change in the party in power postponed repeal of the postal monopoly. Nonetheless, the Postal Service Amendment of 1990 lowered the weight limit for the postal monopoly from five hundred grams to two hundred grams and reduced the price limit to NZ$ 1.25 ($0.53). Further reductions lowered the price limit to NZ$ 1.00 ($0.42) in December 1990 and NZ$ 0.80 ($0.34) in December 1991, less than two times the stamp price of NZ$ 0.45 ($0.19). The 1990 amendment also required NZP to provide more public disclosure about the quality and cost of services.

The Postal Services Act of 1998, a comprehensive postal reform act supported by NZP, abolished the postal monopoly and imposed certain obligations on private operators. In 1998, a new Deed of Understanding was concluded between the government and NZP.

Finance

Prior to reform, NZP incurred major financial losses and needed substantial capital investment. During the first year as a State Owned Enterprise, the government paid a one-time subsidy to keep small rural post offices open, and NZP became profitable after that.[47] In the year before corporatization, NZP set up a sound commercial structure. Properties were assessed and valued; assets were identified and assigned to the business. The government determined a postage rate to get the company closer to profitability.

NZP is free to invest in and acquire other companies, although shareholder (i.e., government) approval is required to buy more than 20 percent of another company. NZP is also free to enter into joint ventures and operate subsidiary companies. NZP may raise capital and borrow at commercial rates, on commercial terms. It has lines of credit with four banks and can issue equity bonds. After 1987, the government was barred from issuing debt to raise capital for NZP.[48] NZP pays the government a dividend and pays the same taxes as any other company.[49] The full Value Added Tax is applied to postage. From the outset of reform, success was defined as profitability and became the driving force of the business. NZP became more vigilant about collecting accounts receivables; it reworked terms of payment and implemented new automated processes to bill customers.

In 2001, on revenues of NZ$ 982 million ($412 million), NZP reported net earnings of NZ$ 21 million ($8.8 million). While this represents a revenue increase of seven percent compared with 2000, net earnings decreased by 31 percent during the same period.

Universal Services

The Postal Services Act neither defines universal postal service nor imposes on the government or postal operators a duty to ensure universal service. The government has decided to ensure universal service by means of an agreement with the dominant postal operator, NZP. The present “Deed of Understanding” was concluded in February 1998. Under the terms of the Deed, NZP agrees:

- To provide delivery service six days per week to more than 95 percent of delivery points;
- To maintain the stamp price below NZ$ 0.45 ($0.19);
- Not to introduce a rural service fee; and
- To maintain a specified number of post offices (some operated by NZP and some franchised to others).

In addition, The Postal Services (Information Disclosure) Regulations of 1998 introduced a new requirement for NZP to disclose certain information to the public. This includes for example, access agreements NZP has with other postal operators and information about products and services.

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[47] Congressional Testimony, “Changes in Foreign Postal Service,” Elmar Toime, 01/25/1996
[48] Investor’s Business Daily, “Postal Reform,” Daniel J. Murphy, 08/28/1995
[49] Investor’s Business Daily, “Postal Reform,” Daniel J. Murphy, 08/28/1995

Regulation

The Postal Services Act regulates the activities of “postal operators” primarily to protect the interests of consumers. The Act states that “A person carries on business as a postal operator if that person’s business consists, wholly or partly, of the carriage of letters” (as defined in the Act) delivered for a charge of NZ$ 0.80 ($ 0.34) or less.

“Postal operators” are required to file a simple registration with the Chief Executive of the Ministry of Economic Development. Under the Postal Services Act, “postal operators” are required: 1) to mark each postal article with that operator’s postal identifier, 2) to respect the privacy of postal communications, 3) to report to the government a postal article or letter posted in contravention of law, 4) to keep a record of postal articles detained or opened and notify addressees, and 5) to assist in carrying out the provisions of the Trade in Endangered Species Act. A “postal article” includes any letter, parcel, or other article carried by a postal operator. Postal operators may also be obliged to comply with additional regulations adopted by the government “for the purposes of ensuring the orderly efficient operation of the New Zealand postal system.”

Reserved Services

The Postal Act of 1998 does not provide for reserved services. There is no mailbox monopoly.

Key Products and Services

NZP offers mail, express, and financial services, electronic business tools, and international consulting through its subsidiary, Transend.[50] In the year ending March 31, 2000, total mail volumes increased five percent to 1.6 billion pieces, with package and courier volumes increasing ten percent and letter mail volumes unchanged.

Half of the revenue increase in 2000 came from the purchase of Ansett Express, a courier service. The strong performance of the international business consultancy branch also fueled revenue growth. NZP is expanding its existing financial services by creating Kiwibank to provide online banking services through a partnership with Bank of New Zealand.

Pricing

Since 1987, NZP has been largely free to set prices without regulatory interference, bound by the Deed of Understanding only to hold basic letter mail postage increases to the Consumer Price Index minus one percent.[51] In 1987, NZP immediately cut the 50-percent publications discount on the grounds that costs depend on weight, not content. In 1988, NZP adopted shape-based prices. Profit enhancement achieved through new pricing strategies and operational efficiencies allowed NZP to reduce postage rates in 1995 from NZ$ 0.45 ($0.19) to NZ$ 0.40 ($ 0.17). In the eight years between 1987 and 1995, the real price of letter postage fell by almost 30 percent.[52]

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[50] New Zealand Post website, www.nzpost.co.nz, “About Us,” 02/11/2002.
[51] Congressional Testimony, “Changes in Foreign Postal Service,” Michael E. Motley, 01/25/1996.
[52] Congressional Testimony, “Changes in Foreign Postal Service,” Elmar Toime, 01/25/1996.

In 1995, NZP also abolished an annual rural delivery fee it had been charging rural mail recipients annually since 1924 (a NZ$5 million [$2.1 million] reduction in revenue). In addition, NZP began offering a number of presort discounts for bulk mailers. NZP did not offer discounts to consolidators who combined mailings from more than one source.

Operations

In 1987, NZP was operating inadequate mail processing facilities, lacked financial and management systems, and needed substantial capital investment. Since corporatization, NZP has modernized its technology, transportation network, and retail facilities, and invested in subsidiary businesses, all funded by retained earnings and the sale of surplus assets. By 1995, with 30 percent more mail to deliver, costs had been reduced by 30 percent, and labor productivity had doubled.[53]

Over the past fifteen years NZP has changed its management structure four times: 1) initially NZP employed a functional structure, with four geographic regions reporting to a head office, giving prominence to new areas of strategic and business planning, finance, and marketing; 2) later NZP switched to a divisional structure, by product, to assist during the main phase of rationalizing the property portfolio; 3) later a matrixed structure was used, with three cost centers (letters, sales and retail, couriers and parcels) and two marketing groups; and, most recently, 4) NZP is organized by profit centers, with five business units: letters, consumer (retail), distribution (parcels), international, and post plus (electronic services).

In 1995, the government appointed a Board of Directors with considerable autonomy in operational decision-making and a biannual reporting requirement to the government. Fifty percent of senior management came from the private sector.

Human Capital

Prior to reform, NZP was overstaffed and had inadequate management systems. Recognizing the magnitude of imminent changes in the human capital area, NZP brought organized labor into the reform process to avoid misunderstandings and disputes. With the help of the unions, NZP reduced the workforce by 40 percent with minimal disruption.[54] NZP has avoided disputes by providing incentives for early retirement and other attractive redundancy packages. Part-time and shift work became major elements of parts of NZP. Overall, however, some union officials felt that deregulation occurred at the expense of postal unions; the NZ Post Office Union went bankrupt and is now represented by another union.

Wages for most employees are negotiated annually. NZP surveys market rates, comparing wages of its employees to employees in similar jobs in other firms and aims to adjust salaries to these market rates. NZP also provides incentives for superior performance, including a company-wide profit-related bonus. Senior managers have individual contracts that are generally below private sector levels. Bonus schemes are tied to a formula. There is no job protection. In 1998, 52 percent of costs were for in-house labor.[55]

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[53] Ibid.

[54] Investor's Business Daily, "Postal Reform: Do Not Forward," Daniel J. Murphy, 08/28/1995.

[55] USPS Future Vision, "Review of Eight Progressive Postal Administrations," PricewaterhouseCoopers Report, 10/15/1998.

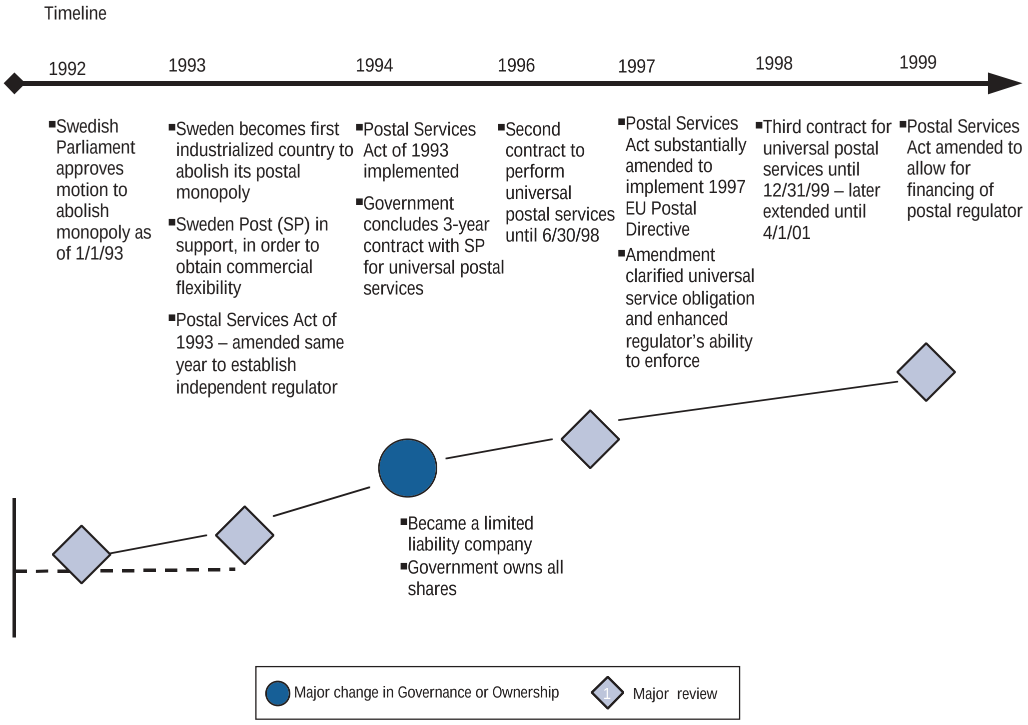
Sweden Post

Legislation and Transformation

In December 1992, the Swedish Parliament approved a motion stipulating that Sweden Post's exclusive right to letter deliveries should end, effective January 1, 1993. Consequently, on that date, Sweden became the first industrialized country to abolish its postal monopoly. The Swedish Post Office supported termination of the postal monopoly because it concluded that it could not otherwise obtain from the government the commercial flexibility necessary to adapt to a changing market. The Post Office was especially concerned with the market entry of a private company, CityMail. In 1991, CityMail pioneered a low-price, twice-per-week delivery service for computer generated mail in Stockholm, Sweden's largest city. Applicability of the postal monopoly law to CityMail was considered unclear.

The Postal Services Act of 1993, which came into effect on March 1, 1994, followed de-monopolization. This act created a new legal framework for delivery services and established an independent regulator. At the same time, the Swedish Post Office was transformed into a limited liability company, Posten A.B. ("Sweden Post" or SP), with all shares owned by the government. Details of the legal framework were set out in an administrative order, the Postal Services Ordinance of 1993. Pursuant to the 1993 Act, the government concluded a three-year contract with SP for provision of universal postal services until December 31, 1996. A second contract was agreed between SP and the government for universal services until June 30, 1998.

SWEDEN POST TRANSFORMATION HIGHLIGHTS



The legal framework for postal services in Sweden proved uncertain in some respects. CityMail repeatedly complained to Swedish competition authorities about SP's commercial tactics. At the same time, the government and SP found it difficult to agree on details of universal service.

In 1997, Swedish postal law was substantially amended to implement the 1997 EU Postal Directive and strengthen the ability of the regulator to ensure provision of universal services. In this new environment, SP and the government concluded a third contract for universal services for the period July 1, 1998, to December 31, 1999, later extended to April 1, 2001. Provisions of this agreement were also attached as conditions to SP's license to provide "postal operations."

Since April 1, 2001, no new contract for universal service provision has been concluded between SP and the government. SP continues to provide universal service in accordance with the conditions set out in SP's postal operations license.

Finance

Even prior to corporatization, SP was required to finance its own investments and survive on its own resources. SP has no access to government funds or capital for operating shortfalls.[56] It cannot be taken over, but is free to acquire and invest in other companies, invest in joint ventures, and form subsidiaries. As part of corporatization, SP was required to charge Value Added Tax (VAT) on letter, newspaper, and parcel deliveries. SP is subject to income tax and pays the government dividends when its equity/assets ratio allows. An internal management objective is a 5 percent return on sales to cover future investments.

In recent years, SP's financial performance has deteriorated significantly. In 2000, on revenues of SEK 24.5 billion ($2.5 billion), SP reported total consolidated negative earnings of SEK -1.4 billion ($-136 million). This represents an improvement on financial results achieved in 1999 when SP, based on revenues of SEK 23.9 ($2.4 billion), reported consolidated negative earnings of SEK-4.1 billion ($-407 million). SP primarily sees this performance as a result of diminishing volume growth rates that have not been met with corresponding cuts in fixed costs.

Universal Services

The Postal Services Act defines universal service to include delivery of parcels up to twenty kilograms and requires uniform nationwide rates for single piece mail: "There shall be a nationwide postal service whereby everyone can receive letters and other addressed mail weighing at most twenty kilograms. Postal services shall be of good quality and the possibility shall exist for everyone to have such mail delivered at reasonable prices. Furthermore, single items of mail shall be delivered at uniform prices." The Postal Services Act also mandates a national system of post offices: "nationwide counter service throughout Sweden whereby everyone has a possibility of effecting and receiving payments at uniform prices." Provision of universal service is an obligation attached to the license of SP but not, so far, other licensed operators.

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[56] Precision Marketing, "International operators show liberalisation benefits," 11/14/1994.

Regulation

The Postal Services Act vests responsibility for universal service in “the government or an authority appointed by the government.” The government has authorized the National Post and Telecom Agency (PTS) to “issue the implementation regulations necessary to apply the Postal Services Act as regards delivery of letters, nondeliverable letters and supervision as the regulator of the postal sector” and to administer the licensing scheme established by the Act.

The Act provides that no person may, without a license, engage in “postal operations,” defined as “regular delivery of letters for a charge.” The term “letters” is, in turn, defined as “addressed mail that is enclosed in an envelope or other wrapping weighing at most two kilograms.”

PTS may attach conditions to a license granted for “postal operations,” including a requirement to provide “universal service” in a prescribed manner, and PTS has been directed to do so by the government. The Postal Services Act further provides that any license holder obliged to provide universal service by its license shall provide “service at prices that are geared to costs,” provide annual reports, establish public procedures for handling complaints, and abide by other conditions established by PTS, including limits on postage rates.

Today, there are about fifty licensed providers of “postal operations” in Sweden. SP (94.8 percent of the market) and CityMail (4.8 percent) are the only large providers; others are small regional companies. PTS has attached universal service obligations to the license of one provider of postal operations, SP. The SP license thus sets out the details of the universal service requirement. SP’s license requires it to provide collection and delivery of postal items up to twenty kilograms on all business days, Monday through Friday.

The licensing system for “postal operations” is the only form of postal regulation in Sweden. Providers of other delivery services, including express services and parcels within the universal service area, are neither regulated nor required to register with PTS.

Reserved Services

The Postal Act does not provide for reserved services. There is no mailbox monopoly.

Key Products and Services

In 1995, SP provided delivery of letters and parcels, banking, and electronic messaging services. By 1996, SP was developing home banking products as an integrated part of its financial service offerings and progressing toward the goal of becoming a financial supermarket. By 1998, Postnet, SP’s e-commerce unit, had created one of Europe’s most popular online shopping malls—and in the process, created new business for itself—delivering thousands of e-commerce goods daily and settling payments for the purchases.

In 1999, however, SP decided to withdraw from the financial business and focus its operations on message forwarding and logistics. In 2001, as a result of its focus on core operations, SP also reduced its ownership in the online shopping mall.

However, SP continues to develop electronic products aimed at both the consumer and business markets. In 2001, SP introduced a new electronic postal delivery infrastructure. This service processes mail electronically, giving recipients a choice of delivery to a regular mailbox or an electronic post box: the “ePostbox.” It enables bills, pay slips, forms and information from business and government sources to be forwarded electronically to private individuals who can receive, respond to, and administer their mail at any time or place.

Given the increased focus on core operations, SP is working to expand its geographic coverage in the Nordic and Baltic regions. According to SP’s 2000 Annual Report, international operations and alliances are imperative in the near term.

Pricing

The Postal Services Act stipulates that a postal operations license holder shall provide “service at prices that are geared to costs.” Based on that requirement SP is free to set all its prices except for that of the standard domestic letter, on which the government and SP have agreed to a price cap equal to the consumer rate of inflation.[57]

Discounts are available to bulk mailers on an individual basis. Under Sweden’s competition law, discounts must relate to explicit criteria even if unpublished. SP’s prices were below the European average until the VAT was added after liberalization.[58] As a result, in 1997 SP raised postage for a single letter by 30 percent, arguing that the price increase was needed to cover costs.[59]

Operations

Over the past decade, SP has gone through a number of organizational changes. In 1989, SP was reorganized into five strategic business areas, which were set up as independent business units in 1992. By 1995, SP was composed of six business units: Postgirot, SP Banking and Counter Services, SP Letters, SP Parcel, Postnet, and SP International. Each business area was responsible for products, sales, operations, and profitability within its area of accountability. That year, the government appointed a Board of Directors that consisted of a chairman, three union representatives, a civil servant, and five members from the private sector.

SP also restructured its sales organization in order to serve the needs of large corporations that require centralized staff to tailor services as well as private citizens and small companies who prefer decentralized staff to quickly address local problems. The new decentralized sales unit began to operate from retail sites rather than from central headquarters.

By 2001, SP replaced its former business areas with six new business units in order to address the different messaging and logistics processes of its customers more directly.

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57 Congressional Testimony, “Changes in Foreign Postal Service,” Tommy Persson, 01/25/1996.
58 Ibid.
59 Direct, “Turning Up the Heat,” David Reed, 12/30/2000.

Human Capital

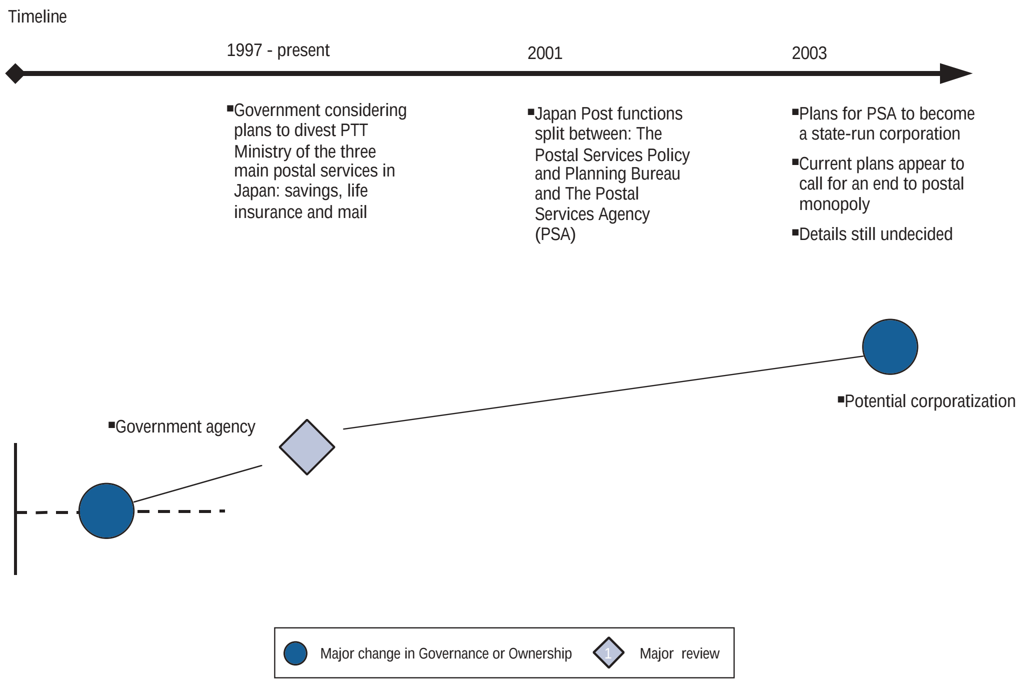
Between 1990 and 2000, SP eliminated approximately 21,900 positions, a 30 percent reduction in its workforce.[60] SP worked closely with the unions to accomplish these staff reductions without a strike. Wages are negotiated annually between SP and the unions. In line with industry norms, employees do not have job security and pay and incentives are tied to performance. SP estimates that its employees earn 5 to 10 percent above the market average. Pension plans, previously administered by the government, have been taken over by SP in return for not having to pay the government a dividend for several years. In 2000, labor costs represented 52 percent of SP's consolidated operating expenses.

The Postal Services Agency (Japan)

Legislation and Transformation

In January 2001, after three years of debate, the Japanese government reorganized its structure for managing postal services. The Ministry of Posts and Telecommunications was repositioned within the newly formed Ministry of Public Management, Home Affairs, Posts and Telecommunications (Ministry). The Postal Services Policy and Planning Bureau was placed in charge of development of plans and the management of postal services. The Postal Services Agency (PSA), an independent agency, provides postal services.

THE POSTAL GROUP SERVICES AGENCY TRANSFORMATION HIGHLIGHTS



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60 Sweden Post Annual Reports: 1991 and 2000.

As depicted in the graphic on the previous page, under present plans, the PSA may become a state-run corporation in 2003. Should this change be enacted, the government plans to introduce an independent, autonomous, and flexible financial and commercial management system for the PSA. It plans to adopt budget and accounting practices that are based on corporate accounting principles, eliminating the need to obtain approval from the Japanese Diet, or parliament, for each annual budget. In addition, there are to be performance reviews based on management objectives, business plans, and full disclosure of financial, business, and other information. It is also possible that Japan will abolish the postal monopoly in 2003, although the conditions for new entry are still under discussion.

The postal service plays a myriad of roles in Japanese culture. Politicians see the postal service as a political tool, through the tightly networked system of Special Post Offices. Business leaders see the agency as the biggest but most stagnant pool of savings in the world (the PSA is the largest private savings bank in the world with $2.1 trillion in deposits)—one that, if used well, could reinvigorate the lackluster Japanese economy. Many citizens see the government-run post as a pillar of stability and fear complications that change might bring. Despite the strong opposition, Japan's Prime Minister, Junichiro Koizumi, is strongly pushing reform as a key component of an economic stimulus and reform package.[61]

Finance

Currently, the PSA's revenues, derived from sales of stamps, postcards, and other postal materials, must cover all of its operational costs.[62] The PSA is not taxed[63] and, although it receives no financial support from the government,[64] closing, merging, and opening post offices, and buying and selling property currently requires the approval of the Diet. The proposed corporatization in 2003 would transfer these powers to the PSA. Further, the PSA is to adopt commercial budget and accounting practices. Full financial disclosure will be required.[65]

Three separate accounts are used to manage the financial condition of each of Japan's three key postal service areas: mail, savings, and life insurance. Each business account is required to breakeven on its own.[66] In 2000, the PSA's mail delivery and savings divisions incurred losses for the third year in a row. These losses were increased primarily due to increased competition in areas like parcel delivery.[67]

In 2000, based on revenues of 2,242.4 billion yen ($17.9 billion), the PSA reported consolidated negative earnings of -10 billion yen ($ -8 million). This represents an improvement on financial results achieved in 1999 when the PSA, based on virtually the same revenues, reported consolidated negative earnings of 55.3 billion yen ($-44 million).

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[61] The Globe and Mail, "Dismantling the pillar of security in Japan…," Joji Sakurai, 05/19/2001.
[62] Japan 2001 Report, www.210.142.46.154\japan2001\index_e.shtm.
[63] Kyodo News, "Gradual opening of mail service draws support at study panel," 10/31/2001.
[64] Japan 2001 Report, www.210.142.46.154\japan2001\index_e.shtm.
[65] PostCom Bulletin, "Japan Plans to Transfer Postal Power," 09/07/2001.
[66] Japan 2001 Report, www.210.142.46.154\japan2001\index_e.shtm.
[67] Daily Yomiuri/Yomiuri Shimbun, "Anachronistic 'special post office'…," 08/23/2001.

Universal Services

The PSA is required by statute "to promote the welfare of the people by the provision of postal services at the lowest possible charges, on a nationwide scale and in a manner fair to all."

Regulation

There is no independent regulator or general regulation of the delivery services sector. The PSA is subject to direction by the Postal Services Policy and Planning Bureau, within the Ministry. This bureau is in charge of the development of plans and the management of postal services.

Reserved Services

The PSA maintains a monopoly on letter mail delivery services and guarantees universal service. As stated above, plans presently exist to remove the monopoly after 2003; however, new entrants may be required to provide nationwide service, a condition that may effectively preclude entry. The final fate of the monopoly has not yet been decided.

Key Products and Services

In addition to providing traditional mail services, the PSA operates the largest savings bank in the world and the largest life insurance company in the country. The savings bank has $2.1 trillion in deposits—more than three times the amount deposited in the world's largest private bank, Mizuho Group.[68] The insurance plan has over $700 billion in assets.[69] The PSA has been losing market share annually in competitive sectors like parcel delivery.[70]

In 2001, the PSA made agreements with thirteen domestic and foreign financial institutions to handle their 401(k)-style investment products at post offices across Japan, and may begin collecting commissions for brokerage services.[71] Agreements between private financial institutions and the PSA allow customers to use the institutions' ATMs and cash dispensers interchangeably.[72]

Pricing

The PSA cannot currently establish its own tariffs. Basic charges for postcards, letters, and other mail services are regulated by the Mail Law. Diet approval is needed to change postal rates. Deregulation in 2003 is expected to transfer pricing authority to the PSA.[73]

The PSA offers discounted postage rates for newspapers and magazines published at least four times a year that are recognized by the Director General of the PSA as

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[68] The Globe and Mail, "Dismantling the pillar of security in Japan…," Joji Sakurai, 05/19/2001.
[69] Chicago Tribune, "Japan in Furor Over Postal Service Privatization Proposal," Michael A. Lev, 11/16/1997.
[70] Daily Yomiuri/Yomiuri Shimbun, "Privatization could be key to saving nation's post offices," 08/24/2001.
[71] Dow Jones International News, "Japan Post Offices to Offer 401K Products," 10/26/2001.
[72] Daily Yomiuri/Yomiuri Shimbun, "Customers benefit as banks, post offices integrate services," 11/23/1999.
[73] Dow Jones International News, "Japan To Sharply Deregulate Postal Sector," 12/18/2001.

playing a "salient role in enhancing society and culture." PSA also offers preferential postage rates for correspondence course materials, academic journals, and seeds and saplings used for agricultural purposes.[74]

Other pricing incentives include discounts for local mail with preprinted barcodes.

Operations

The PSA introduced a new seven-digit postal code system in 1998 to improve efficiency of mail processing through automation. By February 2001, mailers used the new codes on 97 percent of mail. By the end of March 2001, 858 new sorting machines for handling the seven-digit codes were in place. Between 1997 and 2001, the PSA purchased and installed over 5,500 advanced letter sorters that increased the speed of sorting substantially. In 2001, the PSA became the first Japanese government entity to become ISO 9001 certified.[75]

About 75 percent of the nation's 25,000 post offices are Special Post Offices. At Special Post Offices, postmasters provide the land and facilities required for post offices, which they lease to the government. They also receive an annual salary, as well as an annual lump-sum payment for discretionary spending. More than half of the Special Post Offices are staffed by three or fewer workers who provide all three key services: mail, savings, and life insurance.[76]

The Ministry has predicted a revenue loss in 2002. To make the PSA financially viable before corporatization in 2003, the Ministry aims for PSA to make a profit in 2002 through aggressive cost cutting.[77] In January 2002, the administrative evaluation bureau within the Ministry drafted a report urging the Ministry to streamline state-run postal services through large job cuts and consolidation of post offices, in addition to revamping or cutting money-losing operations like express courier services, which suffered losses in 2000 that totaled more than $3 million.[78]

The planned corporatization of the PSA in 2003 calls for some safeguards against post office closures in under-populated areas in order to maintain a universal postal service. Business benchmarks, like return on assets, are expected to be used to gauge performance.[79] After corporatization, PSA is expected to contract out some operations to private companies.[80]

Human Capital

Postmasters of Special Post Offices occupy prized government positions which are usually passed hereditarily and do not require the civil service exam required of most public employees. There are increasing complaints of corruption and collusion with political parties.[81] Postal employees are civil servants. Salaries are generally lower than those of workers employed by private-sector credit unions.

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74 Japan 2001 Report, www.210.142.46.154\japan2001\index_e.shtm.
75 Ibid.
76 Daily Yomiuri/Yomiuri Shimbun, "Anachronistic 'special post office' system should be reviewed," 08/23/2001.
77 Jiji Press English News Service, "Japan to Make Postal Services Profitable," 02/01/2002.
78 Dow Jones International News, "Japan Postal Job Cuts…," 01/10/2002.
79 PostCom Bulletin, "Japan Plans to Transfer Postal Power," 09/07/2001.
80 Dow Jones International News, "Japan To Sharply Deregulate Postal Sector," 12/18/2001.
81 Daily Yomiuri/Yomiuri Shimbun, "Anachronistic 'special post office' system should be reviewed," 08/23/2001.

Between 1996 and 2001, the post laid off about 4,100 postal employees and cut bonuses. The PSA has been negotiating with unions over cutting an additional 15,000 jobs over the next five years.[82] In 2000, personnel costs made up about 62 percent of total costs.[83] Even after the planned corporatization in 2003, PSA employees are expected to remain public sector employees.[84]

Japanese labor law, applicable to state-run enterprises such as the PSA, prohibits certain activities for public officials and unions, including the right to engage in labor disputes. As part of labor union activities, civil servants are entitled to engage in collective bargaining with regard to wages, salaries, work hours, holidays and vacations, and other benefits. After the planned transition to a state-run corporation, PSA workers are expected to retain their right to unionize and bargain collectively. They are not expected to gain the right to engage in labor disputes, i.e., the right to strike.

TNT Post Group (The Netherlands)

Legislation and Transformation

The Postal Act of 1988 transformed the Dutch post and telecommunications administration into Royal PTT Nederland NV (KPN), a government-owned limited liability company. PTT Post, the postal subsidiary of KPN, was obliged by the 1988 Act to maintain universal postal service in the Netherlands in return for a monopoly over the carriage of letters weighing up to five hundred grams. The Act also provided for a price limit on the monopoly.

In 1994, the Dutch government sold 30 percent of KPN to the public. Subsequent sales have reduced the holdings of the government to 35 percent. Nonetheless, the government retains a “golden share” that allows it to disapprove certain types of fundamental corporate transactions. (The European Commission is looking into the competitive implications of “golden shares” held by Member States in partially privatized companies).

Between 1996 and 1998, in a series of acquisitions and divestitures, such as the 1996 acquisition of global courier company TNT, PTT Post transformed itself into TNT Post Group (TPG), a global mail, express, and logistics operator. In June 1998, KPN “de-merged” into two separate companies, KPN (the telecommunications company) and TNT Post Group (TPG). TPG retained all of the operations of PTT Post.[85]

Finance

Since the 1994 privatization of KPN, TPG has been able to pursue an aggressive and innovative commercial strategy in the postal sector, a result of which was the $1.6 billion[86] acquisition of Australia’s global courier company TNT Worldwide Express in 1996. TPG experienced a revenue growth rate of 16 percent and an average profit growth rate of 22 percent from 1996 through 2000 as a result of its prolific acquisition

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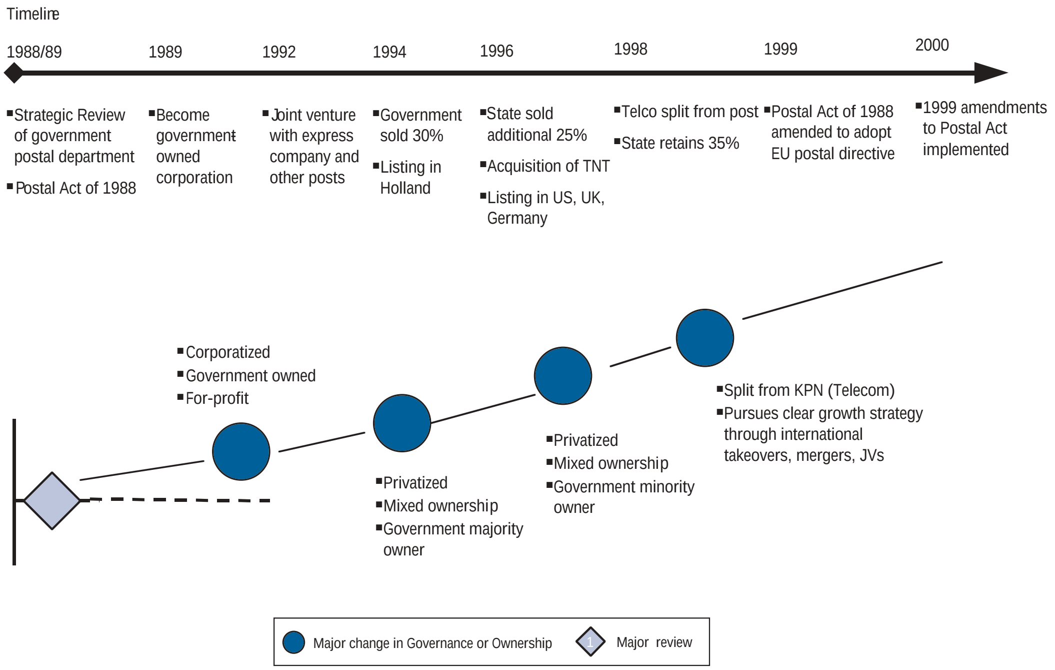
82 Agence France-Presse, “Japan’s postal services soon to see first profits in five years,” 08/28/2001.
83 Japan 2001 Report, www.210.142.46.154\japan2001\index_e.shtm.
84 Voice, “Postal Services Will Not Work as a Public Corporation,” February 2002.

TNT POST GROUP TRANSFORMATION HIGHLIGHTS



activity. In 2000, its mail business represented only 37 percent of its revenues but 70 percent of its profits.

Today TPG is publicly traded on the New York, London, Frankfurt, and Amsterdam stock exchanges and is one of the largest global postal operators. As a public corporation, TPG pays all applicable taxes, does not need government approval to access capital, and is free to enter joint ventures.

In 2001, based on revenues of €11.2 billion ($10.1 billion), TPG reported net income from continuing operations of €555 million ($500 million), an increase of 21.2 percent over the previous year. In 2000, TPG achieved revenues of €9.9 billion ($8.9 billion) and a net income of €458 million ($412 million).

Universal Services

Under the Postal Act, the obligation to provide universal service is imposed on a single public postal operator, a “concessionaire” designated by law in return for a concession (i.e., revenues from a reserved area). The obligation to provide universal service extends to “postal items which have been deposited in letter boxes of the public postal operator that are intended for the public or which have been tendered at premises of the public postal operator that are intended for this purpose.” This definition of universal service excludes bulk mail collected at the business premises of the mailer.

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85 Congressional Testimony, “International Postal Policy,” Simone Bos, 03/09/2000.
86 Traffic World, “Applying Postal Breaks,” John Parker, 01/08/2001.

As a result, postal services for bulk mail are considered commercial services and are outside the special considerations of the postal regime including the universal service obligation.

The Postal Decree provides that universal services shall include letters and printed matter up to two kilograms and parcels up to ten kilograms. The Minister of Transport, Public Works, and Water Management (Minister) is authorized to issue regulations determining the quality and tariffs of universal service.

Regulation

The Postal Act does not provide for a general framework for registration, licensing, or regulation of postal services. Regulation is generally limited to defining and enforcing obligations of the public postal operator. For this purpose supervisory authority is divided between the Minister and the regulator of the telecommunications and postal sectors, the Independent Post and Telecommunications Authority (OPTA).

The Minister, in addition to determining details of universal service, may regulate accounting practices, establish a consultative users group, create a board to resolve certain user complaints, issue guidelines relating to unfair competition, establish limits on increases in basic postage rates, and issue orders on placement and dimensions of letter boxes.

The public postal operator is required to offer other delivery services access to its post office boxes at reasonable fees. OPTA is responsible for resolving disputes about appropriate fees. OPTA is also responsible for regulatory tasks delegated by the Minister or not committed to him. OPTA may investigate violations of law within its jurisdiction and issue orders or impose fines of up to NLG 1 million ($410,000) to enforce its decisions.

Reserved Services

The Postal Act provides that only the public postal operator may carry a “letter” which weighs one hundred grams or less and is conveyed at a postal tariff lower than that determined by administrative order. The Postal Decree sets the price limit at three times the basic stamp price of NLG 0.80 ($ 0.33). The Postal Act defines “letters” as “written communications and other documents, whether in envelopes or not, with the exception of those of which a number of identical copies have been produced by means of printing or other duplicating techniques for the purpose of distribution and which have not been altered by additions, deletions or indications other than the address.” Under this definition, the term “letters” does not include identical printed advertisements.

The public postal operator has the exclusive right to establish letter collection boxes along public highways. There is no mailbox monopoly.

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87 TPG Annual Report, 2000.

Key Products and Services

TPG operates three main divisions: Mail, Express, and Logistics, with Mail representing 37 percent of revenue in 2000, Express 41 percent, and Logistics 22 percent.[87] TPG has worked to become a key European provider of cross-border mail services and to develop both domestic and international mail products.

TPG's current product and service portfolio is the result of a series of acquisitions and divestitures. As a corporate entity, before the 1998 de-merger, KPN diversified into security services, venture capital subsidiaries, and value-added services like database management, response handling, warehousing, and financial services.[88] In 1991, PTT Post joined the public postal operators of France, Germany, Sweden, and Canada to form a consortium, GD Express Worldwide, which bought half of TNT Express Worldwide, then the second largest international express company in the world. In July 1996, PTT Post and Sweden Post bought the shares of the other public postal operators of GD Express Worldwide, and PTT Post became the majority shareholder. In October 1996, PTT Post, through KPN, initiated a purchase of TNT, the Australian company that owned the remaining portion of TNT Express. This acquisition gave KPN majority ownership and complete control of TNT Express. Prior to the acquisition, PTT Post generated 90 percent of its revenue in Holland; afterward that number dropped to 40 percent.[89] As a result of the TNT acquisition, TPG now offers express services to and from more than two hundred countries.

TPG's logistics division is the result of many acquisitions and alliances, such as the $650 million purchase of CSX Corp.'s CTI Logistics in 2000.[90] As a result, TPG has become one of the world's largest international logistics providers.

Pricing

TPG's rates are governed by a price cap regime. Accordingly, the price that the average user pays for services under the postal concession is linked to price indices published by the government's Central Planning Office. Price changes may not exceed increases in these indices. For mandatory services of TPG, the relevant index is wage costs per employee in the private sector.

This system is used to control the overall development of charges that apply to the complete range of postal services. TPG has the freedom to change its prices for individual services on the basis of market considerations by varying percentages within the limits set by the price cap.[91] OPTA audits the application of the price cap system.

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[88] Precision Marketing, "International operators show liberalisation benefits," 11/14/1994.
[89] Congressional Testimony, "International Postal Policy," Simone Bos, 03/09/2000.
[90] Traffic World, "Applying Postal Breaks," John Parker, 01/08/2001.
[91] TPG Annual Report, 2000.
[92] Business Week, "Posts With the Most," William Echikson, et. al., 08/17/1998.

Operations

In the early 1980s poor service, dissatisfied business customers, rising labor costs, declining employee productivity, and increasing prices characterized the Dutch postal service. Business clients began shifting parcel deliveries to private carriers. To improve performance, PTT Post moved to overhaul the infrastructure. In the mid-1990s TPG franchised out most of its small post offices to a retail newsstand chain and built ten large automated sorting facilities. The sorting facilities increased mechanized handling from 30 percent in 1996 to 90 percent in 1999, for estimated annual savings of over $300 million.[92]

To reduce costs, PTT Post restructured its distribution network. To ensure greater transparency and accountability, the company was split into separate business units, each responsible for a single product/market combination and its own profit and loss statements. Overall, TPG was able to reduce overhead costs, reduce the head count at headquarters, implement a new management philosophy, delegate more responsibility to business units, involve managers more in daily business, and develop a new appraisal system tying management to financial performance. Management policy stresses decentralization, management targets, accountability, delegation of authority, and a results orientation.

Human Capital

To prepare for privatization, the Dutch post was required to restructure many of its human capital practices and polices. Compared with other companies, the existing salary structure was too high in the lower pay scales and too low in the higher pay scales, and the appraisal system rewarded seniority rather than performance. PTT Post brought in outside management that started a cultural change. Knowledge that jobs were no longer secure increased the willingness of personnel to cooperate in the change process. In cooperation with the unions, PTT Post established various human resource initiatives, such as training and financial incentives. PTT Post convinced the unions to accept short-term job losses in order to ensure the long-term growth and financial health of the company. Although the company did suffer a strike among postal workers in 1989, TPG has had no major labor disputes since privatization. In 2000, in-house labor costs were 33 percent of total costs.[93]

Following the 1998 de-merger, TPG offered Dutch employees working under a collective labor agreement a one-time opportunity to participate in a stock option plan. Approximately 26 percent of employees chose to participate. Stock options are also offered to TPG’s Board of Management, as well as other senior managers.

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93 TPG Annual Report, 2000.

Appendix I

APPENDIX I — Overview of the Universal Postal Union

Introduction

The Universal Postal Union (UPU) is undergoing a transition in its understanding of its role in the international postal community. The UPU has traditionally seen itself as the primary, if not exclusive, agent for the exchange of mail among countries. It now must define its role in supporting government-mandated mail services at an international level in the context of a larger and more rapidly growing private sector market for delivery services. The UPU member countries and their postal operators are changing their expectations for the UPU. While all UPU members continue to support the UPU as the forum for fulfilling basic universal service commitments at a global level, the more commercially aggressive postal operators are shifting attention and resources to developing operational capabilities outside the framework of the UPU and in the larger delivery services market. Private operators, in turn, see many postal operators becoming more commercially aggressive and expect governments and the UPU to open up to the private operators' own issues and interests. Furthermore, they expect governments and the UPU to be even-handed when it comes to competition in the market place. The future of the UPU depends upon its ability to evolve in response to increasingly diverse expectations and requirements.

Origins of the Universal Postal Union

The Universal Postal Union (UPU) is an intergovernmental organization and United Nations specialized agency with 189 member countries. The concept for this organization was first proposed by U.S. Postmaster General Montgomery Blair in 1863. Established in 1874 by the Treaty of Bern, which was signed by twenty-two nations, it is now the second oldest treaty organization in the world. Originally known as the "General Postal Union," after rapid expansion in membership its name was changed in 1878 to the "Universal Postal Union." On July 1, 1948, the United Nations recognized that the UPU met the conditions set out by its Charter to become a United Nations specialized agency (i.e., that the UPU was set up by an intergovernmental agreement and has wide international responsibilities in the economic field). The United Nations also recognized the UPU as the only organization responsible for international postal matters.

Role and Function

At its inception, the UPU's main function was to provide a forum in which national postal administrations could come together and agree on a common set of international postal services. The services set forth in the UPU Acts apply only to operators that have been designated by their governments to provide these services in fulfillment of a domestic universal service obligation. The UPU Acts reflect, at a global level, the commitment of governments, at a national level, to ensure the provision of a basic set of postal services.

The UPU distinguishes between mandatory international services, which all members are obligated to provide, and other optional international services. Mandatory services include letters and postcards (known as “LC”), printed papers, literature for the blind, small packets (known as “AO”) and parcels. UPU regulations govern the operational procedures, inter-administration charges and payment mechanisms for these products. Optional services include Express Mail (EMS) and financial services such as money orders. The operational procedures, inter-administration charges and payment mechanisms for these optional services are governed by bilateral agreement.

Other key functions of the UPU are to initiate and support programs to improve international quality of service, to promote technological enhancements, to advance mail security, to support marketing efforts, to provide training and technical support, and to transfer knowledge and skills required to promote improved services in developing countries. The UPU also administers a Quality of Service Fund established at the 1999 Beijing Congress. Funded by a portion of the remuneration paid by industrialized countries to developing countries for letter mail delivery, these monies will be used for postal infrastructure development and service improvement in developing countries.

Delivery charges

Another important function of the UPU is to set the delivery charges for mandatory letter post services and the procedures for settlement. With respect to letters and small packets, prior to 1969 it was assumed that a letter sent abroad generated a letter in return. Therefore, postal administrations did not compensate each other as these payments were viewed to balance out. In 1969, in response to concerns of newly decolonized developing countries that were importing far more mail than they were exporting, the UPU adopted interadministration charges to cover the cost of delivery of letter post items; this remuneration became known as *terminal dues*. Terminal dues were initially standardized for all members based on global average costs in order to promote universal services at affordable prices in a manner that was administratively feasible. The structure of the rates evolved over time to reflect more appropriately mail flow characteristics between countries. In 1999, the UPU Beijing Congress took a significant step toward a more cost-based system for industrialized countries, while it continued to apply a global average cost system for developing countries. (The UPU has twenty-nine industrialized country members and 160 developing country members in accordance with the definition of the United Nations Development Program.)

While terminal dues within the UPU must be approved by a majority of the membership, postal administrations may also pursue bilateral or regional arrangements outside the UPU structure. Some administrations that offer more commercial letter post services outside the scope of the traditional universal service obligation, particularly in Europe, have chosen to negotiate such bilateral or regional agreements for their most significant flows. Most administrations, however, continue to apply UPU terminal dues rates.

Unlike with terminal dues, postal administrations set their UPU parcel delivery charges unilaterally. Initially many postal administrations set these rates very high as there was little competition in the parcels market. With the rise of competition in the parcels market, many posts have negotiated parcel delivery rates outside of the UPU, either with other postal administrations or private delivery agents.

Interadministration payments for optional services within the UPU, which include Express Mail and financial services, are also set unilaterally by each national postal administration.

The Rise of Competition

When the UPU was established in 1874, national postal administrations were the primary, if not sole, providers of domestic and international delivery services. Competition was not a significant issue. The emergence of a global marketplace for delivery services, and increasing competition from the private sector for domestic and international delivery markets not covered by national monopolies, has raised questions regarding the role of the UPU and its impact on the private sector. The emergence of competition from the private sector has also raised questions within national postal administrations as to their own involvement in more commercial activities in order to meet the changing needs of national consumers and to maintain the viability of a universal service network in the face of market developments.

These questions have been addressed most thoroughly in Europe where during the past few years the European Commission and national governments have given close scrutiny to the relationship between public postal operators and private operators in addressing competition in the postal sector. Dialogue around this issue has sought to address two questions:

- How can governments help public postal operators fulfill their universal service obligations and become more commercially viable and self-sustaining in a competitive environment so that consumers have access to the highest quality and lowest priced services and;
- As public postal operators become more commercially viable, how can governments ensure that they do not take advantage of their monopoly protection while also promoting fair competition among public and private operators?

In an effort to promote competition and improve the quality of postal services, in the early 1990s most European governments responded to these questions by gradually reducing the scope of the postal monopoly and exposing public postal operators to more competition. The European Commission is seeking to fully liberalize the postal market and drastically reduce or even eliminate postal monopolies by 2009. While public postal operators are still responsible for fulfilling the universal service obligations defined by governments, they are free to offer services on a more commercial basis.

In order to implement most effectively this move towards a more liberalized market for postal services, European governments have also taken measures to separate regulatory functions related to national delivery services from the operational functions related to such services. The regulators oversee fulfillment of universal service obligations, including quality of service standards and affordable prices, essentially for monopoly traffic. Usually part of a government ministry, they are to assume a neutral position in overseeing competition between the public and private operators in order to ensure fair competition and to guarantee that consumer interests are addressed.

The changes in the European postal market and exposure of European postal operators to greater competition in the letter market spurred a flurry of alliances and then acquisitions by European posts as they positioned themselves in the European postal market. Many European postal operators initially adopted a strategy focusing on improving express mail services in order to compete with the private sector and generate revenues that would enable them to continue to support their costly universal service networks. In 1994, the postal administrations of the Netherlands, France, Germany, Sweden, and Canada created a joint venture with the multinational integrator TNT. This alliance was the first significant break from traditional arrangements among national postal administrations for mail delivery as it set a new precedent for alliances between public and private operators.

This new arrangement proved inadequate, however. In a second watershed event, the Dutch Post bought out their postal partners and purchased TNT, marking the first time a postal administration had ever acquired a private global network. TNT's purchase pushed other European postal operators to reevaluate their international strategies. The strategies of four posts, TNT Post Group of the Netherlands, Deutsche Post World Net of Germany, Consignia of Great Britain, and La Poste of France best illustrate the aggressiveness of the strategies pursued.

Netherlands

PTT Post of the Netherlands was one of the first posts to pursue commercial activities outside its borders. In the late 1960s, PTT Post partnered with KLM Airlines to establish operational hubs in the United States and sell its international services to U.S. customers, particularly for publications. They later expanded these services to include electronic transmission and distribution of letters and printed matter, including printing, sorting, labeling, and address correction. PTT Post's purchase of TNT in 1996 for $1.45 billion sent shock waves through the postal world. This acquisition gave PTT Post, now called TNT Post Group, a global capability in the parcels, expedited, and logistics markets. This capability was not limited to Europe and enabled the Dutch Post to compete at a global level.

Germany

Following the collapse of the joint venture with TNT, Deutsche Post World Net began to round out its express and parcels network by purchasing private ground delivery networks throughout Europe. In 1998, Deutsche Post purchased its own share of a multinational integrator—DHL. This share was initially 25 percent and has grown to more than 50 percent. Deutsche Post's stake in DHL allowed it to compete in the express and parcels market both within and outside of Europe.

Deutsche Post next expanded into the market for letters and printed matter. It acquired Global Mail in the United States, which was reported to be the largest private provider of international mail services. Deutsche Post's acquisitions also included Yellowstone International Corporation in Illinois, International Postal Consultants in Maryland, the international mail division of Skymail International Inc., in Utah, and QuickMail in New York.

Lastly, Deutsche Post rounded out its market strategy by moving into the global freight forwarding and logistics markets. It entered this market with the purchase of Danzas, the Swiss leader in sea and air freight forwarding, warehousing and logistics, with offices in sixty countries. Deutsche Post's subsequent purchase of Air Express International (AEI) in the United States gave it ownership of the world's largest global logistics network.

In just two years, Deutsche Post spent more than $5 billion in acquisitions that would make it a major player in the market for delivery services, freight forwarding, and logistics. These acquisitions enabled Deutsche Post World Net to compete with public and private operators both within and outside of Europe.

Great Britain

The initial postal strategy of Great Britain was to concentrate on the market for letters and printed matter, including catalogues and advertising mail, both within and outside of Europe. The postal administration of Great Britain, now called Consignia, established its own sales organization in the United States which offered U.S. consumers not only delivery in Europe, but also access to value-added services such as mail preparation. In 1997, Royal Mail US had invested more than $20 million to expand its sales and operations hubs and was deploying an aggressive strategy using preferential wholesale and retail pricing policies. In 1999, the British moved into the market for expedited delivery in the United States when it spent $40 million to purchase Citipost Group in New York. Citipost provided next-day document service in 155 commercial areas in the United States.

In sum, the British positioned themselves to compete with private providers in the United States and with the U.S. Postal Service. While the services offered by the U.S. Postal Service were set under U.S. law, the British were able to offer services to U.S. consumers and businesses that were set by British law.

France

La Poste of France has pursued activities in the markets for letters and printed matter, parcels and expedited services. La Poste has formed an alliance with Federal Express for the delivery of express mail globally. For parcels in Europe, La Poste has also purchased its own ground delivery network, Deutscher Paket Dienst (DPD). In the United States, like the British and several other European postal administrations, La Poste has set up sales activities to offer services for delivery of letters and printed matter to U.S. consumers, in direct competition with private operators and the U.S. Postal Service.

Extra-territorial Offices of Exchange (ETOEs)

In addition to the establishment of postal alliances and acquisitions as part of their postal strategy, some postal administrations, mainly in Europe, have recently established extra-territorial offices of exchange (ETOEs). ETOEs are offices that postal operators establish outside of their national territory to process and tender international mail. Whereas private mail consolidators must pay domestic postage rates to access postal networks, ETOE operators seek to access the same services under the provisions of the UPU Acts. Furthermore, ETOE operators may choose to offer services to only the most lucrative markets, while the national postal operator must offer services to all citizens.

The U.S. Postal Service has adopted the position that it will not accept items tendered by ETOEs under UPU documentation for delivery under UPU terminal dues rates. In the Postal Service's view, the services that postal operators provide in fulfillment of their universal service obligations under the UPU Acts are services agreed upon by governments. The services that a postal operator may provide from an ETOE established outside its national territory are strictly commercial services. ETOEs should not, therefore, be able to access postal networks under the terms of the UPU Acts, since they are not treaty-based services fulfilling a country's obligations under the UPU Acts. Furthermore, as private operators do not have access to postal networks under the UPU Acts, permitting ETOEs to access postal networks under the terms of the UPU Acts arguably creates an unequal playing field.

U.S. Postal Service's reaction to the rise of competition

The U.S. Postal Service is developing its own strategies to respond to these changes in the postal market, and particularly to the growing competition from European postal operators that are able to pursue more commercial activities.

In the premium market for expedited services, the Postal Service has formed an alliance with DHL for delivery of letters and packages weighing up to seventy pounds. This premium product offers customers a guaranteed delivery time of two days.

In the Express Mail and parcels market, the Postal Service recently signed an agreement with Consignia of Great Britain for delivery of Express Mail (EMS) and air parcels in twenty-three countries in Europe by accessing the General Parcel network that Consignia has acquired. This agreement has enabled the Postal Service to offer consumers enhanced features such as tracking while maintaining affordable rates for expedited handling. In the Asia-Pacific region, the Postal Service is working diligently with its postal partners to implement a system of pay-for-performance for EMS. By linking delivery payments to service performance, the Postal Service intends to drive service improvements for Express Mail both in Asia-Pacific and the United States. For delivery of Express Mail and parcels in the rest of the world, the Postal Service continues to work with national postal administrations. Through the UPU, the Postal Service is pushing efforts to improve service quality for EMS and parcels by introducing value-added features such as tracking and delivery to all individual residences.

UPU reaction to the rise of competition

The rise of competition in the market for postal products and services, and the liberalization of postal markets in Europe, has also had an impact on the UPU. While the UPU does not have a regulatory role at the global level that postal regulators have at the national level, efforts were made to apply the principle of separation of regulatory and operational functions that existed in Europe to the UPU. The majority of UPU members, however, had not separated operational postal functions from regulatory ones. Nonetheless, in 1994 the UPU reorganized its activities into two bodies, the Postal Operations Council (POC) and the Council of Administration (CA).

The POC has the responsibility for addressing issues of an operational and technical nature. National postal administrations represent UPU members in the POC. Where there is a postal regulator, it may participate in an advisory capacity.

The CA, on the other hand, addresses issues of government policy related to the postal sector. UPU member countries that have separated operational and regulatory postal functions assign lead responsibility in the CA to the postal regulator, with the postal operator serving in an advisory capacity. UPU countries not organized along operational/regulatory lines for postal matters, which are still the majority of UPU members, send representatives from national postal administrations with expertise in policy matters.

U.S. Government Participation in the UPU

Until 1998, the U.S. Postal Service led the U.S. delegation to the UPU Postal Operations Council and Council of Administration. The statutory basis for the U.S. Postal Service to represent the United States in the UPU was 39 U.S.C. 407 (a), which provided in pertinent part: “The Postal Service, with the consent of the President, may negotiate and conclude postal treaties or conventions…” The Postal Service exercised this authority in conformity with the foreign policy of the United States by coordinating with the State Department as the President’s representative for foreign policy.

In the years leading up to the 1999 Beijing Congress, however, questions regarding the role of the UPU and the Postal Service’s participation in the organization rose to the forefront of U.S. international postal policy debate. In the view of the private operators, decisions taken in the UPU also affected their interests. More specifically, they saw the UPU as giving public operators access to postal delivery networks in other countries at conditions that were more advantageous than those available to private operators. They also believed that public operators, by virtue of their UPU participation, had a platform to promote postal issues on a more global scale, particularly with regard to their relationship with national customs authorities in other countries. They called for more openness, greater transparency and increased involvement by private sector stakeholders in the UPU. Lastly, they wanted to see further separation of operational and regulatory functions in the organization.

The Postal Service, on the other hand, asserted that the UPU Acts constituted an international treaty that applied only to postal operators designated by their governments to fulfill universal service obligations; they did not regulate private operators. Furthermore, it claimed that because only the Postal Service was obligated to fulfill the UPU Acts, it was only appropriate that the Postal Service take the lead for the United States in formulating the procedures for mail exchange with other national postal administrations. In the Postal Service’s view, it was the only U.S. government agency with the expertise and technical knowledge to negotiate procedures for exchanging international mail among universal service providers.

In 1998, these issues came to a head when Congress amended 39 U.S.C. 407. This ammendment transferred lead responsibility for formulation of international postal policy and lead representation in the UPU from the Postal Service to the Department of State. In implementing this legislation, the State Department now leads delegations to the CA and UPU Congress, while the Postal Service continues to lead delegations to the POC, subject to policy guidance from the State Department.

1999 UPU Beijing Congress

The 1999 UPU Beijing Congress was the first time the U.S. State Department, and not the Postal Service, led a U.S. delegation to a UPU Congress. The U.S. delegation was the only delegation to have representatives from the private sector. The State Department was responsible for building consensus on postal issues not only with other countries but within the delegation itself.

As head of delegation, the State Department's highest priority was UPU reform. The State Department called for greater openness and transparency in the UPU and a wider role for private sector stakeholders (associations of private delivery operators, mailers, postal suppliers, trade unions, etc.). UPU reform efforts encountered significant resistance, however, as the response of most UPU members was initially not very positive. Many questioned the contributions of the private sector in promoting universal service. The only real support came from some European regulators who favored applying European market liberalization policies to the UPU.

Following intense lobbying efforts, the UPU Congress ultimately adopted two resolutions addressing UPU reform. The first resolution approved the creation of an Advisory Group within the UPU. The Advisory Group was to be made up of international nongovernmental organizations, including consumers' associations, associations of private operators, organizations of labor union and mail users' associations. Its purpose was to give these postal stakeholders an opportunity to offer advice and input to the POC and CA on issues of importance to the UPU and the postal industry. These issues included market developments, international trade and commerce, security, the environment and postal development. The Advisory Group would meet twice annually and members could request to observe meetings of the POC and CA.

The second resolution called for the creation of a High-Level Group. This group, composed of twenty-six UPU members including the United States, was mandated to study how to open the UPU to wider participation by the private sector while ensuring support for universal service and the development needs of developing countries. It was tasked with reporting the findings of its study to the 2001 Council of Administration. The U.S. delegation to the High-Level Group was led by the Department of State and included representatives from the Postal Service, private delivery operators, mailers' associations and the Postal Rate Commission.

New mission and structure

The 2001 Council of Administration adopted several recommendations made by the High-Level Group. First, the High-Level Group had debated who should be entitled to membership in the UPU. While the UPU had always been an intergovernmental organization whose members were the governments themselves, some members supported the view that postal operators, regulators and private sector stakeholders should have their own individual membership and membership rights. The CA approved the High-Level Group's recommendation, however, that the UPU continue to be an intergovernmental organization whose members were national governments.

Second, the CA agreed that the UPU's mission would be to promote service quality improvements for universal postal services, ensure freedom of transit for postal items, promote standardization and use of technology, advance dialogue among all postal stakeholders, provide technical assistance for developing countries, and address customer needs.

Most significantly, the CA approved the creation of a third working body, the Consultative Committee, which would include representatives from the private sector and would give them a wider role and more rights than that of the Advisory Group. The Committee's objective would be to represent the interests of the wider international postal sector in the UPU (private operators, mailers, postal suppliers, labor unions, etc) by 1) providing a framework for effective dialogue between stakeholders; 2) providing input to the relevant work of the CA, POC and UPU Congress; and 3) considering wider sector issues and making recommendations. The most significant new feature of the Consultative Committee was that it gave the private sector members their own status as observers in meetings of the CA, POC, and UPU Congress.

Lastly, the Council of Administration would continue to deal with strategic and governmental policy issues, including further UPU reform measures, matters of international law and the budget. The Postal Operations Council would continue to facilitate interconnection among operators responsible for delivering the services set out in the UPU Acts and would be responsible for standards, procedures and operational and compensation arrangements necessary to meet treaty obligations.

The 2001 CA decided that most of the High-Level Group's recommendations could be implemented immediately. These changes would serve as interim measures only, however, until the 2004 Abidjan Congress. The UPU would therefore have almost three years to evaluate these changes and to consider further reform measures before making final recommendations to the Abidjan Congress.

Perspective on the U.S. delivery services market

To put the U.S. international delivery services market in perspective, it is important to note that international mail only accounts for roughly 3 percent of total revenues of the Postal Service.

According to market research conducted by the Postal Service for the year 2000, the overall U.S. international delivery services market, inbound and outbound, was valued at more than $10 billion. Expedited and parcel service revenues make up about 83 percent of this marketing and are growing steadily. It is in this lion's share of the international delivery service market that the private multinational integrators dominate; the Postal Service only has an approximate 5 percent revenue share.

Letter and printed matter revenues comprise only about 17 percent of the U.S. international delivery services market; furthermore with the rise of electronic substitution, overall letter volumes and revenues are starting to decline. The U.S. Postal Service has the largest share of this market, about 75 percent by revenue.

Looking Ahead

The UPU continues to reflect, on an international level, the universal service commitments of governments at a national level and the role they assign to national postal operators to fulfill these commitments. The challenge of the UPU is to ensure that it also reflects varying levels of postal reform and the liberalization of postal markets around the world.

There are varying views on the future role that the UPU will play in the overall market for delivery services. One view projects the UPU as a kind of global regulator promoting the opening up of national and international delivery service markets to all operators on equal terms. In this view, national postal monopolies will diminish, postal operators will be privatized, and several operators may be licensed or otherwise enabled to compete in fulfilling universal service obligations at the national level. At the international level, and depending upon the country, there may no longer be a single national operator designated to fulfill UPU service obligations. Rather, many operators, postal or private, could compete to provide these services. According to this view, the telecommunications sector has already proceeded along this path, at least with respect to long-distance services, and the postal sector is likely to follow. Furthermore, this view asserts that what the World Trade Organization is to global trade and commerce, the UPU could become for the delivery services sector. Developments in Europe provide some support for this view.

Another view projects the UPU as continuing its role as the forum for intergovernmental cooperation in assuring a basic set of universal services at affordable prices on a global level. In this view, although postal monopolies may diminish, and although the market for package and express delivery services will continue to grow outside the framework of universal service obligations, governments will maintain their commitments to a basic set of universal services for the foreseeable future. Furthermore, to enhance their universal service capabilities, governments in developing countries will continue an interest in the postal development and technical cooperation support functions of the UPU. For both industrialized and developing countries, the UPU would continue to have a role with respect to mail security, standardization, interoperability and the application of new technology to mail exchanges. The slower pace of postal reform outside Europe provides some support for this view.

For now, the UPU continues its struggle to find ways to accommodate both perspectives. The more commercially aggressive postal operators will continue their efforts to develop independent delivery networks, outside the UPU framework, through acquisitions, joint ventures or alliances. Private operators will continue to push for reform and market-opening measures, both in the World Trade Organization and in the UPU.

Appendix J

APPENDIX J — Stakeholder Outreach — Process and Results

Summary

Outreach

Stakeholders of the United States Postal Service were asked to comment on postal transformation through an outreach program that included discussion proposals, Web-based and traditional mail channels, focus groups and public surveys, stakeholder group meetings, and employee surveys.

Described by the General Accounting Office (GAO) as a “divided community of interests,” stakeholders nevertheless were able to find consensus on several broad themes:

- Postal Service transformation is necessary and desirable.
- Transformation should get underway as soon as possible.
- The Postal Service should take a leadership role, rather than wait for others to resolve its issues.
- Universal service must be maintained, though not necessarily in its current form.
- The Postal Service should continue to emphasize secure, accessible, and affordable delivery.
- There is no clear mandate for full privatization of the Postal Service.

The Outreach Process

To ensure that stakeholders had ease of access and a context for commentary, the Postal Service published two notices in the *Federal Register* and disseminated a report titled *Outline for Discussion: Concepts for Postal Transformation*. The Postal Service provided a Web-based communications channel as well as that of traditional mail, conducted consumer and small- and medium-sized business customer focus groups throughout the nation, facilitated Board of Governors-directed panel discussions, sponsored a national telephone survey, and presented a transformation questionnaire to postal executives. As a result of the events of September 11 and the anthrax incidents, the deadline for the stakeholder comment period that began September 2001 was extended from November 1, 2001, to January 31, 2002.

Stakeholder Feedback

Postal stakeholders—business mailers, Postal Service employees, consumers, Postal Service suppliers, policymakers, the General Accounting Office and the Postal Rate Commission (PRC)—were posed a series of questions on postal transformation. The questions solicited opinions on the broad concept of transformation and on its specific components: universal service, core services, productivity and affordability, financial challenges, human capital, commercialization, and privatization.

In addition to the areas of agreement noted earlier, stakeholder groups found consensus in other areas.

Mailers urged the Postal Service not to underestimate the seriousness of the problem; to be bold and explicit in its recommendations; to move quickly to implement proposed actions in the near term; to hold the line on large and frequent rate increases; to work to raise its debt ceiling and address the issue of its unfunded liabilities; to pursue cost-cutting measures; and to strive to increase productivity. Some of them also recommended the creation of a presidential commission mandated to bring about postal transformation.

Employees—executives, as well as managers, craft, and the organizations representing them—generally agreed that universal service must be preserved; that the Postal Service should do everything it can to introduce new products and increase revenue; that change should be made quickly and boldly; and that flexibility should be created to allow the organization to become more competitive and experience new growth.

Consumers said they are generally satisfied with the current service and structure of the Postal Service. These consumers recognized the service improvements the Postal Service has made over the last several years, and fully expect further incremental improvements to be made. When told that greater financial pressures would be confronting the Postal Service, consumers expressed a surprising willingness to entertain tradeoffs, such as changes to the laws that govern the Postal Service, modifications to the universal service mandate, and modifications to service levels.

A unanimous opinion voiced by suppliers was the need for the Postal Service to recognize the need for transformation and a desire that the Postal Service act quickly. Suppliers were concerned also about Postal Service reductions in spending on capital.

Policymakers, who include policy institutes and other independent observers, responded to the *Outline for Discussion* by publishing articles, white papers, and other documents containing reform proposals which, while not directly submitted to the Postal Service's transformation planners during the stakeholder comment period, were reviewed and taken into consideration.

In addition to commenting on the questions posed in the discussion document, stakeholders also offered comments on mail safety and security, customer service, new products and services, labor/management relations, rates and pricing, and other topics.

The GAO Perspective

In February 2002, the GAO issued a report that summarized its commentary and recommendations on postal transformation. The report, titled, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, followed two documents containing testimony on the need for transformation that were presented to the Congress by the GAO in April and May 2001.

The February 2002 report expressed a sense of urgency regarding the need for postal transformation. The GAO renewed its request for Congress to revisit the statutory framework under which the Postal Service operates.

Focus Groups and Surveys

The Postal Service conducted consumer and small- to medium-sized business customer focus groups nationwide and separately surveyed both the American public and postal executives on postal transformation and its implications.

Analysis of the focus group results revealed distinct segments that differ in their views about the government's role and freedoms the Postal Service should have. The two largest groups—where the majority of consumers appear to fall—are legislative reformers and operational improvement seekers. Legislative reformers seek changes that will make the Postal Service operate more like a business, but at the same time, ensure that universal service is preserved. Operational improvement seekers are opposed to privatization; they simply feel that better management will ensure the Postal Service's continued viability.

The focus group analysis concluded that finding a universally acceptable proposal will be difficult, if not impossible. Working toward, but not skipping immediately to fundamental transformation, will be most palatable.

A survey of postal executives indicated a significant number believe that revisions are necessary in the definition of universal service, the network of post offices, and the products and services offered by the Postal Service. They believe that new funding sources need to be explored and do not believe that productivity alone will be enough to fund an expanding universal service mission.

Additional Input

Postal modernization and reform issues have been discussed since the introduction of H.R. 22 (a bill developed to modernize postal law in the United States, which was not passed) in Congress several years ago. There are many comments already on the public record, including congressional hearings, testimony, articles, and publications. This additional material represents the positions of many stakeholders on the key issues that were addressed by the transformation outreach program and were reviewed during the outreach process.

Report on Stakeholder Outreach – Process and Results

The Postal Service stakeholder community is generally thought of as being comprised of several constituencies: the Congress, public policymakers, the General Accounting Office and the Postal Rate Commission, postal employees and the organizations that represent them, consumers, business mailers (including small, medium-sized, and major mailers), and suppliers/business partners. Both before and after the publication of the *Outline for Discussion: Concepts for Postal Transformation* on September 30, 2001, a range of commentary was received from these groups. The official comment period ended on January 31, 2002. Additional inputs—comments in magazines, newspapers and industry journals; discussions at industry meetings and other forums; reports and presentations—were also considered during the development of this plan. The stakeholder input confirmed that there is a lack of consensus about many specific aspects of postal transformation.

There was, however, broad stakeholder agreement on the following themes:

- Postal Service transformation is necessary and desirable. Stakeholders largely agree that the current state of the Postal Service will not serve its stakeholders in the future.
- Transformation should get underway as soon as possible. Stakeholders felt the Postal Service has identified many problems it could have already addressed within its current mandate and policy environment.
- The Postal Service should take a leadership role, rather than wait for others to resolve its issues. Many stakeholders believe that the Postal Service can do more to improve, and should move forward boldly.
- Universal service must be maintained, though not necessarily in its current form.
- The Postal Service should continue to emphasize secure, accessible, and affordable delivery.

There is no clear mandate for privatization of the Postal Service. While there were some proponents, the majority of stakeholders did not call for privatization.

There was considerably less agreement on the extent of structural transformation, its timeline and milestones, where legislative action is called for, and how the mandate for universal service might be reinterpreted.

In the following sections, the stakeholder input is catalogued in greater detail, and the outreach process is fully described.

The Outreach Process discusses the process of requesting, collecting and analyzing all stakeholder input during the transformation planning process.

Stakeholder Feedback-Categorized by Group summarizes the findings of the outreach process in terms of each of the five large stakeholder groups—business mailers, postal employees, consumers, suppliers/business partners, and public policymakers.
A selection of representative commentaries is included in this section on a group-by-group basis.

The GAO Perspective discusses the input received from the General Accounting Office on postal transformation.

Outline for Discussion Commentary describes written comments sent to the Postal Service following the publication of the *Outline for Discussion* on September 30, 2001.

Focus Group and Public Survey Results lists the results of two national rounds of consumer and small-and-medium-sized business customer focus group meetings.

Postal Service Executive Survey Results describes the results of a strategic direction survey conducted with postal executives.

Additional Input discusses other comments reviewed by Postal Service transformation planners.

Stakeholder Comment Excerpts presents a range of verbatim stakeholder opinion and comments on all transformation issues raised during the outreach process.

The Outreach Process

As a critical component of its transformation planning process, the United States Postal Service solicited, received, and analyzed comments and recommendations concerning postal transformation from a broad cross-section of its stakeholder community. The Postal Service has heard from Congress and the General Accounting Office, the mailing industry, Postal Service employees and executives, postal policymakers, union officials, major mailers, the Postal Rate Commission, management associations, postal coalitions, postal trade associations, and the American public.

To ensure that stakeholders had ease of access to the Postal Service and its transformation planners, the Postal Service published two notices in the *Federal Register* in addition to the *Outline for Discussion*, provided a Web-based communications channel as well as that of traditional mail, conducted customer and business mailer focus groups throughout the nation, facilitated Board of Governors-directed panel discussions with postal labor/management associations and major mailers, sponsored a national telephone survey, and presented a transformation questionnaire to its postal executives. Industry reports, discussions, and presentations relating to transformation were also reviewed. In addition, those responsible for the development of the plan met with and made presentations to an array of postal interest groups and individuals.

The process of conducting stakeholder outreach is ongoing. Stakeholder input is continuously sought, particularly in conjunction with the preparation and publication of the *Five-Year Strategic Plan FY 2001-2005*, and during the past year, specifically on how the Postal Service should plan for long-term transformational success in a challenging and complex business environment.

Stakeholder engagement has been managed in two steps. In the months prior to the publication of the *Outline for Discussion*, stakeholder input from Congress, the General Accounting Office, the mailing industry, and other constituencies of the postal community directly contributed to the development of the *Outline for Discussion* document, its analysis of the challenges facing the Postal Service, and the description of the structural models then under consideration by the Postal Service and its transformation planners.

Since publication of the *Outline for Discussion*, the second step has included a notice in the *Federal Register*, directing interested parties to a Postal Service Web site set up to accept public comments. Focus groups of small- and medium-sized business owners and employees and consumers were convened, and postal employees were reached through internal communications and surveys. Additional meetings were conducted with representatives of postal unions, management associations, the General Accounting Office, major mailers, and others. The extensive additional input received by the Postal Service has supported its efforts in refining its analysis and modeling and in shaping the final plan.

The unanticipated events of September 11, 2001, and the anthrax incidents the following month led to a heightened focus on mail safety and security for both the Postal Service and its stakeholders. Because of these occurrences and the amount of time senior

Postal Service management was spending on the issues these incidents had raised, Congress approved the Postal Service's request to postpone the filing of the *Transformation Plan* from December 31, 2001, until March 31, 2002. As a result, the deadline for the comment period for the *Outline for Discussion* was extended from November 1, 2001, to January 31, 2002.

In February 2002, the General Accounting Office published its comments and recommendations on postal transformation in a report titled *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*. The GAO assessment and recommendations, summarized in the GAO Perspective section of this appendix, followed two GAO reports, presented as testimony to the Congress, published in April and May 2001. All three reports argued forcefully on behalf of postal transformation, citing the Postal Service's significant operational, financial, and human capital challenges.

The Postal Service, in both the *Federal Register* notices and in its *Outline for Discussion*, suggested a framework for stakeholder comment by posing several questions. One question asked stakeholders to recommend what, if any, structural change the Postal Service should undergo. Other questions prompted stakeholders to comment specifically on the Postal Service's universal service obligation; its core services; its organizational objectives of productivity, efficiency and affordability; its financing mechanisms; its human capital requirements; greater commercialization; and the possibility of privatization. Telephone surveys, hard copy questionnaires, focus group sessions and other forum discussions, including meetings of groups like the Mailers Technical Advisory Committee, employed all or many elements of this framework.

Despite the framework, there was consensus on only the broadest transformation topics. This is not surprising, given the nature of what the General Accounting Office described as "the divided stakeholder community" in its February 2002 report. Nevertheless, as noted earlier, the Postal Service will continue to solicit comments on its transformation strategy.

Outreach Statistics

Customer Outreach Mechanism	Details
Consumer Survey	2,021 interviews conducted
Postal Service Executive Survey	272 completed surveys
Comments on the *Outline for Discussion*	143
Focus Groups	14 consumer focus groups conducted 8 business customer focus groups conducted
Two Meetings of the Supplier Quality Council	20 supplier representatives
Mailers Technical Advisory Committee	170 mailing industry association representatives
Board of Governors Panel Session with Customers	6 major mailer customer representatives
Board of Governors Panel Session with Unions and Management Associations	6 postal labor/management representatives

Stakeholder Feedback — Categorized By Group

Using the framework created by the questions posed in the *Outline for Discussion* and in the *Federal Register* notices, areas of agreement and areas of no clear consensus can be noted. No stakeholder group spoke with a single voice. The summaries in this section reflect the predominant viewpoints obtained in the stakeholder outreach process encompassing input on the *Outline for Discussion*, focus groups, surveys, papers and reports, and meetings and discussions with a range of stakeholder representatives.

The questions posed by the *Outline for Discussion* were:

- To best serve the needs of the American people and the American economy in the 21st century, what should America's postal system be like (or transformed to) in the next decade?
- Should America's postal system provide universal service, and what should that entail?
- What should the core service of the future Postal Service be?
- How should the nation structure a future postal system to be as productive and efficient as possible and to ensure that consumers pay only what they wish to pay, for as much service as they can afford?
- Can the Postal Service continue to provide universal service under the current financial arrangements if volume slows or declines significantly? Are there other financing mechanisms needed?

- What steps should be taken today to anticipate the human capital requirements of the future postal system in a manner that embodies core values of respect, dignity, and diversity while providing incentives to encourage continuous service improvement?
- Is it possible to design a government postal system in the United States that operates more commercially and still serves important social obligations, including universal coverage?
- How should a privately-owned postal entity or entities perform against public expectations for postal services? Are there other models that may do a better job for the American people?

The responses, segmented by stakeholder group and their areas of concern, follow.

Business Mailers

Business mailers have been engaged in an ongoing discussion with the Postal Service regarding transformation. Additionally, many business mailers provided written comments to the *Outline for Discussion*. Small- and medium-sized business customers were also included in focus groups and surveys. The Postal Service Board of Governors facilitated a panel session with six business mailers to discuss transformation, and approximately 170 members of the Mailers Technical Advisory Committee (MTAC) were engaged during two of their quarterly meetings at Postal Service Headquarters.

As a whole, the business mailing community acknowledged the need for transformation and felt that the Postal Service should: 1) not underestimate the seriousness of the problem, 2) be bold and explicit in its recommendations, 3) move quickly to implement proposed actions in the near term, 4) hold the line on large and frequent rate increases, 5) pursue cost-cutting measures, and 6) strive to increase productivity. Several said that the universal service mandate should be reviewed and modified. Others said the *Outline for Discussion* failed to convey a sense of urgency. Some business mailers recommended that a presidential commission be established to respond to the long-term problems of the Postal Service. Others said that the unreasonable funding of the Postal Service’s retirement and health costs needed to be dealt with.

Universal Service

- There was consensus within the business mailing community on the need for universal service, but not on what, if any, changes should be made to its definition.
- Some said the Postal Service should continue to deliver to every address. Others felt that the Postal Service should leave it up to Congress to define.
- Some felt that the Postal Service should propose some modifications, such as offer for a fee, delivery options that would provide more quality of service for those willing to pay for the service.
- Some suggested selective reductions in delivery frequency.
- Some said that postal retail operations need to be reformed and recommended the closure of uneconomical or unnecessary post offices. Suggestions also included more franchising of retail operations in grocery stores and pharmacies.

Core Services

Generally, the input received did not suggest that the Postal Service should venture into new non core services.

Productivity, Efficiency, and Affordability

- Many said that the Postal Service should use existing authority to implement near-term changes.
- Some business mailers felt that there should be a new emphasis placed on productivity and business-building.

Financial Challenges

- Some business and government mailers suggested that rate increases be more moderate, predictable, and below the rate of inflation.
- Others argued that the Postal Service should move immediately to implement negotiated service agreements or that the Postal Service should recommend statutory changes to allow it to enter into such agreements.
- A group of business mailers said that service agreements are not permissible.
- Others argued that the existing discount structure for all classes of mail must be redesigned.
- Many recommended that the debt ceiling be increased and that the unfunded liability not be met exclusively by ratepayer revenues.

Human Capital Requirements

- Some business mailers recommended that the employment model be restructured.
- Several asked that the Postal Service develop more effective methods to manage labor costs.
- Business mailers requested that incentives be tied more closely to productivity.
- Business mailers recommended the organization work to build a more harmonious and productive workplace environment.

Commercialization

- Business mailers said if the Postal Service remains a government organization with a monopoly, it should focus on reducing costs and improving service.
- Many business mailers feel the Postal Service should be allowed to operate in a less restrictive, more commercial fashion, particularly in relation to pricing.
- Some business mailers said a commercialized Postal Service should be able to:
    - Have improved relations between labor and management;
    - Use market-based pricing;
    - Operate under a modified salary cap; and
    - Achieve network optimization.

Privatization

Some business mailers said the Postal Service should privatize, but most felt that privatization should not be an objective of current transformation planning.

Sample Comments from Business Mailers

(For more comments, see The Stakeholder Comment Excerpts Section)

Let’s Roll
[We] cannot stress how imperative it is for the Postal Service to move quickly in....the short and long term. Phase One should already be in full bloom. We stand ready to work with the Postal Service on transformation. We need it. For the Postal Service to miss this chance at transformation would be tragic. Our economy cannot withstand a $900 billion per year disruption. Nine million Americans need their jobs. Stealing a phrase used by President Bush, “Let’s roll. The time for action is now.”

—*Mailing Industry Association*

Be Bold
As you proceed with the transformation project, we urge the Postal Service in the strongest possible terms to be bold in its approach. At this critical juncture in postal history, leadership, vision, and courage on the part of the Postal Service, its Governors, and its senior officers are imperative. This is no time for a risk-averse approach, or the mere compilation of options of others.

—*Mailing Industry Association*

Volume Addition is Unsustainable
An underlying assumption we perceive in the *Outline for Discussion* is that, with the exception of times when the economy is in recession, mail volume will continue to increase. We believe that this assumption is extremely dangerous. The transformation plan must allow for the possibility, if not the likelihood, that mail volume will decline because of the inevitable intrusion of electronic communication and commerce. Escalating postage rate increases have also proven to dampen volume. Therefore, any transformation plan must address how the Postal Service, if it must, would substantially reduce its infrastructure. We believe the Postal Service’s volume addition is unsustainable.

—*Mailing Industry Association*

Transformation Principles
Coping with the challenges facing the Postal Service demands adherence to the following core principles: The Postal Service should remain a public service available to all Americans. It should not favor or discriminate among mail users. It should be required to operate as efficiently as possible and be held accountable if that standard is not met. The goal of the Postal Service should be to fulfill its primary mission of serving as a delivery system for the nation’s correspondence, periodicals, newspapers, etc. that efficiently delivers to every town, city, and state in the country…It should not lose focus and divide the nation by the initiation of new competitive ventures in the private sector.

—*Mailing Industry Association*

Presidential Commission

In preparation for . . .the long term . . . of postal transformation [there] should be the appointment of a presidential commission to provide an even-handed assessment of the Postal Service's problems and a comprehensive plan for achieving a solution. In the absence of a commission, we run the risk of never achieving postal reform or of achieving only minor changes that fail to address the key issues.

—Major Mailer

Don't Sacrifice Service to Cut Costs

It is suggested that eliminating overnight delivery, adding days to current standards or reducing service commitments...will ensure not only lower costs, but promote better consistency. We strongly question whether that is the direction that any viable entity can take.

—Mailing Industry Association

Employees

A number of individual employees, including managers and executives, as well as craft employees and the organizations that represent them, chose to comment on the *Outline for Discussion*. A survey of Postal Service executives was conducted on the topic of the strategic transformation of the Postal Service, and efforts were made to get the views of mid-level managers and Advanced Leadership Program (ALP) enrollees and graduates. Additionally, the Postal Service Board of Governors facilitated a panel session with the presidents of postal unions and management associations to collect first-hand the input of these stakeholder groups.

Employees—executives, as well as managers and craft—generally agreed that universal service must be preserved; that change should be made quickly and boldly; that strategic initiatives should be introduced to promote growth; and that flexibility should be created to allow the organization to become more competitive. Following are their opinions, in greater detail, on the issues.

Universal Service

- Most managers, executives, and craft employees felt that universal service should be maintained in some form.
- Some managers and executives supported a revision to the definition of universal service. This was linked to changes in the postal network, products, and services.
- Craft employees were more likely to support the current definition of universal service as a core value.

Core Services

- Many managers, executives, and craft employees recommended that the Postal Service develop products and services that drive new volume growth.
- Many managers, executives, and craft employees supplied ideas for new products and services that they would like to see become core services. However, the most common suggestion was for Internet-based services.

- Most managers, executives, and craft employees viewed the universal service obligation as a core service.

Productivity, Efficiency, and Affordability

Managers, executives, and craft employees were in agreement that transformation needed to be implemented quickly. Many employees, both in management and craft, urged the Postal Service to move boldly to address its current and future challenges. Major themes from employee feedback regarding an efficient future postal system included:

- Increased pricing flexibility; and
- Less government regulation and oversight.

Financial Challenges

- Managers and executives were in general agreement that the Postal Service cannot continue to improve productivity enough to finance ever-expanding universal service, particularly the increase in delivery points.
- Managers and executives were interested in exploring alternative funding mechanisms driven by the expected flattening of future mail volumes.
- As a group, craft employees are committed to preserving universal service, but had no consensus on how it should be financed.

Human Capital Requirements

Human capital issues were a main concern among employees. Many of the respondents chose to focus on this issue.

Managers and executives believe that reform is necessary throughout the Postal Service in the areas of compensation, recruitment, and the tasks to be performed, and strongly believe that the current collective bargaining process will not yield this reform. Executives suggested the following:

- Pay for performance for all employees.
- Results-driven collective bargaining.
- Removing the executive salary caps to retain top talent.
- Faster and easier resolution to contractual disputes.

Some organizations representing employees also thought reform in labor-management relations was necessary.

Craft employees expressed concern over possible job loss and the issues of fairness and equality of treatment by supervisors and managers.

Commercialization

Managers and executives were optimistic about the Postal Service's ability to compete with the private providers and would be even more so with less governmental oversight and/or regulatory reforms designed to provide more flexibility and market freedoms.

- Despite the desire for less governmental oversight, executives believe that a government-sponsored Postal Service is the best way to provide universal mail service.
- Craft employees also agree that a government-sponsored Postal Service is the only way to ensure universal mail service.

Privatization

- Some managers and executives supported privatization, however, it was not a pervasive theme.
- Craft employees felt that a privatized Postal Service could compromise the universal service mandate.

Sample Comments from Employees

(For more comments see the Stakeholder Comment Excerpts section)

Improve Labor Relations

Any serious effort to address postal transformation must include concrete steps to heal this [labor-management] relationship and individuals within the managerial structure must be held accountable for its resolution.

—Postal Labor Organization

Make Postal Service Employees Accountable for Results

The Postal Service must improve the collective bargaining process to include accountability for results…A fair evaluated route system would resolve many, if not all, of the divisive issues between city carriers and their supervisors.

—Postal Management Association

Close Inefficient Offices

Closure of some of these offices is necessary to reduce the fixed cost burden and provide a more efficient network. Some alternative retail locations may need to be provided, perhaps in storefront or non postal retail locations, but overall cost savings can be significant.

—Manager/Executive

The Wrong Goal

Privatizing the Postal Service would be subjugating its important mission to the bottom-line.

—Postal Labor Organization

Make Tough Choices

Our future direction needs to be clear. We can no longer be everything to everyone. We need to get off the fence and make the "tough" decisions. Once the direction is established, we need to recognize that implementation is equally important to strategic direction. Therefore, we must simultaneously develop the means and methods of carrying out our strategic plan. If we are serious about privatization, we must consider the possibility of dismantling the system and rebuilding the structure from ground zero. Those of you who advocate we continue along the governmental path, make your opinions known through appropriate channels. It's time to get off the proverbial fence.

—Manager/Executive

Recipient Pays For Delivery

What if the recipient were the one paying the delivery cost? There could be a rate for those types of delivery where the carrier must leave the road and walk to the customer (this might include the losses from dog bites). There could be a lower rate for individual curbside delivery. There could be a still lower rate for grouped mailboxes. The lowest rate could be for the standard post office box where the customer gets the mail from the postal facility to the customer's own location.

—Postal Employee

Employee Ownership

I applaud the effort and would be thrilled to be personally involved in any way possible to assist in the "Structural Transformation" plan which has been suggested to recreate this organization into the premier entity it can be. For more than a decade, I have preached that we need to be an employee-owned business, concerned with the bottom line, and not afraid to think. Yet it will take the combined efforts of many to make this a reality. I have never been afraid of privatization, for I believe that the competent, creative, productive employee will always be in demand.

—Manager/Executive

Consumers

Consumer input was obtained through nationwide focus group meetings, and through the publication of the *Outline for Discussion* and its accompanying request for comment.

Generally, consumers said they wanted everything to stay the way it is. While the Postal Service could be marginally more efficient, overall they like the service they receive. However, when told that greater financial pressures would be confronting the Postal Service, they expressed a willingness to entertain such things as changes to the laws that govern the Postal Service, modifications to universal service mandate, and modifications to service levels. The general conclusions to be drawn from consumer comments are as follows:

Universal Service

- Consumers largely support universal service.
- When it was explained to them that the Postal Service's finances could be at risk, some said they would be comfortable with minor adjustments in the definition of universal service, particularly if it precluded taxpayer subsidies or unreasonable postage rates.

Core Services

- Some felt that the Postal Service should refocus only on its core service—delivery of hard copy letters and packages.
- Many were unaware of the backlash from the private sector when the Postal Service begins to offer non postal-related products.
- When it was explained that the revenues from non postal-related products offset the need for higher rates or service reductions, some said that the Postal Service should venture into that arena.
- Mail safety and security should be a core service of any future postal service.

Productivity, Efficiency, and Affordability

- Some feel that the Postal Service does not have an incentive to be efficient. In their view, a future Postal Service should address this issue by having managers pay more attention to the bottom-line.
- Some expressed surprise that the salary of the Postmaster General was capped at Executive Level I. They felt that perhaps the Postal Service could get better people at the top and that those in the top positions would have a greater incentive to be more efficient if they were paid comparable wages to those paid in the private sector.

Financial Challenges

- Universal service was stated as a necessary function of the Postal Service, and that through aggressive transformation a viable postal system could be maintained.
- Although some consumers were aware that the Postal Service was self-sufficient, many consumers still think the organization receives tax support. Generally, the break-even requirement is not understood.
- Although consumers readily acknowledge the impact that the Internet, e-mail, e-banking, e-commerce, and competitive package delivery are having on the Postal Service, there's a lack of consensus on the severity of the financial problem or what should be done to deal with it.

Human Capital Requirements

- Some consumers feel that employees are not motivated or productive because they have no incentive for increased productivity. These consumers suggest a future Postal System should make efforts to bring union-represented employees closer to the management of the organization.
- Generally, consumers were more troubled with the level of service they receive from window clerks rather than the service they recieve from letter carriers. It seems that many of those responding had frequently experienced long lines at post office windows.

Commercialization

When designing a future Postal Service, consumers feel that small operational and managerial changes are best. These types of changes will ensure that the organization will serve its important social obligations.

Privatization

Consumers fall into four opinion groups regarding privatization:

- The largest group, legislative reformers, do not support privatization but do seek legislative changes that will make the Postal Service operate more like a business.
- Operational improvement seekers, estimated to be a fairly large group, are opposed to privatization; they simply feel that better management will ensure the Postal Service's continued viability.
- A small minority are government-endorsing traditionalists who believe privatization will not ensure that universal service is maintained and thus are opposed to Postal Service transformation.
- Also a small group, free-market enterprisers, believe fundamental change is necessary and that market forces will ensure that all American households and businesses that want delivery will receive it.

Sample Comments from Consumers

(For more comments, see The Stakeholder Comment Excerpts Section)

Most consumer comments were collected by means of focus groups and through telephone surveys.

Let Postal Service Set Prices
The Postal Service should be allowed to set the price of a First-Class Mail stamp on its own… The United States Postal Service should not be privatized. Privatization would be a total disaster. The United States Postal Service is doing its job, and doing it well.

—Residential Consumer

Rural America
As a customer in a rural area, I would like to say that the Postal Service needs to continue to provide SERVICE, SERVICE, SERVICE. Business customers sometimes seem to forget that the average American customer needs help and does not have access to the technology that business customers do. There are many U.S. citizens who do not own a computer and many that are illiterate. We still need post offices in small rural towns to give them identity, and because it is the American way.

—Rural Consumer

Saturday Delivery
In this year, your organization considered the elimination of Saturday mail deliveries. This proposal was sensibly dropped. In your new Plan, my input is to notify you that I want included the delivery of mail on rural routes on Saturday, to those like me, who do not have it, and never have had it.

—Rural Consumer

Suppliers

While some suppliers commented on the *Outline for Discussion*, the main source for supplier feedback has been meetings with suppliers and the Supplier Quality Council. The purpose of the Supplier Quality Council is to provide a forum for suppliers to converse with the Postal Service to enhance performance and operations. The council is made up of postal executives and suppliers.

A unanimous opinion voiced by suppliers was the need for the Postal Service to recognize the need for transformation and a desire for the Postal Service to act quickly. Suppliers also were concerned about the reductions in spending on capital. The main topic of discussion at these meetings was the strategic direction of the Postal Service. Specifically, suppliers were concerned about buyer/supplier alignment, and easing the path for suppliers, or making it easier for the Postal Service to do business with its suppliers.

Universal Service

Most suppliers did not directly comment on the universal service obligation.

Core Services

- Suppliers felt that delivery should be the priority of the Postal Service.
- Suppliers also felt that the safety of the mail should be a primary concern of the Postal Service.

Productivity, Efficiency, and Affordability

- Some suppliers felt that an important way to structure an efficient future postal system was to continue with the Supply Chain Management (SCM) initiative. SCM involves internal cost reductions, enhanced productivity, the removal of non-value-added activities, and streamlined business processes.

- Suppliers want continued capital investments to fuel Supply Chain Management improvements.
- Suppliers offered ideas to help the Postal Service make its supplier relationships more efficient, including:
  - Longer-term contracts;
  - Rewards for previous performance success; and
  - Improved communication.

Financial Challenges

Some suppliers made the point that maintaining overall volume levels does not ensure the financial well-being of the Postal Service.

Human Capital Requirements

Some suppliers felt that it was important for the Postal Service to improve its labor relations and organizational culture.

Commercialization

Suppliers feel that it is possible to design a viable government postal system. They believe that this can be accomplished using short- and long-term approaches, however, the phases must be done in parallel.

Privatization

A few suppliers suggested that the Postal Service be privatized, but this was not a pervasive theme. Most suppliers did not directly comment on this issue.

Sample Comments from Suppliers

(For more comments, see The Stakeholder Comment Excerpts Section)

Current Model Will Not Work
Unfortunately, we would have to agree with the other stakeholders that this current model is “not sustainable in the long term” in light of the continued financial uncertainty caused by mail volume declines due to the economy, diversion, and now mail security.

—Supplier

Total Factor Productivity
The Board of Governors abandoned the volume-per-workhour measure of productivity in 1985 because it is inaccurate. The discussion should be rewritten in terms of workload versus resource use total factor productivity (TFP). TFP drives the Postal Service’s financial situation. Had TFP grown at the rate of mail volume-per-workhour, the Postal Service’s financial situation would be significantly better today.

—Supplier

Cost and Service

Clearly the events of September 11, 2001, the recent biological anthrax attacks, and a weakened economy have all been contributors to these challenges. However,...there are fundamental issues which have contributed to the Service's weakened financial state. Two of these issues mentioned...relate to airmail transport. They include cost containment and service quality.

—*Supplier*

Policymakers

Policymakers, who include policy institutes and other independent observers, covered the subject of transformation through a series of papers, articles, testimony, books, and other discussion documents since the Postal Service was called upon in the spring of 2001 to initiate transformation planning. An annotated bibliography at the end of this appendix includes some of the policy institute publications that were considered in the planning process. As the bibliography indicates, there are no overarching trends in the comments the policy community offered other than that the Postal Service is facing major challenges and must make substantial changes to respond.

Given the lack of commonality across the policymakers' reports, and that these are publicly available, the summaries below present selected viewpoints of specific policy organizations that focused on the questions raised in the *Outline for Discussion*. These selected viewpoints provide a cross section of policymakers' input.

Universal Service

- One policy-making group reported that the statutory responsibility to bind the nation together requires more clarity.
- Another policy-making group stated that a key objective of reform should be preserving universal delivery.

Core Services

- One policy-making institute reported that recent terrorist activities call for a rethinking of the authentication function of the Postal Service.
- Another policy-making institute has undertaken a multiyear study of the global mailing industry. It reports that postal administrations around the world will have to choose between scaled down roles as universal deliverers of paper-based messages at a set price or expanding into value-added services.
- A federal agency conducted an inquiry on the effectiveness of electronic mail in the delivery of records, as compared with the delivery of records via the United States Postal Service and private express mail services. Its report concludes that both methods of transmission are critical to a fully developed economy and that traditional mail will remain an effective communications channel for consumers and businesses.

Productivity, Efficiency, and Affordability

One policy-making group reported that the Postal Service is at the center of a dynamic business ecosystem, and that by tapping opportunities within this ecosystem, along with a reduction in its product portfolio, the Postal Service can creatively respond to operational challenges.

Financial Challenges

Another policy-making group submitted a paper outlining a plan for complete privatization of the Postal Service. In this plan, a privatized post would raise funds in the capital markets like other private corporations.

Human Capital Requirements

In the plan mentioned directly above, the employees would own 10 percent of the privatized corporation and would have the right to strike. The plan envisions legal protections for employees, including a law that would guarantee there would be no layoffs for unionized personnel with five years tenure, at least for the duration of the next five years.

Commercialization

- One policy-making group reported that the Postal Service is extremely limited in its role as a government organization.
- Still another policy-making group recommended that a transformed Postal Service be neither a small change from the status quo nor a completely privatized organization.

Privatization

- Another policy-making group generally supported privatization of the Postal Service and opening the postal system to greater competition. The group generally favored market-based solutions and did not support permitting the Postal Service greater market freedoms in its current form.
- The Mailing Industry Task Force recommended that the mail channel be made more competitive.

Sample Comments from Policymakers

(For more comments, see The Stakeholder Comment Excerpts Section)

Benefits of Privatization

Under the current regulatory system, the Postal Service is given little incentive to be efficient for much of its business and its overall performance has been mediocre… The main benefit of privatization likely will be the resultant market forces (such as the oversight of shareholders) that discipline the Postal Service's operations.

—Policymaker

Different Vision

[We propose]...a plan that represents a third way between propping up the status quo and privatization. It would preserve the Postal Service monopoly on "last mile" delivery while opening up the acceptance, transport, sorting, and processing of the mail to much greater competition. In our vision, customers will be able to send mail from local stores instead of the local post office, private companies will sort and transport the mail faster and more cheaply, and customers who put more effort into preparing their mail will get discounts on postage. All the while, Postal Service mail carriers will deliver to American homes and businesses.

—Policymaker

The GAO Perspective

In February 2002, the General Accounting Office issued a report that summarized its commentary and recommendations on postal transformation. The report, titled *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation* followed two documents containing testimony on the need for transformation, that were presented to the Congress by the GAO in April and May 2001. In his testimony last year, Comptroller General David Walker asked the Postal Service to "develop a comprehensive plan" for its transformational efforts, one that addressed the organization's long-term outlook. The report suggested that, in its April 2001 testimony, the GAO should offer a "reassessment" of the Postal Service's financial options and operating plans. In Walker's May 2001 testimony, the GAO recommended eight areas to address in the transformation planning process, and called for broad-based stakeholder engagement. The eight areas were:

- The Postal Service's mission and its universal service definition;
- Whether or not the Postal Service should be mandated to break-even financially over time;
- Governance;
- How the Postal Service is regulated;
- Workforce planning;
- Performance management;
- Operational improvement; and
- Network optimization.

The February 2002 report expressed a sense of urgency regarding the need for postal transformation stating that "The Postal Service's basic business model…is increasingly problematic since mail volume could stagnate or decline further, and the Postal Service has difficulty in making and sustaining productivity increases."

Noting that "postal stakeholders often have diverging views on postal issues," the GAO report recommended that the Postal Service develop a near-term approach to transformation, stating "the actions it can take;" and "what incremental legislative changes are necessary;" and a long-term approach that relates "what additional comprehensive legislative changes are needed." The GAO report indicated support for both incremental and comprehensive legislation and suggested that Congress "consider…establishing a commission" to facilitate any legislative action.

The February 2002 GAO report reiterated the need for the Postal Service to undertake whatever operational improvement initiatives were possible in the current environment. The report also restated its recommendation that transformation planning focus on several specific areas, which might include: mission and role; public/private provision of postal services; accountability and transparency; the postal monopoly; the break-even mandate; the rate-setting structure; network operations; and human capital challenges.

"A comprehensive transformation of the Postal Service is needed to ensure its financial viability," concluded the GAO report, "and fulfill its mission in the 21st century in the dynamic communications and delivery sectors."

Outline for Discussion Commentary

The principal stimulus for stakeholder community input was the publication, on September 30, 2001, of the *Outline for Discussion*: *Concepts for Postal Transformation*. This document was an interim step toward the *Transformation Plan*. The *Outline for Discussion* reviewed the need for transformation and described the framework that the Postal Service used to prepare the plan. It included a summary of the challenges and opportunities for change.

Many industry and interest group meetings held in the fall and winter of 2001 - 2002 used the content of the *Outline for Discussion* as a framework for their own discussions, and shared the outcome of those discussions with postal executives and planners.

Both the *Outline for Discussion* and accompanying *Federal Register* notices invited—but by no means required—stakeholders to frame their comments as answers to questions posed in the *Outline for Discussion* and the *Federal Register* notices. Most respondents elected not to address specific points within the *Outline for Discussion*. Instead, they chose to use the comment process as a vehicle to express general concerns about the future of the Postal Service. In alphabetical order, those concerns are summarized below.

Customer Service

Several respondents elected to comment about customer service. In general, they observed what they described as a declining quality of customer service. Many of those who commented on this theme also indicated their belief that the declining quality of customer service is influencing the Postal Service's financial situation.

Labor-Management Relations

A few respondents chose to comment specifically on labor-management relations within the Postal Service. Most recommended increased efforts to bring union-represented employees closer to the management of the organization. They also suggested that continuing labor grievances are a prime reason for the state of labor-management relations. All of the respondents who commented on this issue urged the Postal Service to improve the collective bargaining process.

Mail Safety and Security

In light of the events of fall 2001, many respondents expressed a desire that the Postal Service take steps to ensure the safety and security of the mail, even though this topic was not originally addressed in the *Outline for Discussion*. Specific suggestions for improving safety and security were few, although respondents who commented on this theme universally expressed support for the Postal Service as it confronts this crisis. All respondents who commented on this issue expressed their hope that the Postal Service will move quickly to protect the mail and its recipients.

Postal Operations

Several respondents offered comments on how the Postal Service could improve its operations. Among the responses received, there was general recognition that "business as usual" will not prepare the Postal Service for the coming years. Among the suggested operations changes were advice to eliminate Saturday delivery, close unproductive offices, and increase productivity within the Postal Service.

Mapping the Stakeholder Responses

A wide range of stakeholders submitted written comments to the *Outline for Discussion:*

Comments Received In	**Numbers**
Electronic	120
Hard copy	23
Total	*143*

Stakeholder Type	**Numbers**
Employee (including Craft, Managers, and Executives)	55
Consumer	31
Mailer—Business Customer	27
Mailer—Mailer Association	17
Mailer—Government Customer/policymakers	7
Postal Labor Organization or Management Association	3
Supplier/Business Partner	3
Total	*143*

The table shows the themes raised and the number of times each theme was discussed. *Note*: Some stakeholders elected to address more than one theme.

Different Themes Mentioned	Numbers
Business Environment	5
Cultural Transformation	4
Customer Service	7
Decline to Comment	1
Human Resources	28
Improved Core Services	28
Labor Relations	10
Mail Safety	14
Mission and Goals	2
New Products and Services	23
Postal Operations	27
Postal Privatization	13
Postal Transformation	38
Productivity	2
Public Perception	2
Rates and Pricing	19
Regulatory Reform	13
Stakeholder Education Question	2
Universal Service	24

The following table combines the information from the previous two tables, showing the number of instances in which a stakeholder group raised a particular issue.

ISSUES RAISED BY STAKEHOLDER CLASSIFICATION

Theme	Employee	Consumer	Mailer-Business Customer	Mailer-Mailer Association	Policymakers Government Customer	Union or Mgmt	Supplier	Total
Business Environment	1			2	1		1	5
Cultural Transformation	4							4
Customer Service	4	3						7
Decline to Comment			1					1
Human Resources	19	4	2	1		2		28
Improved Core Services	6	7	9	6				28
Labor Relations	3	1	2	1		2	1	10
Mail Safety	3	4	2	3	1		1	14
Mission and Goals	1			1				2
New Products and Services	10	5	6	1	1			23
Postal Operations	13	6	1	7				27
Postal Privatization	3	3	4	2	1			13
Postal Transformation	5	3	13	12	4		1	38
Productivity			1				1	2
Public Perception	1			1				2
Rates and Pricing	4	4	6	4		1		19
Regulatory Reform	6		1	3	2	1		13
Stakeholder Education Question		2						2
Universal Service	6	4	7	6		1		24

Focus Group and Public Survey Results

The Postal Service commissioned a market research firm to obtain the opinions of both consumers and small and medium-sized business customers concerning how, if at all, the Postal Service should be transformed. Specifically, the research had four objectives: 1) identify any misperceptions of the Postal Service’s structure, funding, and operations; 2) obtain input on the challenges facing the Postal Service; 3) determine explanations for the differing attitudes toward Postal Service reform; and 4) gauge business customers’ and consumers’ reactions to potential structural and operational changes.

The resulting report, *Customers’ Attitudes Towards Postal Service Reform & Transformation*, is summarized below.

Methodology

The Postal Service project team accomplished its four objectives by conducting both focus groups and a survey of the general public. The focus groups provided a more intensive venue for consumers and business customers to express their viewpoints. Moreover, the focus groups afforded the Postal Service a chance to clarify any misperceptions and ensure meaningful discussion of the objectives. Meanwhile, the survey of the general public provided a context of initial public sentiment to the issue of transformation. The focus groups and the survey were intended to work in concert with one another; however, they had different research methodologies.

The focus groups, split into consumer groups and small- and medium-sized business customer groups, were conducted across the United States using materials developed in close collaboration with the Postal Service project team. The table below provides a breakdown of the distribution of focus groups by geographic location.

DISTRIBUTION OF FOCUS GROUP BY GEOGRAPHIC LOCATION

Type of Respondent	Total	Atlanta GA	Denver CO	Chicago IL	Houston TX	Lancaster PA	Little Rock AR	Los Angeles CA	Miami FL	Washington DC
Consumers	14	2	1	2	1	2	2	1	2	1
Business Customers	8	1	1	1	1			1	1	2
Total # of Groups	22	3	2	3	2	2	2	2	3	3

The focus group effort was divided into two stages. In the first stage, ten focus groups were conducted October 15–24, 2001, and focused on a broad range of consumer types and customer groups. Specifically, the first stage split consumer groups by community type and business customers by size. In the second stage, consumer groups were stratified by mail volume, income, and community type, while business customers were split by product usage characteristics. In this stage, twelve groups were conducted January 17–24, 2002, and focused on more specific types of consumers and business customer groups. Despite the differences in the two stages, the focus groups returned similar themes that are detailed below. The focus groups facilitated interaction among participants, which the survey could not.

Under the direction of the Postal Service, the survey of the general public was conducted by a market research firm via a weekly TeleNation survey. In all, a total of 2,021 telephone interviews were completed October 19–21, 2001. The interviews were conducted across a random sample of adults who had either sole or partial responsibility for handling the household's mail. The interviews consisted of non-competing client-specific questions and a shared set of demographic questions with transitional phrases between survey segments.

Results

The combined results are summarized in the Stakeholder Feedback—Categorized by Group section. The focus groups and the general public survey tended to have similar conclusions to the objectives. However, the focus groups provided a more probing examination of the issues, while the general public survey allowed for an assessment of initial public opinion of the objectives. Participants' initial perceptions are as follows:

- Awareness and knowledge about the Postal Service's current structure, funding sources, and its internal operations are limited and often misconstrued.
- Whatever type of organization they think it is—governmental agency, quasi-governmental entity, or private company—some believe the Postal Service is poorly organized, not well-managed, and generally inefficient.
- Similarly, there is a perception that postal employees who are retail associates are not highly motivated or productive, largely because they are part of a bureaucracy that offers little or no incentive for increased productivity.
- Although business customers and consumers readily acknowledge the impact that the Internet, e-mail, and competitive package delivery are having on the Postal Service, few believe that its financial situation is as precarious as it seems.
- Nevertheless, both consumers and business customers feel that the Postal Service offers a good product at good value, even if its customer service tends to be lacking.
- In addition to providing good value, consumers and business customers alike believe the Postal Service is the backbone that propels the nation's vital communications network and its commerce.

Three key dimensions emerge from the analysis as drivers of consumers' and business customers' attitudes toward transformation of the Postal Service—current perceptions, social responsibility, and privatization. The intersection of these dimensions yields four distinct segments that differ in their views about the government's role and freedoms the Postal Service should have.

- Legislative reformers. The largest group, legislative reformers seek changes that will make the Postal Service operate more like a business, but at the same time, ensure that universal service is preserved.

- Operational improvement seekers. Operational improvement seekers, estimated to be a fairly large group, are opposed to privatization; they simply feel that better management will ensure the Postal Service's continued viability.
- Government-endorsing traditionalists. A small minority is government-endorsing traditionalists who believe privatization will not ensure that universal service is maintained and thus are opposed to Postal Service transformation.
- Free-market enterprisers. Also a small group, free-market enterprisers believe fundamental change is necessary and that market forces will ensure that all American households and businesses that want delivery will receive it.

Notwithstanding the sentiments of free-market enterprisers, complete privatization would face significant opposition, due to perceptions that service would deteriorate and prices would rise.

The study also focused on attitudes toward specific reforms. Furthermore, when asked specifically about their agreement or disagreement with possible changes, as many disagree as agree with almost every proposal.

- Almost without exception, both business customers and consumers affirm that it is essential that mail delivery be universal.
- There is some divergence of opinion on the issue of mailbox access. Some feel the sanctity of the mailbox must be maintained, while a few are open to providing access to other reputable organizations.
- The in-depth focus group discussions indicated that reducing delivery to five days would be generally accepted; more severe reductions, however, would be strongly opposed.
- As for post office closings, when the financial implications and proximity of other offices are discussed by participants, many agree that such closings would be acceptable.
- Many consumers and business customers are opposed to the concept of zoned First-Class Mail pricing (a First-Class equivalent to zoned parcel post) primarily due to the anticipated confusion it would create.
- While some—particularly rural and suburban consumers—recognize that added pricing flexibility may be beneficial, many prefer the perceived protection that the current process provides for First-Class Mail service.
- Considering the perceived inefficiencies that currently exist, many participants believed that the Postal Service should have wider latitude to increase or decrease the size of its workforce.
- Generally, consumers and business customers would like the Postal Service to have greater flexibility to pursue expanded business opportunities.
- In general, suburban and upper income urban consumers tend to be most supportive of possible reforms. Trade-off exercises conducted in the focus groups confirm that most consumers and business customers prefer rate increases over tax subsidies, and favor giving the Postal Service added flexibility to compete with private industry.

- In mild contrast, the survey results indicate that the general public is not in favor of most changes, especially those that would alter the universal service mandate.

CONSUMER/BUSINESS CUSTOMER ISSUE COMPARISONS

Issue	**Consumers**	**Business Customers**
Type of Organization	More believe it is governmental	Likely to think it is quasi-governmental
Customer Service	Okay; generally forgiving as it is seen as improving	Okay at best; not forgiving because improvements are generally not seen
Employee Motivation & Productivity	Perceive that they are not highly motivated	Consider them wasteful, burned out, and mismanaged
Funding Problems	Not too serious; bailout is likely	Result of inefficiencies; skeptical that problems are real
Product/Value	Good and affordable	Not as good as competition, especially expedited services
Universal Service	Most supportive of maintaining it	More willing to support legislative reform and private enterprise
Reduced Delivery Days	Willing to accept	Less willing to accept because they want consumers to receive their mail and to be able to process mail received every day
Mailbox Exclusivity	Are particularly in favor of maintaining exclusivity	Might like it reduced to be able to take advantage of alternative delivery options
Retail Access	Reluctant to endorse post office closings at first	Supportive of post office closings from a business perspective, but concerned about effect on service
Pricing Flexibility	Willing to support higher First-Class Mail rates in order to maintain the special relationships they have with their letter carriers and in order to maintain universal service	Want business freedoms, within reason, to avoid huge and unpredictable pricing fluctuations

The study concluded that finding a universally acceptable proposal will be difficult, if not impossible. Working toward, but not skipping immediately to, fundamental transformation will be most palatable.

- The extremes—fully regulated governmental agency or fully privatized company—will satisfy few and antagonize many.
- Modest service improvements and legislative reforms will be attractive to most of the general public; many perceive service improvements as the first logical step, with legislative reform naturally following, if necessary.
- Universal service—to everyone, everywhere—and preservation of mailbox sanctity are critical.
- Additionally, other costly endeavors could be changed and new services developed and promoted, albeit with opposition from a small portion of current customers.
- Selected post offices could be closed, while investing in the remainder to provide better customer service.
- Delivery days could be reduced as needed or basic service could be offered at no cost. Premium services could be offered for a fee.
- "Quick response" employee management and pricing policies that serve the public's interests could be put in place, but some stakeholders would like to see the Postal Service follow private sector business practices.
- Effective communications will be necessary to inform the public about the Postal Service's products and services and why changes are mandated.

Postal Service Executive Survey Results

The Postal Service conducted a Web survey of its Postal Career Executive Service (PCES) executives on the topic of the strategic transformation of the Postal Service. The survey consisted of a ten-minute online questionnaire that covered a number of topics. They included: awareness of strategic issues, universal service, challenges facing the Postal Service, structural transformation, and mail safety and security. The survey also included a section on demographics that was used to tabulate the results of the survey, and to determine a demographic composition of the sample. The results of the survey have been incorporated into the employee summary in the Stakeholder Feedback—Categorized by Group section. Specifically, they are, in alphabetical order:

Financial Challenges

Costs and funding sources are clearly important concerns for Postal Service executives. They believe that new funding sources need to be explored and do not believe that productivity alone will be enough to fund an expanding universal service mission.

- Seventy percent of executives believe that universal service should be more narrowly defined in order to reduce overall costs.
- There was near unanimous agreement among the executives regarding the need to explore alternative funding mechanisms.

- Sixty-nine percent of executives believe the Postal Service cannot afford to make necessary investments to improve productivity and enhance services.

Human Capital Challenges

Three issues are clear in this section.

- Executives believe that reform is necessary throughout the Postal Service in the areas of compensation, recruitment, and the tasks to be performed, and strongly believe that the current collective bargaining process will not yield this reform.
- There is very strong support for the ideas of performance-based incentives throughout the organization and the removal of salary caps to retain talented executives.
- Executives also see a need for more outsourcing of Postal Service functions in the future.

Operational Challenges

There appears to be a mixture of opinion on cost and operational issues.

- Most executives who participated in the survey do see opportunities for cost reduction that do not adversely impact service quality.
- However, many of them also question the idea of meaningful cost reduction because of regulatory hurdles and difficult prospects for enough cooperation with the mailing industry.
- Nearly 90 percent of executives agree that significant cost savings can be achieved with network redesign.
- Over 60 percent of executives agree that costs can be reduced without impacting the quality of service.
- Executives are divided on the question of whether significant improvements can be made without regulatory reform.

Structural Transformation

- Executives are generally upbeat about the Postal Service’s ability to compete with private providers and would be even more so given less governmental oversight and/or regulatory reforms designed to provide more flexibility and market freedoms.
- Just over 70 percent of executives feel that a publicly-owned Postal Service should compete with private providers.
- Eighty percent of executives believe that current performance measures and targets are not sufficient to ensure success in the market.

Universal Service

- Postal executives generally question the current state of the universal mail service.
- Significant percentages of executives appear to believe that revisions are necessary in the definition of universal service, the network of post offices, and the products and services offered by the Postal Service.
- A majority of executives feel that if the current universal service mission is to be carried out, a government-sponsored Postal Service is best suited for the task.

Additional Input

Postal policy has received considerable recent attention, especially since the debate over H.R. 22, a bill developed to modernize postal law in the United States, which was not passed. A number of papers and books have been published that represent the positions of many stakeholders on the key issues addressed by the transformation outreach program. This section includes an annotated bibliography on postal policy, or a list of the relevant works referred to in constructing postal policy as well as an explanation of each source. The purpose of this bibliography is to reflect the range of material and thought reviewed by transformation planners during the planning process. Specifically, the annotated bibliography includes pertinent meetings, hearings, media, and articles from 2000, 2001, and 2002. The following pages lists the many important input sources accompanied by a brief summary of each source.

Mail at the Millennium: Will the Postal Service Go Private?

Edward L. Hudgins (editor), CATO Institute, Washington, D.C., 2000

Based on a conference held in December 1998, the CATO Institute supports privatization of the Postal Service and opening the postal system to greater competition. The Institute favors market-based solutions and does not support permitting the Postal Service greater market freedoms in its current form.

> **Comment**
>
> “The United States should not move into the 21st Century with a Postal Service born in the 18th, operating on a monopoly model established in the 19th, and found wanting in the 20th…the U.S. Postal Service should be privatized and its regulatory and monopoly model repealed to create an efficient and cost-effective system for the new century.”

Forecasting the Consumer Direct Channel: Business Models for Success

Peppers and Rogers Group, 2000

The Peppers and Rogers Group, with the Institute for the Future, has been conducting a major multiclient and multiyear study of the challenges facing the online shopping industry. They have conducted numerous interviews, focus groups, surveys, and literature reviews to assess the context in which retailers, manufacturers, and logistics providers, such as the Postal Service, will have to operate.

> **Comment**
>
> “By 2010, the Consumer Direct channel will account for more than one-tenth of all retail sales, one of the largest scale shifts in economic history. Even more impressive, it will have a much larger impact in altering consumers’ entire shopping experience…clearly, one of the keys to success for any consumer direct model is building a scalable, efficient logistics system…”

Report to Congress: Electronic Signatures in Global and National Commerce Act, National Telecommunications and Information Administration

U.S. Department of Commerce, Washington, D.C., 2001

Congress directed the Commerce Department to conduct an inquiry and report on the effectiveness of electronic mail in the delivery of records, as compared with the delivery of records via the United States Postal Service and private express mail services. The Department sought extensive public comment.

Comment

"Based on our analysis at this time, the Department concludes that both methods of transmission are essential to a fully developed economy…both electronic mail and traditional mail delivery are, and will continue to remain, an effective method of communicating for consumers and businesses..."

United States Postal Service at a Cross-Roads: Insights and Questions

Strategic Decisions Group, Washington, D.C., 2001

Comment

1) Recent events call for a rethinking of the authentication function of the Postal Service.
2) The statutory responsibility to bind the nation together requires clarity.
3) The Postal Service is at the center of a dynamic business ecosystem.
4) The long-term outlook for the Postal Service business portfolio is worrisome.
5) The Postal Service is extremely limited in its role as a government agency.

"In addition to meeting the immediate challenges, the Postal Service needs to creatively examine the emerging, untapped opportunities in the overall postal ecosystem, rigorously scrutinize its current portfolio of products and services to eliminate (or trim down) the white elephants, and systematically determine what new growth opportunities it can create from existing platforms—and what institutional mechanisms need to be established to assure continued business innovation."

The Rise of Global Delivery Services,

James I. Campbell, Jr., Washington, D.C., 2001

Comment

"In the United States…postal reform has lagged behind Europe and other industrialized countries by five years or more…One way or another, the United States will be forced to address postal reform…the technological and commercial trends which have persuaded other industrialized countries to reform their postal laws are at work in the United States as well."

Seizing Opportunity: The Report of the 2001 Mailing Industry Task Force,
Michael J. Critelli and John M. Nolan, Co-Chairs, Washington, D.C., 2001

The Mailing Industry Task Force was led by the chief executives of eleven leading companies and the Deputy Postmaster General of the Postal Service, and worked for six months to develop recommendations.

Comment

The Task Force is continuing its work, focusing on three recommendations:
1) Respond to today's customer environment;
2) Make the mail channel more competitive; and
3) Unify the mailing industry.

U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation, GAO-02-355 (www.gao.com)
The General Accounting Office, Washington, DC 2002

Comment

The General Accounting Office reported, in February 2002, that the Postal Service's worsening financial outlook created a sense of urgency about postal transformation. In this report, the GAO proposed a three-phased transformation plan.

In the first phase, the GAO recommended that the Postal Service state "the actions it can take" without legislative reform. In the second, the Postal Service was told to describe the "incremental legislative changes necessary" to succeed. In the third phase, the GAO suggested that the Postal Service *Outline for Discussion* "more comprehensive legislative changes needed" in order to remain viable.

The GAO report indicated support for both incremental and comprehensive legislation, and suggested that Congress "consider …establishing a commission" to facilitate any legislative action.

The President's Management Agenda, FY 2002
Office of Management and Budget, Washington, D.C., 2001

Comment

"Federal managers are greatly limited in how they can use available financial and human resources to manage programs; they lack much of the discretion given to their private sector counterparts to do what it takes to get the job done. Red tape still hinders the efficient operation of government organizations; excessive control and approval processes afflict bureaucratic processes. Micromanagement from various sources—congressional, departmental, and bureau—imposes unnecessary operational rigidity."

The Administration will sponsor a three-part "Freedom to Manage" initiative to clear statutory impediments to efficient management:
1) Statutory clean-up;
2) Fast track authority; and
3) Management flexibility and authority.

USPS: Information on Retirement Plans
GAO-02-170 (www.gao.gov)
General Accounting Office, Washington, D.C. 2001

Comment
This report identifies long-term structural or operational issues that may affect the U. S. Postal Service’s ability to provide affordable universal postal service on a break-even basis. One key issue is the Postal Service's retirement costs and future liabilities. The Postal Service had a net loss of $199 million in fiscal year 2000 and recently announced a $1.7 billion net loss for fiscal year 2001.

USPS: Update on E-Commerce Activities and Privacy Protections
GAO-02-79 (www.gao.gov)
General Accounting Office, Washington, D.C. 2001

Comment
Management of the U.S. Postal Service's e-commerce program has been fragmented, and implementation of e-commerce initiatives has varied at different business units. Overall, the Postal Service's performance in this area has fallen short of expectations. Last year, the Postmaster General announced a sweeping management restructuring that changed both the reporting structure and program managers. The Postal Service also revised its procedures for approving and implementing new Internet initiatives, including e-commerce.

USPS: Financial Outlook and Transformation Challenges
GAO-01-733T (www.gao.gov)
General Accounting Office, Washington, D.C. 2001

Comment
The U.S. Postal Service faces major challenges that collectively call for a structural transformation if it is to remain viable in the 21st century. This testimony discusses the Postal Service’s current financial outlook, actions that the Postal Service has taken or planned to take, and the transformation issues that will need to be addressed. GAO concludes that structural transformation is essential if the Postal Service is to overcome its financial, operational, and human capital challenges. It is at a growing risk of being unable to continue providing universal Postal Service at reasonable rates while remaining self-supporting through postal revenues. Although the Postal Service has announced steps to address its mounting problems, it lacks a comprehensive plan to address its various financial, operational, or human capital challenges.

USPS: Transformation Challenges Present Significant Risks
GAO-01-598T (www.gao.gov)
General Accounting Office, Washington, D.C. 2001

Comment
This testimony discusses the challenges facing the U.S. Postal Service. Overall the Postal Service faces major challenges that collectively call for a structural transformation if it is to remain viable in the 21st century. The Postal Service's financial outlook has worsened, and it is not clear how the Postal Service will address its mounting financial difficulties and other challenges. These challenges include: 1) reduced net income, 2) increased debt, 3) increased competition, 4) management-labor relations problems, and 5) statutory restrictions. Because of the Postal Service's rapidly deteriorating financial situation, GAO is placing the Postal Service on its high-risk list. GAO believes that several actions need to be taken to address the Postal Service's continued problems. Such actions include: 1) developing a comprehensive plan to address the financial, operational, and human capital challenges; 2) providing quarterly financial reports to Congress and the public; and 3) identifying, in conjunction with GAO and other stakeholders, improvement options that will cut costs and improve productivity.

USPS: Major Management Challenges and Program Risks
GAO-01-262 (www.gao.gov)
General Accounting Office, Washington, D.C. 2001

Comment
This report, part of GAO's performance and accountability series, discusses the major management challenges and program risks facing the U.S. Postal Service. To be successful in providing affordable universal service, the Postal Service must address formidable challenges in the following areas: 1) self-support, 2) cost-control, 3) human capital, 4) performance information, and 5) legal issues.

Opening the Mail – A Postal System for the New Economy
(www.ppionline.org) ***Shane Ham and Robert D. Atkinson,***
Progressive Policy Institute, Washington, D.C., 2001

Comment
The objectives of any postal reform effort are relatively straightforward: cut costs by bringing the benefits of competition to the postal system to the greatest extent possible, while maintaining service and preserving universal delivery. The Progressive Policy Institute believes that this cannot be achieved either by small changes to the status quo or by completely privatizing the Postal Service. Instead, it offers several proposals to reform the postal system.

The Posts: A Decade of Challenge, Report of the Future of Global Mail Program
Institute for the Future, Menlo Park, California, 2002.
The Institute for the Future has been managing a multiyear study sponsored by a number of foreign postal administrations, major mailing industry suppliers, and the U.S. Postal Service. In the 2001 program, the Institute conducted in-depth interviews with global experts in the mailing industry, paper, printing, and related industries. The Institute sponsored an expert panel, an online conference, and conducted secondary and original research.

> **Comment**
> "The posts that succeed in the coming decade will have to decide between two mutually exclusive paths: accepting a modest, scaled-down role as the efficient universal deliverer of paper-based messages at a set price; or expanding into a new marketplace by adding new services…even in the more modest delivery role, successful posts will have to transform themselves…in either role – improving household delivery or building value-added services – the posts will have to change the way they do business in the next decade. Neither approach will be easy."

Stakeholder Comment Excerpts

Excerpts from selected stakeholder comments are transcribed below to demonstrate the broad range of opinion collected by the Postal Service during its stakeholder comment period.

Transformation in General

Transformation of Foreign Posts
As you move forward, I also encourage you to explore and analyze the various transformation efforts undertaken by postal services in other nations, particularly New Zealand, the Netherlands, Sweden, and most recently Germany. Over the past decade, each of these nations has experimented with different approaches to regulation and competition, organizational structure, and the integration of their postal service into the rapidly evolving and increasingly diversified communications and transportation marketplaces. There is always much to be learned from the experience of others.

—Federal Agency

Supports Legislative Change
We support the need to change legislation in order to encourage competitive pricing and alternate delivery methods.

—Federal Agency

Study Commission
[We have] long advocated a high-level commission to examine these major, and to date politically controversial, issues and reiterate that suggestion here. The formation of such a commission is the one action that could hasten postal transformation. The Postal Service should incorporate such a suggestion in its final report.

—Mailing Industry Association

Critical Need

We have discussed core items in critical need of resolution in order to solve the impending crisis, a crisis that will affect employment across a swath of the USA. We look to the Postal Service to present a clear strategic plan answering the vital vision question—what should the post office be. We look to the President and the Congress to show leadership and courage…and put the Postal Service on the road to a long and successful future. Let's not wait until we hit the wall. Let's try to find a way of agreeing on the basic steps we need to take to successfully move the Postal Service structure into the 21st century.

—Mailing Industry Association

Postal Service Needs to Reorient

If the Postal Service is to maintain the public's patronage and support—with the postal monopoly and the very substantial contributions to overhead that comes with that support and patronage—then it must reorient its future planning to serve the household mailer and mail recipient. If the Postal Service undertakes that reorientation, we are confident it can maintain and increase patronage.

—Mailing Industry Association

Transform Boldly

As you proceed with the transformation project, we urge the Postal Service in the strongest possible terms to be bold in its approach.

—Mailing Industry Association

Make Tough Choices

Our future direction needs to be clear. We can no longer be everything to everyone. We need to get off the fence and make the "tough" decisions.

—Postal Employee

Products and Services

Mail Tracking

It is very important to our customers to be able to track their orders.

—Major Mailer

Internet Services

Customers are also looking at using the electronic billing and payments. With the government's help, the Postal Service could provide additional Internet services.

—Postal Employee

Human Resources

Labor Costs

[We] appreciate the opportunity to comment on this very important effort. This association has always considered itself a partner of the Postal Service and has usually supported efforts to modernize and improve postal operations. Our membership views the viability of the Postal Service as essential for its survival. Therefore the membership has given much consideration to this Transformation Plan. Notwithstanding the previous comments, (we) firmly believe that any postal transformation must include a fully developed, detailed plan to deal with the estimated 76 percent of postal costs that are related to labor. The plan must include annual total factor productivity increases and corresponding hiring restrictions and right-sizing. The plan must provide every opportunity for worksharing by mailers so that total combined costs may be efficiently reduced. The plan must include the Postal Service's plans to improve its labor climate as well as proposals to reduce inflationary wage increases resulting from binding arbitration.

—*Mailing Industry Association*

Reduce the Number of Employees

We must pursue the reduction of craft positions through attrition and operational improvements.

—*Postal Employee*

Mail Safety and Security

Address Mail Safety Issues

Transformation-planning efforts should address actions for preventing the use of the postal service as a vector for chemical or biological terrorism and the safety of postal employees and mail recipients.

—*Federal Agency*

Mailbox Monopoly

To protect customer privacy and ensure security, the Postal Service should retain exclusive rights to the mailbox.

—*Postal Employee*

Postal Operations

Reduce Costs

The transformation plan must demonstrate concrete, specific ways in which the Postal service will reduce its escalating costs. Additionally, the Postal Service must have a plan for decreasing its costs as its volume declines. This is just as important as planning for volume increases when times are good for the Postal Service.

—*Mailing Industry Association*

Reconsider Saturday Delivery
As the Postal Service addressed most recent and projected challenges, perhaps now is the time to reconsider Monday – Friday delivery.

—Postal Employee

Fundamental Problems with Postal Operations
A blurring of the basic mission, failure to restrain costs and outdated statutory restraints on postal operations have created fundamental problems for the Postal Service and the American public.

—Mailing Industry Association

Reduce Facility Network
The Postal Service needs to quickly assess and reduce the size of its facility network. It is apparent that there is excess capacity in the system today. If retaining the current network is a matter of public policy, then it should be paid for with public funds. If Congress is unwilling to fund the cost of the network, then it should step aside and allow the Postal Service to make the changes necessary to bring its network into line with financial realities.

—Major Mailer

Close Inefficient Offices
Closure of some of these offices is necessary to reduce the fixed cost burden and provide a more efficient network. Some alternative retail locations may need to be provided, perhaps in storefront or nonpostal retail locations, but overall cost savings can be significant.

—Postal Employee

Improve Efficiency
Delivery methodology must be changed dramatically, and other steps toward efficiency must be taken.

—Federal Agency

Core Services

E-Government Infrastructure
Postal Service has been saying for years that it intends to be the leader in providing the national infrastructure to support e-Gov.

—Federal Agency

Stay with Core Mission
Eliminate electronic commerce, telecommunications, financial service and other Postal Service ventures in the private sector that are not part of its core mission.

—Mailing Industry Association

Transform, but Continue to Provide Core Services

Looking forward, we envision a Postal Service that is able to adjust to a rapidly changing marketplace, able to identify and understand its customers' needs and provide the services all of its customers have come to expect.

—Major Mailer

Focal Points Should Not Be Non-Core

Mail delivery should be the core of the future Postal Service, as it has since the time of Benjamin Franklin. The key service that the Postal Service provides is a hardcopy "last mile" delivery to every American. The Postal Service also provides retail, processing and transportation services to the mailers. These traditional services will undoubtedly continue as well, but the new Federal Express alliance and various work-sharing arrangements that have evolved over many years suggests that creative partnership arrangements may be the heart of future opportunities in the retail, processing and transportation arenas. Noncore activities should not be focal points for the Postal Service as it moves to deal with future challenges.

—Policymaker

Focus on Core Business

An effective postal transformation plan must focus more intentionally on the Postal Service's core business: delivering the mail. Accordingly, Postal Service should define specific, aggressive objectives and metrics for each of the "five points on the star": cost management, people management, service measurement and performance, revenue growth and reform.

—Major Mailer

Universal Service

Universal Service is Most Important

Of the issues discussed in the *Outline for Discussion*, the most important to federal agencies is universal service. Federal agencies would be comfortable with minor adjustments in the definition of universal service, but maintaining universal service in a form quite similar to the present is critically important to almost every federal agency.

—Federal Agency

Maintain Universal Service

A transformed postal system will continue to have a "universal service obligation." For our company, America's long-standing policy commitment to universal mail service is synonymous with the Postal Service's statutory charge to "bind the nation together." Transformation will not—and should not—change that obligation.

—Major Mailer/Business Partner

Change May be Required

If the Postal Service is unable to continue operating under its current business model, changes in the definition of universal service may be required. The *Outline for Discussion* fails to address the topic of universal service or to offer alternatives.

—Mailing Industry Association

Keep Six-Day Delivery

[We] firmly believe that universal six-day delivery must be maintained. We do believe that the current retail operations policy should be reviewed to determine if more cost-effective policies can be implemented, including the closing of unneeded postal facilities.

—Mailing Industry Association

Continue to Deliver to Every Address

[We strongly believe] that the Postal Service should continue to be charged with a mandate to deliver to every address currently served.

—Major Mailer

Leave it to Congress

The larger questions surrounding the definition of “universal service” or the description of “the public service obligations” must be left to Congress. Especially for those members of the nonprofit and charitable community who rely upon the mails to raise funds for important social causes or disseminate information to the nation – the concepts of “universal” and “public” service strike to the heart of our mission.

—Mailing Industry Association

Public Responsibility

The Postal Service must continue to serve every address, whether it is rural, urban, or suburbs. [We] believe new strategies can be developed to better serve all mail customers, but the Postal Service has a public responsibility to carry out this obligation. We are ready to assist in the process to redefine and improve the concept of universal service.

—Mailing Industry Association

Postal Service Needs to Redefine

Another troubling aspect of the *Outline for Discussion* is its treatment of the universal service obligation. The *Outline for Discussion* indirectly recognizes but avoids expressly stating that the term “universal service” is not in fact used in any applicable law. The term “universal service” is a term the Postal Service uses to describe what it sees as it obligation under the current law. However, the *Outline for Discussion* fails to effectively acknowledge and address the fact that the term can and probably should be redefined by the Postal Service. Indeed, it is my understanding that it has been asked to do so by the Congress but has not done so.

—Mailing Industry Association

Universal Service is the Postal Service's Reason for Being
Universal service to every address in America, every day, is the core value upon which the Postal Service was built. It is why we work and the predominant means with which we reach our customers. To diminish or reduce that level of service would have a detrimental effect upon the Postal Service's value and utility as a service provider in the eyes of the American public.

—Postal Employee

Postal Privatization

Privatization is Inevitable
The worldwide trend does appear to favor privatization at some time in the future, and our comments are geared toward helping prepare the Postal Service for that eventuality.

—Major Mailer

No Turning Back
It is hard to imagine the Postal Service turning its back on fundamental free market principles, bucking the world trend towards capitalism, and creating a new socialized state owned company that will enter the marketplace to compete against the private sector.

—Mailing Industry Association

Postal Service Needs to be Privatized
The imperative is clear for the Postal Service to become privatized. The Postal Service needs to emphasize its core mission, and to help accomplish that, it needs to be able to operate like a private-sector business rather than a quasi-governmental entity favored with special privileges.

—Major Mailer

Re-federalize the Postal Service
The Post Office should be an agency of the government providing a legally mandated service to the citizens of the United States…Let's go back to being a government agency and use some tax dollars to shore us up when we're in trouble.

—Postal Employee

Commercialization is the Wrong Goal
[We do] not believe that the role of the Postal Service is to be "commercial." The role of the Postal Service is to serve the American public in the most efficient and effective means possible.

—Policymaker

Regulatory Reform

No Consensus on Regulatory Flexibility

One important reason for the lack of consensus about flexibility that exists within the current regulatory framework may be the Postal Service's reluctance to push hard to determine just how much flexibility it does or does not have.

—Major Mailer

Give the Postal Service Flexibility in Setting Rates

We would not object to changes that would give the Postal Service more flexibility in adjusting rates.

—Federal Agency

The Postal Service Needs Reform to Raise Capital

As a government agency, the Postal Service is different from a private corporation with respect to raising financial capital because it cannot issue equity to private shareholders. At the same time, Congress refuses to infuse it with any capital, and the Postal Service is mandated by the governing statute to operate at financial breakeven. Practically speaking, this means that it is constrained from earning and retaining any profits in excess of its original equity capital.

—Major Mailer

Reform to Create Jobs

Congress must be convinced that legislation needs to be passed in order to allow us to operate and meet the needs of the American public efficiently. Laissez-faire should be recognized by private industry and allow us to join the competitive arena if it will improve service, maintain faith and the image of an icon and create more competition and jobs.

—Postal Employee

Reform Needed to Maintain Universal Service

I believe if we are to remain a universal service, we need to introduce regulatory reform.

—Postal Employee

Debt Ceiling

The *Transformation Plan* does not describe what the Postal Service will do if it reaches its statutory borrowing limit of $15 billion. In this situation it would be better to deal with this issue now while there is a cushion, rather than wait until the eleventh hour.

—Mailing Industry Association

Debt Ceiling

Raise the borrowing limitations while preserving the long-term break-even mandate.

—Mailing Industry Association

Unfunded Liability

The Postal Service and the Congress must also come to grips with the problem of unfunded pension and retiree health care costs, which are rapidly escalating out of control.

—Major Mailer

Improve the Rate-Making Process

We would welcome a streamlined rate-making process which may allow for more moderate and predictable rate increases.

—Major Mailer

Unfunded Liability

In 2001, the Postal Service paid $3.8 billion to the government toward retirement liabilities and interest at 5 percent imposed by Congress. The debt service for annual retirement liability payments will increase to $16 billion by 2010. A business charged by its shareholders to make normal returns could not meet this bill, never mind a business charged with breaking even. Congress has saddled the Postal Service with liabilities it simply can never meet. The Postal Service has not focused on this inequity and only recently realized it has been overpaying interest.

—Mailing Industry Association

Give the Postal Service Price Flexibility

The Postal Service must have pricing flexibility.

—Postal Management Association

Let the Postal Service Set its Prices

The Postal Service should be allowed to set the price of a first class stamp on its own.

—Residential Customer

Customer Service

Customer Service Getting Worse

I work in customer service and know and hear every day, what is angering our customers, and it only seems to be escalating.

—Postal Employee

Cost-cutting Efforts Misdirected

We keep cutting corners in all the wrong places and wonder why we are losing business and revenue.

—Postal Employee

Labor Relations

Improve Labor Relations

Any serious effort to address postal transformation must include concrete steps to heal this relationship [labor-management] and individuals within the managerial structure must be held accountable for its resolution.

—Postal Labor Association

Change the Culture of the Postal Service

Given the record of labor grievances, the Postal Service should, unconditionally, address the culture of the organization, irrespective of changes in the Postal Service's market.

—Supplier

Appendix K

APPENDIX K — Growth- and Value-Based Strategies

In today's economy, creating customer value means both improving quality and affordability of products and services and providing the ability to access and use these products and services at times and places most convenient to the customer. For major mailers, the Postal Service will emphasize an increasingly wide range of customizable products that respond to the specific needs of these businesses. For small businesses and consumers, the Postal Service will improve the simplicity and accessibility of its products and services.

This Appendix to the *Transformation Plan* contains additional explanations, details and examples of near-term strategies that are customer-focused. This is not meant to be a comprehensive list of postal projects, but meant to outline those that will contribute to the transformation of postal products and services.

Strategies in the Appendix include:

Retail: Expand Access to Postal Services

- Move Simple Transactions Out of Post Offices
- Create New, Low-Cost Retail Alternatives
- Optimize the Retail Network Optimization

Products and Services: Improve Value and Growth

- Use Technology to Enhance Value
- Design Rates and Mail Preparation to Match Customer Capabilities and Needs
- Position Mail as a Key Communications Medium and a Customer Relationship Management Tool
- Enhance Package Services
- Generate New Revenue by Retaining and Increasing International Market Share
- Promote Greater Ease of Use
- Develop A Corporate Pricing Plan

Strategy 1: Move simple transactions out of post offices

Trends/Supporting Data

- 450 million stamps only transactions conducted in post offices annually
- 31.7 percent of customer visits to post offices are for stamp purchases only
- Comparable Stamp Channels Cost Per Revenue Dollar
  (SOURCES: FY’01 - PSFR, NWRS,CRA, VESS)

Retail Counter	$0.24
Consignment	$0.01624
Contract Postal Unit	$0.10
Vending	$0.14

- Percent Share of Stamps Revenue by Channel
  (SOURCES: FY’01 – PSFR)

Retail Counter	80%
Consignment	7%
Vending	6%
Contract Postal Units	5%
Stamps by Mail	1%
PC Postage	1%

Substrategy 1: Communications on alternative services

Description

Informing customers of alternative means of conducting simple transactions will result in increased convenience for the customer and cost savings for the Postal Service. This will be achieved through an aggressive and continuous advertising campaign of the Postal Service’s basic product information and how best to use the postal products and services.

Benefits

- Shorter lines in post offices
- Reduction in window staffing needs

Metrics

- Change in window hours relative to same period last year
- Customer Service Measurement (CSM) scores
- Increase the percent of stamps sold through alternate channels

Strategy 2: Create new low-cost retail alternatives

Substrategy: Expand self-service

Description

Vending Operations—The Smart Vending strategy seeks performance improvement by:

- Offering self-service space as part of kiosk services (e.g., partnering with banks – ATMs); and
- Investing only in technology solutions that are obtained through fee for service contracts and that offer debit/credit capable machines supported and maintained by third-party providers.

Benefits

- **Vending Operations.** In 2002, the target is set for a $1.5 million reduction in stamp packaging costs. Additionally, the target is set for a reduced cost per revenue dollar – down to $0.12. Potential savings are estimated at $13 million based on reduced cost to support same period last year (SPLY) revenue.
- **Smart Vending.** The strategy will be implemented during 2002. It is anticipated that costs will be approximately $0.03 to $0.05 for basic stamp purchase capabilities and approximately $0.10 to $0.12 for mailing and stamp capabilities. Traditional vending will continue to be offered for at least another five to seven years based on expected machine lifetime.

Milestones

■ New technology for basic stamp purchases	RFP	2002
■ Automated postage printers	Installs	2003
■ New technology for mailing services	RFP	2002
■ Automated postal center	Installs	2003

Metrics

- Reduced cost/revenue dollar for vending
- Reduced costs for packaging stamps for vending
- Increased market share of stamp sales versus counter

Strategy 3: Optimize the Retail Network

Description

Today, the postal retail network design is fundamentally driven by local considerations and is influenced by decisions related to delivery operations. As such, retail demand does not always match the appropriate retail channel.

To determine how best to provide public access to retail services, the Postal Service will employ a more consistent and systematic methodology. We will use a national database that contains cost, revenue, and demographic data, along with specific evaluation criteria, to determine when and how to add to or to subtract from the retail network. This network design process will result in equal to or better retail services value for our customers in addition to avoiding unnecessary future postal expenditures.

The specific components of this sub strategy are:

- To baseline current retail network;
- To accommodate retail growth demand via a logical system that matches appropriate channel with demonstrated marketplace needs;
- To replace redundant post offices, stations, and branches that do not supply appropriate value with alternative retail channels.

Trends/Supporting Data

Fixed infrastructure: The Postal Service has reduced incremental expenses for new retail infrastructure. In 1999 and 2000, the capital expenditure for combined customer service/retail and delivery facilities construction averaged $636 million per year. In 2001, only $65 million was committed to capital expense for facility construction.

Benefits

Upon implementation, the Postal Service will have a market-based, multi-channeled network that:

- Provides high customer value (required retail services for reasonable cost);
- Is flexible and easily modified for rapid expansion or contraction as dictated by marketplace conditions; and
- Is aligned to local demographics and market segmentation opportunities.

Milestones

- Complete network database (2002)
- Validate critical data, criteria, and threshold values at the area and district level (2002)
- Implement network restructuring

Metrics

- Cost per revenue dollar
- Net cost savings over a five-year period

Products and Services: Improve Value and Growth

Overarching Objective

To increase the use of traditional products, the Postal Service will use technology to add value to the mail and develop new features and services. The Postal Service will enhance the capabilities of traditional products to complement and compete effectively with other communications methods. To address the raised expectations on the part of both the sender and the receiver for richer information and higher levels of service, the Postal Service will leverage technology to provide information-based services surrounding traditional products.

Strategy 1: Use technology to enhance value

Embrace technology that will use data and information embedded in the mail to generate a rich stream of information for both individual consumers and commercial mailers to better equip them to promote their business objectives.

Substrategy 1: Identify and track mail pieces

Background

There is a need to track mail from induction into the mail stream to delivery, make each piece of mail unique throughout the mail stream, and have data about the mail piece available before the arrival of the physical piece. The Confirm™ service is developed to address a key customer need—the ability to track First-Class Mail, Standard Mail and Periodical mail pieces through the mailstream. Using Confirm, mailers receive near real time intelligence from the mailstream that can help improve marketing efforts to increase profitability, growth, and customer retention. By integrating Confirm into their business processes, postal customers can improve order fulfillment, customer support staffing, and cash management, as well as their ability to measure the effectiveness of advertising campaigns. Confirm will also allow for the capture of accurate performance measurement data. These benefits make Confirm a vital contributor to the Postal Service’s efforts to stem the erosion of letter and flat mail volume to electronic alternatives.

Substrategy 2: Use technology to improve the response mechanism

Background

Business Reply Mail and Courtesy Reply Mail response cards are an integral part of the Postal Service’s product offerings and provide customers a simple and convenient mechanism to respond to offers. Processing these response cards, however, requires intensive manual labor. The Postal Service is exploring Image Lift technology to automate the processing of response cards. The concept is to electronically capture images of reply mail cards and to facilitate electronic access by mailers for faster processing. Image Lift technology will reduce processing costs and processing time, and will greatly improve accountability.

Substrategy 3: Use technology to improve the access, speed, and reliability of accountable mail services

Background

The Certified Mail service has not kept pace with the changing demands of its customers. For years, the service has been a rather slow, manual, paper-based service with escalating costs and price. The overall service value has declined at a time when customer expectations are changing and competitive alternatives are proliferating from both electronic and physical delivery services. Recent Postal Service Information Platform developments have created a new opportunity to reverse this trend by upgrading the speed, reliability, and access for the Certified Mail service. The upgrade opportunity will come about by tailoring new customer features using the electronically captured delivery data and signatures now captured and held in the Product Tracking System (PTS). The planned upgrade is an enhanced Certified Mail service that includes Internet access to delivery date and time.

In addition, customers will be able to purchase return receipts via the Internet for mail that was sent using the Certified Mail, Registered Mail, Insured Mail, or Collect on Delivery (C.O.D.) service. Return receipts will provide customers delivery dates, times, and ZIP Codes for their accountable mail as well as the recipients' signatures. When a customer purchases a return receipt from the Internet, they may choose how information is sent: by fax, mail or e-mail.

Metrics

- Volume of tracked mail
- Adoption rates
- Customer satisfaction
- Incremental revenue
- Cost avoidance and savings
- Service performance indicators
- Data reliability and capture rates

Milestones

A rate filing to establish fees for customers who subscribe to the Confirm service will be filed in the Spring of 2002 with the Postal Rate Commission. The Postal Service expects to offer Internet access to the Certified Mail service in the Spring of 2002 and to the Return Receipt service in the Fall of 2002.

Interdependencies

These services are dependent on the regulatory process.

Strategy 2: Design Rates and Mail Preparation to Match Customer Capabilities and Needs

Overarching Objective

The Product Redesign initiative will tailor traditional Postal Service products to better meet customer needs, to reduce Postal Service and customer costs, to design products to fit future postal operations, and to price products to encourage growth in volume and contribution.

Substrategy 1: Simplify the rate structure, preparation, and acceptance requirements in accordance with differing customer needs

Background

There has been a significant change in customer needs and capabilities relating to postal products and services. The Postal Service's processing capabilities are greatly enhanced with increased reliance on automation. Both the Postal Service and its customers face increased competition and recognize the need to tailor products and services to make the mail channel more competitive.

The Postal Service recognizes that mailers differ considerably in their needs and capabilities. At one end of the spectrum, mail is a central part of business for mail-intensive customers. They want to be completely informed about mailing options and workshare requirements, so they can optimize their use of postal products according to their particular needs. At the other end of the spectrum, there are the moderate users who mail in bulk, but for whom mail is not a central component of their business. As it stands today, due to the complexities in postal regulations and requirements, these moderate mail users expend considerable resources to meet their mailing needs.

The Product Redesign initiative will simplify the rate structure and the mail preparation and acceptance requirements across all mail classes for the moderate users. For intensive mail users, this initiative will continue to explore ways to reduce costs for both the Postal Service and the industry.

Major opportunities exist in the flats product line to replicate the successes achieved through letter automation. The Postal Service has invested in automation equipment that will greatly improve flats processing and the Postal Service will restructure rate categories and preparation requirements to fully realize the benefits of this investment. Higher throughput of the automation equipment implies that bundle and container handling costs represent the larger share of total processing costs. The Postal Service and the industry will look to modernize preparation, employ container-based rates, and fully leverage workshare discounts.

Several initiatives are also underway in the First-Class Mail, Standard Mail, and Package product lines to redesign the products to meet the differing needs of customers, both large and small.

Metrics

- Rates
- Customer satisfaction
- Reduced Postal Service and customer costs
- Contribution and volume growth

Milestones

The Product Redesign initiative will take approximately three years. The Postal Service is currently meeting with customers to refine the proposals and new ideas. It will then engage in a detailed cost analysis, market research, extensive documentation, and written testimony in preparation for a rate filing. The expected implementation is the Summer of 2004.

Obstacles

Regulatory process

Substrategy 2: Simplify the rate structure for mailing books and parcels from nine rates to two rates

Simplifying the rate structures will make it easier for all sizes of mailers to do business with the Postal Service. Rate case proceeding will be easier, will consume less time, and therefore, will be less expensive. Small businesses and mailers, as well as large mailers, will find it easier to mail their packages.

Overarching Objective

Customer ease of use. The Postal Service has nine different rates for mailing a book–Express Mail, Priority Mail, First-Class Mail, Standard Mail, Parcel Post, Parcel Select, Bound Printed Matter, Media Mail, or Library Mail. The objective of this proposal is to simplify doing business with the Postal Service.

This strategy works in conjunction with the “New Parcel Categories” substrategy. The strategy is for rates to mirror the simplified processing and transportation networks. As processing of packages becomes more standardized, the rates will become more simple and standardized as well. The content of packages will not determine the rate, except for hazardous materials or other special concerns. Instead the method of processing will determine the rate.

Background

As with “Small Parcel Processing and Transportation”, this idea has evolved out of the Product Redesign initiative with the Parcel and Bound Printed Matter workgroups.

Metrics

- Rates
- Customer satisfaction
- Volume growth

Interdependencies

Dependent upon agreement from most, if not all, the major mailers and the Office of the Consumer Advocate within the Postal Rate Commission. Large dependency on the regulatory process.

Milestones

The timelines are dependent on the Product Redesign initiative schedules.

Obstacles

A substantial change like this would face a long process with the Postal Rate Commission. Although this concept makes sense for many mailers, the mailers who take advantage of the low cost subclasses would most likely oppose such a concept, unless the new rates were equal to or less than current rates.

Strategy 3: Position mail as a key communications medium and as a customer relationship management tool

The Postal Service will enhance its traditional product features and services and improve access to them to promote mail as a key communications medium and as a customer relationship management tool.

Substrategy: Adopt optimal channel strategies to improve access to postal products and services

Customize postal products to enable small- and medium-sized business customers to leverage the mail channel for promoting their business objectives.

Background

Customer acquisition, retention, and service fulfillment are a focus of marketing efforts for most businesses. Major mailers have long used traditional postal products to acquire new customers, to maintain and to grow relationships with existing customers, and to fulfill customer service needs. However, small and medium customers find it increasingly difficult to use postal products. The Postal Service employs numerous customer facing channels such as a direct sales force, retail outlets, mail acceptance units, carriers, and the Internet. The Postal Service will optimize its channel strategies to target the under-penetrated small and medium market segments.

The Postal Service is engaged in several efforts to make traditional products more convenient and more powerful as customer acquisition, retention, and fulfillment tools for small and medium businesses. It will leverage technology and the increased use of the Internet to provide greater access to the small and medium market segments and to generate a rich stream of information for customers on the status and effectiveness of mail. An example of this is the effort to leverage the Internet to help customers prepare Reply Mail. The Confirm and Certified Mail services, described previously, enrich traditional products by providing trackability and security, and by improving delivery predictability and reliability. Electronic access to these value-added features will serve to enhance customer convenience and ease of use.

The Product Redesign initiative bears testimony to Postal Service efforts to understand its customers' differing needs and capabilities and to tailor its products and services accordingly. The Postal Service will simplify the rate structure and the preparation and acceptance processes to make it easy and more convenient for smaller mailers to use the mail channel.

The Postal Service is engaged continually in efforts to analyze customers' value chains in order to understand how traditional Postal Service products affect customers' business processes. It will identify innovative ways to help customers optimize these processes and will educate customers on the effectiveness of the mail channel.

Metrics

- Growth in mail volumes and revenue
- Increased penetration in small and medium market segments

Milestones

The Postal Service is engaged in ongoing efforts to understand customer value chains and to position its traditional products accordingly. It is continually involved in enhancing products and services, and extending access to them in order to keep the mail channel viable and competitive, and to increase market penetration.

Strategy 4: Enhance Package Services

This strategy consists of three key categories of substrategies:

- Merchandise return
- New parcel categories
- Online postage label application

Overarching Objective

Improve existing merchandise returns service. This can be achieved through value-added services and competitive rates.

Conducting business either online or by means of a traditional mail order catalog involves a complicated series of obstacles for even the most experienced businesses. Selling merchandise to customers through the mail inevitably results in a portion of the merchandise being returned; and the volume and cost of returns is growing as online commerce and mail order sales continues to grow. The Postal Service can 1) offer free en route carrier pickup service and 2) develop a reverse rate for the Parcel Select service.

Substrategy 1: Merchandise return — Implement acceptance scanning of return parcels

Background

By 2003, an estimated 2.8 billion residential parcels will be shipped from online storefronts and approximately 360 million parcels will be returned. In a consumer panel conducted by PricewaterhouseCoopers, 41 percent of online purchasers have wanted to return a product they purchased online but thought it was too much of a hassle to do so. Nearly 50 percent of respondents, and women in particular, identified the fact that returning an online purchase requires a trip to the post office, UPS or FedEx pickup location, and was deemed problematic. According to an article in Business2.com regarding customer demographics, women accounted for roughly 51 percent of the total population last year and 41 percent of the online shoppers. The number is expected to increase with the growth in the online community.

Package pickup service is a way to address returns from a consumer ease-of-use viewpoint. With advance notice, a delivery unit could be notified that a package pickup is necessary at a specific address. A carrier would pick up merchandise return packages (with postage due by permit holder or prepaid postage) while en route, provided there is sufficient capacity in the vehicle. This service would be offered free-of-charge versus a costly scheduled pickup, which sends a vehicle to the location at a particular time.

A reverse rate for the Parcel Select product would provide a rate for large return mailers. The rate, perhaps below the intra-Bulk Mail Center rate would encourage consolidators to pickup returns at the destinations they are delivering Parcel Select for their customers. In essence, the outbound Destination Bulk Mail Center or Destination Delivery Unit would become the inbound origin Reverse Bulk Mail Center or Reverse Delivery Unit for returns. Through limiting the number of return acceptance units, consolidators can pick up returns in the high-volume locations in which they deliver.

Metrics

Ease-of-use indicators will be developed for package pickup; volume and revenue will be tracked upon reverse rate implementation.

Milestones

- Meet with industry to ensure offering meets their needs
- Develop a preliminary cost and rates structure
- File a rate case with the PRC proposing the category and rate structure

Interdependencies

As these initiatives are being pursued, other opportunities exist: Data information exchange between the Postal Service and the mailing industry; track, trace and payment initiatives; and the alignment of package refusals and package delivery attempts initiatives.

Substrategy 2: New parcel categories — Make it easier for customers to mail with the Postal Service by reducing the number of mail categories, rate structures, and confusing requirements

By processing all packages the same, the customer has an easier time understanding our rates and delivery times, which allows them to better anticipate their costs.

In addition, parcel consolidators will now have access to more packages, which will grow their business. By merging nonbulk retail packages, delivery units will have greater economies of scale for consolidators.

Overarching Objective

More than 85 percent of the packages the Postal Service carries are less than five pounds. Regardless of whether a package is Parcel Post, Library Mail, or Standard Mail, a package should be processed as a package. Therefore, the Postal Service proposes to merge the processing of deferred packages regardless of their mail category. In the long term, the Postal Service is exploring combining all non-expedited ground packages in only two categories—packages under five pounds, and packages between six and seventy pounds.

Background

Deferred packages exist in six different mail classifications—Parcel Post, Parcel Select, Library Mail, Bound Printed Matter, Media Mail, and Standard Mail. That’s six different rate structures, six different requirements to understand, and six different manifests. Yet from an operational perspective, if it’s a package, it will be processed as a package regardless of its mail classification.

Metrics

- Customer satisfaction
- Ease of Use for customers and postal operations, retail, carriers, and clerks
- Productivity – pieces per hour (PPH)
- Reduced costs and labor hours

Milestones

Product Redesign

Interdependencies

Dependent upon the customer’s agreement and the Office of the Consumer Advocate within the Postal Rate Commission. Large dependency on the regulatory agreement.

Substrategy 3: Online postage label application — Design and implement online postage label for mailing package

Direct consumers to the Postal Service Web site for online postage application.

Overarching Objective

To improve Ease-of-Use in package mailing for small business and consumers and reduce transactions at the retail window.

Background

Directing small businesses and consumers to the Postal Service’s Web site can create an awareness of the Ease-of-Use option in online postage labels. This label option would be made available through prepaying postage with a credit card or debit card. The online postage label can be downloaded for printing and placed on the package. Finally, the package can be dropped in a post office box, handed to a carrier, or picked up by the carrier en route.

Metrics

- Develop Ease-of-Use indicators for package pickup
- Track number of labels generated with online postage

Milestones

Operational by the Fall 2002 mailing season.

Interdependencies

As these initiatives are being pursued, they can easily be adapted for use with merchandise returns and en route carrier pickup.

Strategy: Promote Greater Ease-of-Use

Overarching Objective

The Postal Service is transforming the *Domestic Mail Manual* (DMM) into a series of hard copy documents and electronic systems that will be designed around how customers perceive and use the mail. By organizing its mailing standards around the shape of the mail piece—letter, flat, or parcel—the Postal Service will focus on the key decisions that customers make while doing business with the Postal Service.

Strategy: Make rules and regulations more market-responsive

Working with postal customers, the Postal Service will transform the information in the DMM using a user-centered design that will be specialized to serve different customer and employee segments (e.g., retail customers, nonprofit organizations, small businesses, bulk mail clerks, Postal Service administrators). The design solutions will make it easier for business mailers and consumers to do business with the Postal Service in order to improve customer satisfaction and increase sales.

Substrategy: Improve access to and ease-of-use of postal products and services as a way to build additional customer loyality and penetrate new markets

The information in the DMM is necessarily complex, in that the Postal Service offers many mailing alternatives to many kinds of customers. The DMM Transformation Project will clarify these complex alternatives. The design solutions will focus on structuring information in new ways by clarifying alternatives, using common sense language, and applying a variety of intuitive and logical navigational devices.

The Postal Service believes that this new approach to its mailing standards will:

- Articulate the key decisions that different customers must make when doing business with the Postal Service, then connect those decisions to the procedures required to transact the mailing;
- Create a system of information that will support Postal Service marketing efforts by providing consistent, clear information that employees can use to explain Postal Service products and services to retail and business customers;
- Reduce redundancy in the Postal Service workplace by creating an information system that is easy to use and understand, thus eliminating the need for information subsystems;
- Increase customer confidence in the mail by making it clear which mailing alternatives will best suit their needs and provide the most value for their business;
- Protect revenue by helping customers make the right decisions about the level of service they need and ensuring that customers pay the correct postage rate for that service; and
- Identify mailing standards or Postal Service procedures that can be eliminated or improved.

Background

The current DMM codifies the rules and regulations that support the Domestic Mail Classification Schedule (DMCS). The complexity of the current DMM and its underlying information structures and regulations tends to frustrate employees and customers and deters some potential customers who wish to use the Postal Service but then find other channels of communication more user-friendly. In publishing mailing standards, the Postal Service has placed emphasis on compliance with the law, engineering requirements of Postal Service equipment, and the operational flow of mail through its system. While these are important objectives, there has been no comparable attempt to present mailing standards in a way that allows different groups to get the information they need in a manner that is convenient and easy to understand.

Metrics

If successful, this strategy will be reflected in greater volumes, and in greater customer satisfaction ratings, particularly among small- and medium-sized business customers by providing:

- Greater convenience and clarity, particularly for consumer and small business customers;
- Improved communication between Postal Service representatives and customers; and
- More uniform application of rules, regulations, and standards, with greater efficiencies expected to result.

Strategy: Develop a Corporate Pricing Plan

Develop a plan and set of strategies designed to develop market-based pricing in the Postal Service.

Overarching Objective

The Corporate Pricing Plan will identify the range of activities that either affect or are affected by pricing in order to define the scope of change needed to transform the Postal Service's approach to pricing. In addition it will serve as the main policy document through which pricing strategies are communicated throughout the organization and will present a timetable for completing the steps identified as necessary.

Background

Pricing is not independent of other organizational activities, and changes in other parts of the Postal Service will be necessary in order to make the best possible use of whatever pricing freedoms are available.

The Postal Reorganization Act of 1970 created the modern Postal Service and has had a profound impact on the way its rates are set. The Act established the Postal Rate Commission and the laws that govern the rate-making process. Since then, a series of rates and classification cases have established rules and precedents that further govern the rate-making process.

Under the Act, the Postal Rate Commission has to consider a set of nine pricing criteria. These criteria ensure, among other things, that prices are set so that revenues exceed costs and that the resulting rates are fair and equitable. Much of the pricing strategy is to apply mark-ups over subclass costs to achieve break-even results. Deciding the level of mark-up for each product has been one of the most contentious issues in rate cases and has been heavily influenced by dominant outside interests, including mailers and competitors.

If the Postal Service gains pricing freedoms, it will strive to price like a commercial entity. Leading pricing practices in the commercial sector are driven much more by market factors, by what customers value, and by what the competition offers, rather than by costs. Costs are clearly a factor but are treated more as a threshold factor in the pricing decision.

Metrics

The Corporate Pricing Plan will include high level timelines and action plans against which progress will be measured.

Strategy: Generate new revenue for the Postal Service by retaining and increasing international market share

The Postal Service will retain and increase international market share by:

- Developing business relationships between the Postal Service and major international postal operators;
- Improving service quality by elevating service in the international exchange offices and also by introducing end-to-end services that consistently meet or exceed customer needs; and
- Redefining the existing product offering and developing, testing, and introducing new services and line extensions that continue to meet the value chain requirements of customers while expanding more deeply into the value chain.

Background

In 1995 the U.S. Postal Service established its International Business Unit (IBU) in order to participate in the development of a global postal network. Since then, the IBU has formed strategic business alliances with a select group of postal administrations and Universal Postal Union-affiliated commercial firms around the world. It is also working to continuously improve baseline products, to introduce new services to fill gaps in the value chain, and to promote the Postal Service’s ability to provide seamless international services. The IBU’s efforts are designed to generate revenue while supporting the Postal Service’s business objectives and strategic goals.

Trends/Supporting Data

The Postal Service has significant competition in every major category of service, not only from traditional carriers from deregulated and privatized foreign postal operators such as those of the Netherlands, Germany, Canada, and Great Britain. FedEx and UPS now offer new residential delivery options. Many foreign postal operators have entered the U.S. market and are contesting the package delivery market, and have been open about their interest in serving U.S. customers in more fundamental ways. All are free to enter the U.S. market and offer services that would be regulated if offered by the Postal Service.

In 1999, less than 3 percent of the Postal Service’s revenue came from international mail. In comparison, Deutsche Post World Net and TNT made approximately 50 percent of their revenue internationally. Of a $4 billion worldwide market for packages weighing seventy pounds or less, the Postal Service captures less than $100 million.

The German and Dutch posts have been aggressively developing global networks in order to obtain end-to-end control of their distribution networks. The Postal Service’s ability to develop a similar end-to-end network is inhibited by current law. Instead, the Postal Service focuses its efforts on international outbound mail, partnering with third-party operators, such as Consignia and DHL.

Existing Plans

Global Direct. Ships mail from the United States to foreign countries, bearing the appearance of the destination country's domestic mail. Services include premail assistance, acceptance, transportation, customs clearance, and entry into the destination country's mail system. Available in Canada and Mexico.

Prequalified Wholesaler Program (PWP). Establishes relationships with consolidators, extending the Postal Service's reach to many small and mid-size mail order companies. The PWP allows approved Postal Service consolidators to prepare customers' direct mail for bulk delivery overseas.

Import Boutique Kiosks. In cooperation with the SANYO Corporation, a market test of this new retail sales channel is underway in Japan with several U.S.-based mail order customers based in the United States participating in a pilot test.

Global Marketing Solutions (GMS). Provides the framework necessary for companies to systematically "approach" specific country markets, to provide access to peripheral services needed for success and to directly provide catalog distribution, product fulfillment and merchandise return services.

International Business Reply Service. Uses prepaid business reply cards and envelopes to lift customer responses from international direct marketing campaigns.

Global Priority Mail® (GPM). Ships to more than fifty countries and territories through agreements with foreign operators, meaning correspondence, documents, and merchandise receive priority handling along the way. Priced lower than competitors' published rates for international expedited service.

Global Airmail™ Letter-post and Global Airmail Parcel Post. Provide convenient ways to ship items to virtually every country in the world.

Global Express Mail™ (GEM). Delivers documents or packages to more than 180 countries and territories on an expedited basis in the destination country.

Global Express Guaranteed™ (GXG). Offers guaranteed, time definite, international expedited delivery service to more than 200 countries and territories, through an alliance with DHL Worldwide Express, Inc.

Global Economy™ Parcel Post and Global Economy Letter-Post. Offers lower postage rates when shipping eleven pounds or more of printed matter to the same addressee. Delivery is available to nearly every country in the world.

International Surface Airlift™. Transports virtually all types of mail weighing up to four pounds to global markets.

Benefits

By introducing new products and services, the Postal Service will both retain and gain revenues from customers who would otherwise have sought alternatives offered by competitors. The new products and services also amplify the value proposition the Postal Service offers U.S. companies.

Risks

These products and services will increase the Postal Service's reliance upon outside entities and increase the need for effective alliance management.

Future Plans

International Service Centers. Move international processing operations that are now co-located in domestic mail processing plants to a new network of centers dedicated to international mail, packages, and services.

Global Business Systems. Collect and store mail/transportation pipeline, financial, and customer data in a data warehouse to enable managers to make timely and informed decisions.

Benefits

These new services offer new sources of revenue, improve customer satisfaction, and expand the Postal Service's product portfolio as customer demand for global products increases.

Appendix L

APPENDIX L — Transforming Pricing in the United States Postal Service

In the ongoing debate over the need for postal reform in the United States, there appears to be a consensus among stakeholders that the current ratemaking process could be vastly improved. As a result, there is the possibility that, even under a relatively moderate reform proposal, the Postal Service will be given more freedom to set prices, subject to some kind of constraint or oversight.

In the following sections this appendix describes, citing examples, how pricing reform might alter the Postal Service as an organization, along with some of the implications for the Postal Service and its stakeholders. The goals of this section are to:

- Clarify the issues surrounding the need for pricing flexibility;
- Promote discussion among the many constituents regarding what changes are necessary; and
- Describe concrete steps to improve the ability to price products in the current environment and under various reform scenarios.

To achieve these goals, today's Postal Service is compared with the kind of organization it needs to become in order to thrive in its changing environment. By contrasting the Postal Service's pricing practices with firms in the private sector, the appendix illustrates the potential increase of value to the Postal Service's various stakeholders.

Introduction: The Importance of Pricing to the Firm[†]

"Pricing is the moment of truth – all of marketing comes to focus in the pricing decision."[1]

Prices are economic signals that firms use to accomplish objectives and corporate strategic missions. For unregulated profit-making firms, the primary long-term goal is generally considered to be maximizing shareholder value. However, depending on the firm, and the market in which it operates, prices can be used to further a number of more specific tactical aims in support of the long-term goal.

In describing the Postal Service's pricing strategy, both in the near term and in the future, the appendix discusses how the Postal Service might use prices to support a number of different corporate objectives. To frame the discussion, reform of Postal Service pricing practices should adhere to the following principles:

[†] Research on private sector pricing practices was based on publicly available media and marketing information. This information was not validated with the individual private companies discussed.

[1] E. Raymond Corey, Industrial Marketing: Cases and Concepts (Englewood Cliffs, N.J.: Prentice Hall, 1962).

Principle 1: Prices should reflect the organizational strategy

Compaq

Compaq successfully reinvigorated sales in the crowded personal computer market by implementing a new high-volume, low-price strategy. In order to implement this strategy, Compaq embarked upon a bold targeted cost-cutting program that reduced operating costs by up to 50 percent. Basing its price on its newly lower costs plus a markup, Compaq was able to underprice most competitors while improving profits on volume.

AOL

AOL's corporate strategy is to provide easy-to-use dial-up Internet service for a premium price to that segment of customers who value a simplified product. By addressing the needs of this segment, AOL surpassed its competitors who offered Internet service for lower prices or even for free, to become the nation's number one dial-up Internet service provider. Indeed, AOL now sets prices for the industry: when it raises fees, so too do competitors focused on other market segments (e.g., DSL providers).

The Postal Service, like any other organization, exists to create value for its customers, by providing universal communications to all people residing in the United States. Today this is reflected in its publicly mandated universal service obligation. The Postal Service must balance goals of capturing value against its break-even requirement. Pricing is the tool used to capture value in earnings, and in that sense is a potent strategic lever. This fact may be obvious but not trivial. Many large companies clearly create great value for their customers, but fail to capture related earnings.

There is a myriad of pricing strategies an organization can pursue, including cost-based, competitive-based, value-based, and combinations of each. The cost-based approach, historically the most common for regulated firms, carries an aura of financial prudence and equity, and is the required approach used by the Postal Service in the current legal environment. In theory, it is a simple and a fair way to ensure products cover costs; in practice, it can create disincentives that lead to mediocre financial performance. The competitive-based approach can be an appropriate tool if the corporate strategy is to achieve sales objectives, and/or market share, and is desirable only to the extent that these goals improve the financial performance of the firm. The value-based approach is the most effective in capturing value in earnings. The goal of this approach is to maximize the difference between the value created for the customer and the cost incurred by the firm, and to price accordingly. This approach may be most desirable for a firm wishing to maximize its value.

The relationship between strategy and pricing ought to be dynamic. Any pricing strategy should influence corporate, and product, strategies. In developing a strategy for a certain product line, pricing will undoubtedly have to integrate its understanding of costs, customers, and competition. For example, if recommended market prices are set below costs in order to remain viable in the market, the organization may implement a strategy to reduce product costs. If cost reduction is not feasible, an exit strategy may be more appropriate, or an attempt to add perceived value to the product. Obviously, pricing should have the flexibility to be able to effectively maintain this dynamic relationship with corporate strategy. The more the Postal Service has control over the price signals it sends to its customers, the more it is able to execute strategic plans.

Principle 2: Prices should reflect the specific competitive goals of products or groups of products

Jeep

In 2001, facing a saturated SUV market and increased comparison shopping via the Internet, Jeep changed its pricing strategy in order to reposition its products relative to competitors. Across-the-board price cuts and the introduction of several new products are intended to preserve Jeep's dominant place in the SUV market.

Kodak

In the U.S. film industry over the past decade, Fuji has relentlessly turned up the heat on its primary competitor, Kodak. Fuji has continually offered a product of similar quality to Kodak's, but always for a lower price. Faced with declining market share, the fear of commoditization and a resulting deterioration of its valuable brand name, Kodak set out to reposition its products relative to Fuji. Kodak avoided a price war by holding firm in the pricing and positioning of existing brands, while introducing new brands in different price bands and offering products via new channels.

As there are different pricing strategies to pursue, it is essential that the strategies chosen be consistent with the overall organizational strategy. However, pricing is typically done at the product or service level. This means that pricing can actively position a product (or service) in the marketplace based on corporate strategies. The implication of this principle is that the organization's current and/or desired position within the marketplace (or relevant market segment) are the strongest determinants of prices. For example, if the Postal Service wishes to protect its dominant position in a declining correspondence and transaction market segment, it may want to ensure that prices remain affordable and competitive. On the other hand, it may want to deliberately charge high prices for a premium forwarding service. A low cost penetration strategy might be pursued for a new product or service if the goals are to reach critical mass rapidly (by accelerating adoption rate) and to establish a stable leadership position in that market space. The important point here is that different pricing strategies are appropriate in different circumstances, and as circumstances change, the ability to adapt or modify pricing is critical.

While the existing rate-making criteria allow a means for any of these strategies to be pursued, the political and regulatory environment in which the Postal Service operates creates constraints. In part these constraints reflect well-intended public policy goals; for example the requirement that rates be set to ensure that the revenues earned by specific products are sufficient to cover attributable costs. The procedures for rate and classification changes now restrict the organization's ability to respond to emergent situations and has negative economic consequences for the Postal Service and its many stakeholders.

Principle 3: Prices should reflect the value that customers place on the product or service

The Airline Industry

Rather than segmenting the market and offering separate flights for customers with different needs and budgets, the airline industry created a sophisticated tiered pricing system that gave access to virtually the entire market. By offering different packages of luxuries and conveniences to customers with varied perceptions of value, the airlines have been able to discriminate amongst customers based on their own preferences.

DuPont

In a largely commoditized chemicals industry, DuPont differentiates products by offering chemicals at both a standard offer price and a premium offer price, allowing customers to select the grade of product they prefer. This graded pricing strategy gives special attention to the market opportunities presented by the diverse perceptions of value among DuPont's customers.

Successful pricing strategies are continuously refined depending on changing costs, product life cycle considerations, price sensitivity, value-addition, and competitive factors. Throughout this process, the market(s) in which the firm operates can be segmented into groups of customers who value specific elements differently. Customer segmentation allows for value-based pricing strategies that provide flexibility in pricing products to meet the differing needs of segmented markets.

Value based pricing depends on the ability to segment prices along multiple dimensions; by category, purchase location, time of purchase, quantity, product design, or product bundling. In fact, a large organization with multiple product lines may incorporate a seemingly unlimited set of variables in its pricing decisions; stopping at the point where additional transaction costs exceed the gains from additional pricing complexity. The important point is that segmented pricing enables a company to develop pricing strategies that are more appropriate for the customer in each market segment.

The Postal Service's current pricing strategy is based on nine fundamental criteria, which affect prices differently from subclass to subclass. Value of service is one of the principles used in determining a suitable price for a subclass. However, there are problems with the current use of 'value of service' in that it encompasses too broad a spectrum of customers and products. For example, value of service is generally considered at the sub-class level, while the relevant value drivers may not be on the sub-class level but rather on the product level. Moreover, other criteria may act as countervailing factors and overwhelm the ability to reflect market value through pricing.

Principle 4: Prices should reflect the costs of the organization

Amazon.com

Amazon.com has shied away from a cost-plus pricing strategy that guarantees profits to many commodity sellers. Instead, the company has focused on building brand name, trust, and sales volume. Although they have achieved only one modest quarterly profit ever, Amazon.com veritably owns the market and continues to rank as one of the most-visited sites on the Internet.

Webvan.com

Webvan.com's ambitious strategy was to provide everything to everyone, every day of the week—online. It chose the grocery industry first, charging a premium over bricks-and-mortar grocery stores, but less than its online competitors. Webvan.com was essentially a massive warehousing, distribution, and same-day-delivery service that hoped to eventually compete against the likes of Amazon.com based on speed of delivery and lower shipping prices, but was faced with a greater and more immediate challenge of changing decades-old consumer shopping behavior in the grocery industry. Unfortunately Webvan.com's hub-and-spoke business model was capital intensive, rivaling its bricks-and-mortar competitors, with pressure to deliver extremely high levels of service, while its pricing strategy was limited by the need to attract customers to this new way of shopping. Unable to execute even the most basic cost-plus pricing model to achieve profit, Webvan.com finally succumbed to the pressure, declaring bankruptcy in 2001.

In the long run, every organization must price its products in such a way as to cover its costs, support capital expenditures, and return a sufficient net return on investment. The Postal Service, which does not earn a rate of return on its investments because of the statutory break-even requirement, still must ensure that it covers its ongoing costs while fulfilling its obligation to provide universal service. In the thirty years since the Postal Reorganization Act, the Postal Service has built elaborate costing systems designed to provide information in a form designed to serve the requirements of the existing regulatory regime. Moreover, thirty years of precedent have resulted in a number of conventions that inform how costs determine prices. As this appendix discusses how the Postal Service's approach to pricing will change, the legislative and internal changes that affect the Postal Service's financial goals and have implications for pricing will be addressed in the relevant section.

In the following sections, the pricing principles and concrete steps needed to help the Postal Service improve its ability to price its products and services in both the short and the long term will be described. The discussion will provide illustrative examples of how to price a specific existing product—in this case advertising mail.

Pricing in the Near-Term

The Current Situation: Postal Service Pricing Today

Under the Postal Reorganization Act of 1970, the Postal Service has to comply with a set of nine statutory pricing criteria (see 39 U.S.C. 3622(b); 3623(c)). These criteria ensure, among other things, that prices are set such that revenues exceed costs and that the resultant rates are fair and equitable. Deciding which product gets what markup has been one of the most contentious issues in rate cases and has been heavily influenced by dominant outside interests, including mailers and competitors.

Advertising Mail

A "rough" customer segmentation by proxy

Mail preparation requirements and legally-mandated subclasses are a form of customer segmentation—albeit a "rough" segmentation.

Level of mail preparations

- *Enhanced Carrier Route (ECR):* High volume, high level sortation, deeply drop shipped saturated mail. A low hanging fruit.
- *Regular:* Lower volume, nonsaturation with same level of preparation as ECR.

Legally-mandated segmentation

- *Nonprofit mail:* A "preferred" segmentation for nonprofit mailers.

Strategic Considerations

Even under the current regulatory constraints, in many respects the Postal Service has already gone a long way toward achieving market segmentation. This has been accomplished through the development of extensive worksharing discounts. These discounts encourage private sector agents to take over part of the Postal Service's traditional role. The effect of this has been a quiet, de facto commercialization of certain upstream postal activities and some guarantee of relative efficiency. In the 1970s, the Postal Service introduced presort discounts. The 1980s and 1990s brought more presort, drop-ship, and other discounts. The discounts are based on the cost savings the Postal Service achieves. An estimate by one analyst showed that the value of work sharing discounts exceeded $15 billion in 1999. Perhaps more importantly, that same analyst calculated that had worksharing not been instituted, the costs of the Postal Service would have been more than 20 percent higher in that year alone.[2]

The pricing strategy behind work sharing discounts is called "lowest combined cost" because the goal is to minimize the combined cost of the mailers and the Postal Service. A mailer may choose to use the Postal Service from induction through delivery or receive a discount by doing part of the work themselves. For example, the cost to large businesses of meeting the requirements for automation rates is smaller than the discount provided. The key point here is that many of the most obvious benefits of increased pricing flexibility have already been exploited under the current rules.

Worksharing has had positive impacts on Postal Service mail volume and contribution by targeting customers more willing to share in the sorting and movement of the mail. The largest effect has been with advertising mail where volume has grown 240 percent since 1978 when the first discounts were introduced there. Econometric analyses have shown that work sharing discounts do generate new mail volume.[3]

Still, the Postal Service's ability to use pricing to achieve strategic aims is currently hampered by many factors.

- Substantial effort and lead-time are required to prepare and litigate a rate or classification case.

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[2] "The Impact of Using Worksharing to Liberalize a Postal Market", February 2001, Cohen, et. al., Office of Rates, Analysis, and Planning – US Postal Rate Commission

[3] Ibid.

- The rate-making process can create a contentious environment and distract management focus away from the customer.
- There is an over reliance on costs as a determinant of prices.
- The lack of a profit motive dampens innovation and does not provide incentives for creativity and change.
- Consequently, the Postal Service has been unable to fully take advantage of the potential strategic value of pricing.

Competitive Considerations

Typically, firms use price to further competitive goals and improve their position in the marketplace. In the regulated Postal environment, this goal is turned on its head. The rate-making criteria explicitly requires the Postal Service, and the Postal Rate Commission (PRC), to mitigate against potentially harmful impacts on competitors when setting rates, despite potential benefits for customers from an increasingly competitive market. In addition, competitors propose alternative pricing scenarios that must be considered in the regulatory process. While these considerations are consistent with good public policy, in reality they have important implications on Postal Service prices.

Pack and Send

In 1996, the Postal Service began testing a service that offers customers the opportunity to have packages wrapped for shipment—a service commonly offered by shipping outlets such as Mailboxes Etc. This offering evolved from popular customer feedback, which requested that retail outlets become more convenient. Shortly after testing began, a complaint was filed with the PRC, and consequently the Postal Service decided to suspend the service while an experimental classification case could be litigated.

Despite the presence of rules designed to expedite litigation for small-scale experiments, the litigation of the Pack and Send case (MC97-5) consumed more than eight months, and required extensive use of internal resources. The PRC recommended fees for the service that were higher than those proposed by the Postal Service, thereby responding to concerns raised by small companies that the pack and send service would cause financial harm to their businesses. Moreover, the PRC made fundamental alterations to the product by requiring that insurance be incorporated into the service, irrespective of customer preference. The result was that although the PRC recommended the Postal Service be authorized to offer a provisional classification, the Postal Service found the recommended fees to be inconsistent with market conditions and customer expectations and did not implement the service.

The ability to launch successful new initiatives is important to any organization for several reasons: to meet changing customer needs and generate new revenues, among others. In order to do so, firms need the ability to quickly introduce products in response to changing market conditions and to employ pricing strategies designed to spur customer adoption. With more regulatory freedoms, the Postal Service could introduce experiments efficiently and offer them at prices, such that, customers would determine their viability.

Price changes are not the only competitive tool companies use to enhance their market position. New product introductions are commonly used to enable corporations to remain competitive as customer needs evolve. For example, the Postal Service recently proposed offering free delivery confirmation for customers using branded shipping services during the holiday season. Given the need to adhere to a procedural schedule that gives great latitude to competitors' due process rights, the Postal Service had to withdraw free delivery confirmation as proposed. The lead time and expense required to litigate cases has a dampening effect on product innovation.

Customer Value/Segmentation Considerations

Value of service is one of the statutory rate-making criteria that is used to set postal rates and an important reason for the range of cost coverages in the existing rate schedule. Today, however, the primary unit of analysis in determining appropriate cost coverages is the subclass. Intended to prevent cross subsidization across classes of mail, this requirement may have the effect of limiting the Postal Service's ability to reflect different customer perceptions of value within a subclass.

Currently legislative and political interests of competitors and customers may also hinder the Postal Service in its ability to price products efficiently. For example many new products are priced using the cost coverage ratios that are used for existing products. Furthermore once cost coverage ratios are set, it is difficult for the Postal Service to either lower or raise the coverage as market demand changes. The evidentiary burden necessary to support long-term pricing strategies hampers the ability of the Postal Service to take the product life cycle into consideration in the pricing equations and create prices that are suitable for entry products (Pack and Send) or fully developed (First-Class Mail®). Furthermore because individual products within a sub-class are in different stages of their lifecycles, it becomes impossible to take this element into consideration when dealing with subclass pricing.

In addition to limiting the Postal Service's ability to match price with customer value, current application of the value of service criteria may create other perverse incentives. For example, if management perceives cost coverage for a given sub-class to be fixed and low, it may be unwilling to make investments related to such products because cost coverage acts as an artificial upper boundary on return on investment.

Cost Coverage Considerations

In the current environment, the Postal Service's overall financial goal is to breakeven over time. The underlying incentive to cover costs does not necessarily correspond to cost minimization. To be fiscally responsible while continuing to operate, the Postal Service files a rate case when total costs exceed revenues by a significant amount. While long-term profitability is the goal of private businesses, the Postal Service, by law, was not established for profit-making purposes.

For example, rates are based on cost estimates developed through hearings at the PRC. Active rate case intervenors (outside organizations or individuals) fight for higher or lower discounts often based not on the actual savings, but based on their particular perspective or vested interests. Rates are set based on the PRC's estimate of true savings. If costs or cost savings for discounts end up in practice being significantly different than expected, there is no way to change the rates in the short term. The rates are set until the decision of the next rate hearing at the PRC. Also, if significant cost changes occur in the economy such as higher fuel rates, no changes can be made. This may result in a substantial decrease in the contribution of various products and may even cause costs to exceed rates in some cases.

In the current environment, rates are set based on the current classification system. The current classification system may not correspond well to market conditions and customer needs. In some instances, there are numerous products with significant cost and market differences all within the same subclass. The Postal Service has made efforts to correct examples of cost averaging and the PRC has been relatively supportive where solid cost information has been provided. For example, it was determined that within the Parcel Post subclass, costs are largely based on size while rates are based on weight. In some areas it was found that costs for some Parcel Post pieces paying identical rates differed by a factor of ten. The Postal Service instituted both size-based and nonmachinable surcharges to attempt to deal with these concerns. While these extreme examples have been dealt with gradually, significant cost averaging still exists within product categories or subclasses. Many perceive this cost averaging to be perfectly acceptable because the long run goal is breakeven, but it creates a situation where some users contribute relatively more than other users apart from any business or fairness goals. It can also create a system where the Postal Service handles the most expensive pieces because competitors appropriately surcharge these segments while the Postal Service historically has not.

The data systems of the Postal Service generally do an excellent job of providing data to support the current regulatory environment. For example, there is substantial data regarding the price sensitivity of various subclasses of mail. Revenue and cost systems provide data to comply with requirements developed over many years of litigation at the PRC. While these systems are not perfect, they do function extremely well given the incredible complexities they face. The Postal Service spends a large amount of money to operate these systems. In some ways the current systems provide more detailed data than most private businesses would have. However, this does not mean that the data systems provide the right types of data to run a business. In fact, the need to maintain these systems in order to produce information in support of litigation may act to discourage necessary investments to modernize the Postal Service’s management information systems.

In the current legal/regulatory environment each subclass of mail must set prices in a future “test year” such that the forecasted revenues equal the forecasted costs. In fiscal year 2000, this resulted in almost all products covering their variable (attributable) costs. Based on this regulated pricing regimen, some rates are set well below what the market would bear and contribution margin is sacrificed.

Meeting the Challenge

It has been observed that the Postal Service appears to have significant freedoms under the present law that it does not currently employ. If the Postal Service is to make a successful transition to a less monopolistic, more competitive organization it is likely necessary to begin immediately identifying the freedoms that exist and to consider their pricing implications. A crucial part of this analysis is the examination of the constraints that currently prevent this from happening and the specific steps needed to move forward.

For the purposes of this discussion, the break-even assumption remains intact. Pricing emphasis is likely to be on small experiments permissible under current regulatory structure: small negotiated service agreements (NSAs) (customized pricing), targeted experimental products, and phased rates.

Advertising Mail

Refine segmentation of the base case: render it less “rough”

Provide seasonal pricing: For example, offer a price premium for peak-volume accounting periods, or a price discount for off-peak volume accounting periods.

Strategic Implications

Absent some form of legislative change, major strategic shifts are unlikely. Thus the key pricing strategy in the short term is to look for opportunities to experiment more aggressively with pricing innovation and flexibility that is allowed under current law. Emphasis will be on a number of initiatives that are either in development, or dormant, but that can be attained under current law. For example:

- **Phased rate changes.** Support the strategy of developing a flexible market-facing organization by requesting the PRC to develop rules for a phased rate proposal that will establish a PRC recommended schedule for incremental rate changes. Develop a workable plan for recommendation to the Commission.
- **Operationally targeted experiments.** Support full use of operational resources by developing experimental rate offerings that encourage the strategic usage of resources.
- **Major reclassification effort.** Alter strategically the current classification scheme by incorporating additional factors into the existing classification scheme.
- **Segmentation for major products.** Reclassify major products into commercial and retail categories by pricing them differently. For example, reclassify First-Class mail into customer segments using indicia (permit, meter, and stamps) as a proxy for large volume, small office/home office (SOHO), and individual consumers and price accordingly.
- **Negotiated service agreements (NSA).** Develop beneficial and valid NSA that is compensatory and offered to all parties on equal basis. For example, offer a discounted rate for periodicals mailers who are willing to pay directly for forwarding.

- **Use of volume discounts.** Offering a discount structure designed to promote volume and contribution growth by tying discounts to volume growth.

Competitive Considerations

The Airline Industry

Using First, Business, and Economy classes, airlines discriminate across the entire range of customer segments, taking advantage of individual price elasticities. Recognizing that the flying experience may be more important for the business traveler, while ticket price is often most critical for the leisure or family traveler on a limited budget, airlines customize pricing by significantly differentiating services, luxuries, and conveniences between the classes. In effect, the airlines work to build a high enough fence between the classes that customers falling into the premium segments will continue to pay for the associated benefits. Further, airlines maximize their profit in situations during which the customer must use their service (e.g., a last-minute long trip) by pricing these seats very high. At the same time, when capacity is not filled, airlines offer last-minute deals and "e-savers" to fill seats, taking advantage of the low incremental cost of serving an additional passenger. Understanding the different segments' price thresholds, as well as managing capacity utilization and the resulting fluctuation of air fares requires an airline to use top-of-the-line technology and to constantly monitor competitors' service offerings and prices, as well as trends in customers' responses to its own services.

Of the categories of initiatives outlined above, segmentation by products has the most obvious competitive implications. Indeed, the Postal Service has already begun to differentiate between business customers by categorizing between large operations and small office/home office (SOHO) customers. These customers can then be targeted for various mixes of existing products and services, under the assumption that an appropriate pricing strategy can be crafted for each segment. In order to be successful, this effort will require a moderate reorientation of Postal Service capabilities and commitments. For example:

- There needs to be selective "bundling" of products and services, specific to the needs of particular customer groups.
- Customer response to products and services needs to be more explicitly incorporated into pricing and product decisions.
- Product definitions need to be realigned to reflect market segmentation: For example, a reclassification proposal might consolidate similar product lines across current rate categories. This is fundamentally different from the current structure in which rate class and subclass definitions are largely the result of the rate structure existing prior to the Postal Reorganization Act. A more comprehensive examination of the Postal Service's product lines could result in a modernization of the product lines by considering how the products and services interrelate and are perceived by the market. For example, shape-based, market segment, or service based groupings may be more appropriate than the current mail classifications.

- The Postal Service will presumably require more extensive market and competitive intelligence capabilities and will need to use these in developing pricing strategies.

In some cases, these priorities may have greater utility in the long term where some form of legislative reform places the Postal Service in a more competitive environment, but it will be necessary to begin the process of developing necessary capabilities in anticipation of such a change.

Customer Value Considerations

AOL

Using market surveys and watching the competitive environment closely, the founders of AOL observed that even free dial-up Internet service providers were not attracting many novice customers. By talking with its own subscribers as well as competitors' subscribers and nonsubscribers, AOL discovered that a large number of people perceived Internet technology to be difficult to use and therefore intimidating. Further, most people did not consider the technology an easy and friendly means of communicating with friends and family. In direct response to this customer feedback, AOL developed a product that offered ease of installation, step-by-step real-time online instructions, a friendly user interface, and short-cuts for communicating with other subscribers, all for a flat fee that allowed users unlimited time to become familiar with the technology. AOL employed more skilled programmers and help desk staff than most of its competitors, but was able to charge a premium for its enhanced services, making it the dominant dial-up Internet provider in the nation.

In the current environment, value is considered to be reflected almost exclusively in terms of service.

In the transition to a more flexible pricing regime, the Postal Service will need to explore the other variables that customers consider when purchasing postal services, and how to incorporate such variables into its pricing strategy. For example, it may be possible to segment customers along multiple dimensions:

- Segmenting by buyer identification requires the seller to collect data and distinguish between its clients. Occasionally pricing differently among segments is easy because customers have obvious characteristics that distinguish them. For the Postal Service this would entail, for example, distinguishing between high-volume, frequent mailers and those who mail less regularly. The Postal Service currently has the ability to distinguish between its clients and determine what value mailers place on value-added services, yet it has been unable effectively to utilize this data in developing its pricing strategies. The problems that arise with segmenting by buyer identifications is that sometimes it is very difficult to develop customer segments for the different products.
- Purchase location segmentation requires that customers be segmented according to area of purchase or service. This would mean the Postal Service could charge a premium for its services in areas where it was more influenced by locality factors, which resulted in higher fixed or operating costs and are specific to that locality. The

Postal Service currently does not offer destination entry discounts for First-Class mail service. However, current post office box fees, which reflect underlying cost differences based on locality, provide an example of how such pricing might work.

- Time of purchase segmentation allows for companies to offer more attractive prices during off-peak work times. One form of time segmentation is yield management, which simultaneously integrates differences both in the costs and in price sensitivity. The purpose of yield management systems is to help sellers determine how much of their unused capacity they can afford to sell at discount prices without negatively effecting their ability to serve those customers who are willing to pay the full price. The Postal Service could utilize yield management in pricing for large mailers if they agree to enter the mail into the delivery system during nonpeak times.
- The ability of private companies to negotiate rates with large, low-cost customers allows these companies to segment and offer incentives to their more profitable clients who are continually doing business with them. The Postal Service currently is unable to reward its prized clients with such incentives, which would allow the Postal Service to retain and build its relationship with this customer segment. Furthermore, many large companies offer customized incentive plans to individual clients. While the flexibility to price independently on a customer-by-customer basis may, or may not be the answer for the Postal Service, there is a need for an ability to provide universal discounts open to all customers for volume and repeat business.

Cost Coverage Considerations

In the near term, the Postal Service assumes no change in the statutory requirements that all subclasses cover their costs and assumes that the Postal Service retains the break-even financial goal. All rate proposals remain subject to review by customers who generally argue for lower rates, and competitors who generally argue for uniformly higher rates. In addition, the PRC operates under its own legal and political constraints and attaches significant value to precedent. It is possible, however, for the Postal Service Governors to modify a PRC recommended decision with a unanimous vote.

More modest changes could be accomplished under current law, but have not been implemented because of various political and public policy concerns. However, a number of actions have been taken to charge segments below the subclass level more appropriately. For example, nonmachinable surcharges have been instituted for Parcel Post service. Other opportunities for similar discounts and surcharges remain but have not been attempted for various reasons. For instance, the possibility exists that targeted price changes can be used to align costs and prices more appropriately outside of the context of an omnibus rate case. Such cases involve a nontrivial use of resources and are therefore not a practical solution in all cases. However, this approach was used successfully when the Postal Service changed prices for a number of special services in a recent classification case (MC 96-3).

Perhaps under current law, the Postal Service could propose a subclass-specific energy price inflator on mail categories where transportation costs are a significant portion of the attributable costs. For example, Priority Mail rates, set at “X”, could decrease as fuel prices go below a specific level within a set time period. The law would presumably allow this type of adjustment if supported with compelling cost evidence. A completely different approach allowable under current law would be to manage fuel price risk by financial hedging. The PRC's willingness to use a pricing formula for Mailing Online indicates that potential exists to experiment with more innovative approaches.

Pushing Ahead

While the Postal Service believes that a cooperative approach could yield significant gains under current law, it is possible that some initiatives will prove impracticable and require some form of moderate regulatory reform. Postal Service reform has been actively pursued for several years, and various proposals have been presented. Moreover, the recent histories of foreign posts and other domestic firms in deregulated industries provide a wide array of reform models for consideration. In describing possible pricing strategies under some form of regulatory reform, the Postal Service would continue to assume the universal service obligations remain, and that the fundamental structure of the organization is largely unchanged. However, the ratemaking process would be streamlined to allow reasonable pricing changes to occur without extensive regulatory hearings. As a result, the Postal Service would be better able to react quickly to changing market conditions and focus directly on the needs of its customers.

Strategic Implications

The existing cost-of-service regulation could be replaced with some form of incentive regulation. Under this scenario, the Postal Service would receive some pricing flexibility for competitive products subject to some specified rules designed to protect the market from anticompetitive Postal Service actions. Incentives for efficiency would be enhanced because limits would be placed on the extent to which cost increases could be passed routinely to customers via rate increases. Incentive regulation would also give the Postal Service more control over the price signals it sends to its customers, enhancing its ability to execute strategic plans. This new pricing flexibility would afford the Postal Service more incentives than under current law.

Under this scenario, price changes are likely to be more orderly and predictable, as prevailing macroeconomic trends govern price changes. This lack of price shock should help customers plan and budget their own business cycle. Nonetheless, the cumulative effect of even small and predictable price changes can have dramatic impact on rate levels and relationships. A strategic pricing plan for existing products would need to be developed and implemented consistently and with discipline over time.

DuPont

DuPont has created value for customers by offering standard chemicals in a variety of gradations of quality or characteristics, allowing customers to select and pay corresponding prices for the product option they prefer. DuPont has worked closely with customers to develop appropriate product offerings, and in the process, has developed strong, long-term relationships that serve to further differentiate DuPont from its competitors. To develop viable prices, DuPont closely tracks competitors' product offerings and prices, often by buying samples of their products. To establish and communicate the rationale behind the tiers of pricing, DuPont clearly enumerates the enhancements over the standard product and attaches a corresponding value, for example: DuPont offers Standard Grade Chemical A for $100. The Premium Grade product includes the following enhancements:

Premium Characteristic	**Value**
10 times fewer impurities	$1.40
Delivery time cut in half	$0.25
Additional R&D support	$0.35
	$2.00

Thus, the customer who wants the Premium Grade product will pay $102 for the additional value provided. At times, the customer may ask for some, but not all of the added values. DuPont may unbundle the premium offer and the customer will pay for only the chosen added values.

Pricing flexibility subject to some specified rules will determine prices for competitive products. Experimental products, negotiated service agreements, and methods to provide pricing incentives for larger volume commitments, such as declining block rates, would be vigorously pursued. To accomplish this, the Postal Service needs to develop a quick response capability to identify opportunities in the marketplace. In contrast to the old regime of relying on costing systems, market research analysis, and econometric forecasting in support of cost-of-service regulation, a new supporting data system needs to be developed. The system must be designed to provide management with timely data to make a decision on the return expected from an experimental new product and negotiated service agreements. Moreover, the Postal Service needs to develop some criteria to protect the current revenue base from unjustified revenue leakage. Experience with new product development and negotiated service agreement costing and pricing of international mail, plus the experience and the practice of other entities offers guidance on how to design and manage a pricing program at the tactical level. Some initiatives likely to be considered include:

- **Contract/customized pricing.** Negotiate rates for mailers, which offer win-win opportunities for the customer and Postal Service.
- **Bundle pricing.** Develop a bundling price for mailers who use multiple postal products or services.
- **Seasonal discounts and premiums.** For example, price premium on Standard Mail for two peak-volume accounting periods and a price discount for two off-peak-volume accounting periods.

Jeep

For 2002 models, Jeep is reducing Grand Cherokee pricing by $2,000 across the board, while creating a more affordable Jeep Wrangler model and launching an all-new Jeep Liberty and a Jeep Cherokee Overland model to compete in the luxury class. These measures are in response to crowding in the SUV marketplace and the resulting erosion of Jeep's share in that market. Because Jeep tenaciously analyses internal and competitor sales data to identify areas in which it is losing ground as well as opportunities to regain share, it was able to identify incursions by its competitors before the situation became desperate. Recognizing that price is a powerful differentiator in this tight market, Jeep implemented a rigorous cost-reduction program a few years ago that is now paying for its price reduction.

Competitive Considerations

Prices, because they are more likely to reflect market conditions, may provide information that can be used to guide competitive strategies. For example, under intense price pressure in the personal computer segment, IBM sought new pricing strategies and value-adding opportunities to build loyalty and market share. In addition to introducing lower-priced products with limited success, IBM introduced computers with more internal memory at a slightly lower price. One possible outcome of having to operate in a more competitive environment would be to force the Postal Service to reposition selectively various products and in response to increased competitive pressure.

In the current environment, the Postal Service has been partially sheltered from aggressive competitive campaigns. Pricing freedoms would place the Postal Service in a highly competitive environment among private enterprises, which are generally thought to be more agile in responding to market trends and consumer buying habits. In recent years foreign posts have undertaken privatization efforts in varying degrees, with target objectives of liquidity, profitability and efficiency in service. For a variety of reasons, the Postal Service has not developed a consistent, thorough, competitor-monitoring program. The Postal Service would need to develop a position and identity, which drives all other functions of an efficient organization. The Postal Service would have to identify objectives, based on competitive advantages, and use price as a tactical element in achieving them.

Customer Value Considerations

In the discussion of the near-term pricing, this appendix discussed a number of different ways to segment markets effectively as a way to capture value through pricing. Under the reform assumptions, the Postal Service would be allowed to pursue experimental service offerings designed to reflect customer value more explicitly in its prices. Among other possibilities, this envisions the ability to:

- Customize product and service offers according to the needs of customers; and
- Allow prices to be negotiated apart from a published tariff structure.

Of course the Postal Service would still be subject to regulation, but it would be better able to offer innovative products and services without the burden of extensive litigation. This would require the Postal Service to reexamine the way it collects and uses customer and cost information and would require the Postal Service to make better use of market information in developing its product and operations strategies.

Cost Management Considerations

In the long term, the financial incentives of the Postal Service would change. It is essential to note that cultural changes and the concrete actions associated with those changes will take time. In the meantime however, a number of actions could be taken and these are discussed below. However, the largest financial impacts may be those that are unknown at this time, but would take place across the vast and complicated organization that is the Postal Service. Structuring financial incentives appropriately will be critical to maximize the organizational transformation.

Presumably under moderate reform, the Postal Service would gain some pricing flexibility, but if political constraints remain, the financial value of modest reform may be limited. It also must be remembered that appropriate incentives must be in place for Postal Service management to ensure that increased pricing flexibility is used in ways that benefit the Postal Service bottom-line. For example, private sector companies that employ best practices carefully set compensation for sales people to encourage them to make pricing decisions consistent with the best interests of the organization. This might entail rewarding managers based on profitability as opposed to revenue.

Presumably under moderate reform, an appropriate source of funds for capital investment would start to open up. A recent blue ribbon panel complained that the Postal Service does not invest nearly enough in capital spending and spends substantially less than similarly sized private organizations. The panel further noted the fundamental illogic of merely breaking even in a future test year with no ability to raise rates based on increasing costs. Without the ability to raise funds through shareholders or profits, the Postal Service is limited to replacing existing equipment through depreciation and increasing debt. Modest pricing flexibility would provide a source of funds for new equipment and facility updating and replacement.

Modest reform would allow the Postal Service to move quickly in markets where competition demands price flexibility. It might allow for some geographic, season-based, or entry time-based prices that would have numerous financial and operational advantages. Again, cultural change and incentives will be necessary to ensure that flexibility allows changes to maximize the Postal Service’s financial value as a whole rather than that of a particular district or area. This is a common problem in large, national, geographically dispersed private sector organizations. For example, McDonald’s Corporation receives no or potentially negative benefit if advertising and promotion dollars are spent to merely take business from one local franchisee to another.

Modest legislative reform might allow for a more appropriate view of pricing across the product life cycle. Currently, pursuant to statutory requirements,the Postal Service has limited ability to implement marketing strategies consistent with standard business practices, and limited ability to vary prices based on the product life cycle. The Postal Service cannot consider market conditions facing mature products or offer low introductory prices on new products to gain a foot hold in the marketplace. In some cases, the PRC has assigned much higher prices on new/experimental products than was desired or would make marketing sense for any private business. This can result in killing the product before it starts, or handicapping it so much that it never achieves its full potential. In modest reform, it is hoped that new products could be priced with long run financial success in mind.

Preparing for the Future

The Postal Service's structure and role in the economy are less easy to define precisely in the long term beyond moderate reform as they depend on a variety of comprehensive legislative reforms. Irrespective of the specific reform legislation that is implemented, the Postal Service is expected to operate in a very different context. For example:

- The Postal Service faces a turbulent environment at home and abroad on many fronts: technology, changing business environment, and regulatory framework.
- Current and emerging technologies will provide challenges to mail volume. The Internet, telephone, and fax machine will become increasingly viable alternative to mail. As security issues are resolved, this threat could increase. Also, changes in the business environment (mergers, acquisitions, focus on cost and cycle time 24/7/365 business) will effect demand for mail services.
- Mail volume will be facing severe pressures in key segments (e.g., bill payment and business correspondence).
- Speed and sources of change are multiplying.
- Market opportunities have a finite and shorter time horizon, creating a need for increased agility in markets and services. This also implies the ability to penetrate new and financially attractive markets and exit existing and unattractive ones.

Kodak

Kodak and Fuji are the principal film manufacturers in the U.S. market, with Kodak maintaining a share that is more than double Fuji's. Despite Kodak's relative dominance, Fuji has been a very tough and aggressive competitor over the years, causing Kodak to assidiously monitor Fuji's marketing policies and any incursions on its market share in preparation to respond immediately to any advances by Fuji. Using scanner data and customer surveys, Kodak has been able to identify means of competing directly with Fuji without inciting a price war for its near-commodity film products. Kodak introduced new products, like Kodak Fun Saver film, which was sold in bulk at prices below Fuji's, thus preserving Kodak Gold's price level and brand image. In addition, Kodak added channels, including large discount stores like Wal-Mart, as well as grocery stores, thus making its products available to a wider range of customers.

Customized Pricing for a Niche Market Segment

The Postal Service may identify a potentially lucrative distinct market segment and create a customized pricing for a mailer, or a set of mailers, serving it. Records have shown there are forty million addresses, which have not yet purchased items through the mail. Due to perceptions of low response rate, mailers have ignored this niche market segment. The Postal Service can work with mailers to develop prices that encourage them to enhance the effectiveness of their solicitation effort, eventually enticing them to target this market segment.

Strategic Implications

In light of this rapidly changing business environment, pricing would evolve into a quickly deployable tool. As a Commercial Government Enterprise, the Postal Service would no longer be limited by the break-even requirement that currently exists. Thus, the Postal Service would be allowed to increase its net income. The financial impact of this change should result in a gain in new volume/revenue that could be achieved through a more business-like pricing approach and other changes in the ability to serve customers directly. A lingering issue would be the degree that the Postal Service is constrained by previous precedent and political concerns. For example, could the Postal Service make appropriate service/price changes where costs exceed revenue in various segments, or, would they be compelled to limit businesslike changes because of statutory requirements or political concerns? It is possible that a future Postal Service might resemble a utility in some ways in that the goal of financial maximization is constrained by fairly tight regulation. Many of the fundamental financial design failures of the Postal Reorganization Act that have been documented could be solved by changing the Postal Service goal from break-even to further commercialization and earnings retention.

Another issue is that a reasonable net income assumes a stability of costs that would likely be inaccurate in the actual business climate in which the future Postal Service would operate. The Postal Service would make changes on a number of fronts. In some areas there might be dramatic cost decreases, while in other areas costs might go up as additional services were found to be necessary or desirable for customers. Therefore, the underlying costs might change in ways wholly unrelated to other costs, such as wage rates. Finally, it must be recognized that pricing in the future would start from the current pricing base, which is far from ideal from a business perspective. In some instances prices should be higher for various products and in other cases they should be much lower. As prices change, political pressure might be exerted that would diminish the advantages of more flexible pricing.

As a Commercial Government Enterprise, however, flexible and innovative pricing would be the prevailing paradigm of the organization. The Postal Service would develop and employ ancillary tools and data systems on costs, customers, and competition at the market segment and product level. Below are some of the pricing principles that would govern the new paradigm:

- Adopt value-based pricing to maximize value.
- Base strategy on market segments and products and not on postal rate classifications.
- Pricing strategy should accompany Postal Service products and services through their life cycles, from the introduction to the harvest phases.
- Develop all the necessary tools and data systems (on costs, customers, and competition) to support pricing.
- Develop and implement an internal transfer pricing mechanism to ensure that cross-functional products are optimally priced.
- Integrate information on costs, customers, and competition into a pricing strategy quickly.

- Pricing would be a tool that could be deployed quickly.
- Pricing would be an important signal in the marketplace. It would reflect customer perceptions of value.
- Pricing would be a signal of Postal Service competitive advantages.
- Pricing could be used as a promotional tool for new products—no other weapon in a marketer's arsenal can boost sales more quickly or effectively than price.
- The infrastructure for deploying a variety of customized pricing arrangements would be implemented throughout the postal system. The current infrastructure presumes a uniform pricing change every couple of years. This would need to change.

Advertising Mail

Customized Pricing for a Niche Market Segment—Sophisticated Segmentation

Under this phase, the Postal Service identifies a potentially lucrative distinct market segment, and creates a customized pricing for a mailer, or a set of mailers, serving it. Records have shown there are forty million addresses, which have not yet purchased items through the mail. Due to perceptions of low response rate, mailers have ignored this "niche" market segment. The Postal Service can work with mailers to develop prices that encourage them to enhance the effectiveness of their solicitation effort, eventually enticing them to target this market segment.

Illustrative Examples

There are no limits to the kind of innovative pricing scenarios that could be utilized here. Here are some examples for illustration purposes:

- Pricing to optimize capacity
  - Develop a variable pricing system based on standard daily peak and nonpeak hours (i.e., charge a premium price during busiest time, and a discount during slow times) to help level workload.
- Competitive pricing
  - Provide new customers some incentive (a gift, limited free or discounted service) for customers who switch from a competitor's service.
- Membership-based pricing
  - Charge a fee for noncustomers (those who have not paid for membership privileges), similar to an ATM fee structure.
  - Introduce corporate accounts as a standard option allowing major customers to pay monthly.
- Cost- and volume-base pricing
  - Develop prices based on the cost of goods/services sold (e.g., stamps sold on the Internet—a low cost channel—would have lower transaction costs than stamps sold in a post office.

  - Mark-up prices by channel or location (e.g., like gas stations with price based on the willingness to pay of individuals in a geographic area). For example, post office boxes located in areas with vanity addresses (e.g., Beverly Hills) would be priced relatively higher.

- Other pricing innovation
  - Consider auction pricing for certain services, as well as excess capacity.
  - Utilize "complex" pricing to make price comparison difficult.
  - Allow various business units to offer "competing" products with differential pricing (e.g., one business unit may focus on premium customers, another on "average" customers—offering similar products with different pricing and positioning.)

Competitive Considerations

In the long term, while some portion of the postal monopoly is liable to remain, a significant portion of the Postal Service would operate as a commercial entity and would therefore be free to use some of the initiatives outlined above to serve specific competitive goals not feasible today:

- The Postal Service may elect to enter new lines of business where it perceives the potential to successfully serve an emerging market. If a cost advantage exists, the Postal Service would compete directly on price.
- Postal Service sales personnel would be free to negotiate with strategically important accounts and to offer price incentives (subject to management rather than regulatory controls) where it makes sound business sense.

Effective use of these capabilities depends on the operational and other changes outlined elsewhere in this report and on developing the market intelligence capabilities described above.

Customer Value Considerations

As mentioned above, customer perceptions of value become the primary consideration in pricing. In addition to determining prices, the dynamic interaction between the Postal Service and its customers influences a wide array of strategic and operating decisions, e.g., which markets to enter, whether operational changes are required to serve particular markets, and what wage rates are feasible for specific services.

Cost Coverage Considerations

In the current regulated world, prices are based on estimated costs plus a reasonable markup with a break-even requirement. In an essentially nonregulated world, prices would no longer be cost-based, but costs would still be very important. Very different cost data than those available now would be required. The Postal Service would need a cost system based on products, rather than subclasses. It would need data sliced in many new ways and the ability to quickly provide data as requested by those responsible for pricing.

Improvements and changes would be very important in using new pricing flexibility appropriately. Alternately, it would be very expensive, time consuming, and all but impossible to produce the necessary data accurately using the current costing systems. In the long term, the Postal Service must have a product-based costing system to provide data for business pricing decisions. For example, data broken out geographically, urban vs. rural, by mail shape, mail size, delivery distance, customer, and any number of other categories, would be required to support pricing decisions based on the competitive environment and the value to the customer. The Postal Service needs to know their costs based on market/customer segment, not classification category. Former UPS CEO Kent “Oz” Nelson said the most important benefit of focusing on customers “was learning what our true costs were”. He also suggested that the key to negotiating rates with customers is understanding what the costs are. Clearly, even where costs may bear little resemblance to the final prices charged, good cost data is a critical element in developing prices that maximize shareholder and organizational value. The Postal Service would not be able to take advantage fully of increased pricing flexibility unless good product cost data can be extracted.

Appendix M

APPENDIX M — Efficiency-Based Strategies

Operational efficiencies keep costs down, which directly benefits customers. Major mailers have cited cost control as one of the major initiatives that they would like to see included in the near-term transformation effort. Postal Service operations costs are significant.

Collecting, sorting, transporting, and delivering the nation's mail to every household and business across the country is an enormous task. On an average day, the Postal Service delivers 687 million pieces of mail to 138 million addresses, some as near as the house next door, and some as distant as the mountains of Alaska and the shores of Puerto Rico. To accomplish this great task, the Postal Service utilizes a workforce of nearly 770,000 career employees and a physical infrastructure that includes over 38,000 post offices and contract units, 270 processing plants, sixty-three airport mail facilities, twenty-one bulk mail centers and a number of other facilities. The Postal Service also partners with private sector contractors for highway, air, rail, and water transportation services.

This Appendix to the *Transformation Plan* contains additional explanation, detail, and examples of near– and longer– term strategies that are efficiency-focused. This is not meant to be a comprehensive list of postal projects, but is meant to outline those that will contribute to the transformation of postal operations.

Strategies in this Appendix include:

- Enhance already efficient letter processing;
- Complete automation of flats processing;
- Expand mechanization of material handling operations;
- Improve delivery efficiency;
- Deploy next generation package sorting equipment;
- Optimize transportation and distribution networks;
- Increase retail / customer service productivity;
- Improve performance management;
- Manage realty assets; and
- International air transportation deregulation.

Increase Operational Efficiency

Overarching Objective

The Postal Service is implementing strategies in nine operational areas to improve the efficiency and effectiveness of its network and processes. In addition, the Postal Service will explore opportunities to reduce international air transportation cost. The Postal Service will utilize new technology, cost management, and planning to improve operational efficiency.

Strategy 1: Enhance already efficient letter processing

Like any other large business, the Postal Service relies heavily on modern technology to improve efficiency and to control costs. Automation equipment has been central in this respect, resulting in a world-class letter distribution system. The Postal Service will further enhance this system by investing in equipment to automate the forwarding of letters.

Substrategy 1: Deploy Postal Automated Redirection System

Description

Postal Automated Redirection System (PARS) is an initiative which is targeted toward resolving undeliverable as addressed (UAA) mail, which includes mail that:

- Needs to be forwarded because the addressee has moved;
- Needs to be returned to sender because the addressee moved and left no forwarding instructions, or for other reasons; and
- Is not easily deliverable because of incorrect, illegible, or insufficient addressing.

Using PARS, the UAA mail will be intercepted earlier in the sorting process, resulting in a reduction in total handlings and in time spent within the Postal Service. The Postal Service expects to invest in equipment to automate the forwarding of letters, which will produce significant savings in 2004 and 2005.

Trends / Supporting Data

The primary cause of mail becoming UAA is the geographic mobility of the American public. The Census Bureau reports that 16.1 percent of the American population moved during the period 1999–2000. The Bureau found that America’s overall moving rate has stayed constant, but people are moving longer distances. In 2001, the American public submitted over 40 million Change of Address order forms to the Postal Service.

Every piece of UAA mail must be processed until a final disposition is made. At present, the Postal Service uses manual and mechanical means to perform this work, and incurs an average additional cost of 20.9 cents if a mailpiece has to be forwarded, and 58.6 cents if it has to be returned to sender. The Postal Service is forwarding approximately 2 billion of pieces of mail per year as well as returning approximately 1.3 billion pieces to senders.

The initial phase of the PARS program will cover comprehensive implementation of the PARS system in 53 postal Processing and Distribution Centers/Facilities (P&DC/F), all 20 of the Postal Service’s remote encoding centers (RECs), and the delivery units they serve. Deployment of phase one is expected to begin in July 2003 and end in February 2004. A second deployment phase is expected to follow the first phase.

Benefits

- The first phase of the PARS program is expected to yield net savings of approximately 2.4 million workhours per year. These labor savings will appear in three types of postal facilities: computerized forwarding system units, delivery units, and processing and distribution centers / facilities.
- The total savings anticipated from the second phase of PARS will be approximately 5 million workhours.
- PARS also will improve service, by significantly reducing the time required to get UAA mail to its final destination.

Milestones

- Phase one PARS Board of Governors (BOG) Review / Approval (April 2002)
- Phase one deployment (July 2003 through February 2004)

Metrics

- The extent to which each type of letter processing equipment equipped with the PARS upgrade intercepts UAA mail.
- The extent to which a PARS' machine, equipped with the combined input output sub system (CIOSS), properly processes mail that has been identified as being UAA.
- The reduction of total workhours in CFS units.
- The discontinued use of mechanical terminals for letter mail processing.

Strategy 2: Complete automation of flats processing

New automation programs are now shifting to the flat mailstream with investments improving the productivity and controlling the cost of handling flat-sized pieces. Additional investments will increase machine throughput, improve address recognition, enhance feeder systems, and add tray handling systems.

Substrategy 1: Complete Deployment of Automated Flat Sorting Machine 100 (AFSM 100)

Description

The Automated Flat Sorting Machine (AFSM) 100 is allowing the Postal Service to improve productivity and control processing costs for flat mail. It is based on state-of-the-art flat sorting technology and provides many capabilities not present on its predecessor, the Flat Sorting Machine (FSM) 881. With its automated feeders and online video coding system for non-OCR readable flat mail, it allows the Postal Service to process flat mail more efficiently than ever before. Deployment of 534 operational AFSM 100s began in April 2000 and should be completed by March 2002.

Trends / Supporting Data

- The Postal Service receives over 50 billion flat mail pieces each year in a wide variety of sizes and packaging materials. This mail includes large envelopes, newspapers, catalogues, circulars, and magazines. Over 40 percent of this mail is presorted to individual carrier routes by mailers and can be sent directly to the carrier for delivery; the remaining percentage requires sorting by the Postal Service.
- In order to increase the distribution capacity and efficiency for flats, the Postal Service began deploying the automated Flat Sorting Machine (AFSM) 100. These machines have automatic feeders, Barcode Reader / Optical Character Reader (BCR/OCR) capabilities, and online video coding. The AFSM 100 deployments will fully address machine capacity needs throughout the entire system.
- Utilization of the AFSM 100 has demonstrated that a large number of FSM 881s can either be relocated or excessed without negatively impacting operational performance. This conclusion has resulted in a continuous review of the criteria and rationale used to deploy the AFSM 100 and to redeploy the FSM 881 and possibly the FSM 1000. The machine reallocation efforts are based on mail volumes and potential system savings. These efforts also consider space requirements, staffing levels, maintenance support availability, and work practices.
- The table below provides information concerning the projected end-of-year national equipment inventories. It is important to note that even though the total number of FSMs will be reduced during the near term, the overall system processing capacity will increase due to the higher throughput of the AFSM 100.

FLAT SORTING MACHINE INVENTORIES

	FY 2000	FY 2001	FY 2002
AFSM 100	107	355	534
FSM 881	814	480	114
FSM 1000	353	353	353
Total	1,274	1,188	1,001

Benefits

Improvements in flat sorting productivity and efficiency at P&DC/Fs as well as reducing manual flat sorting requirements at P&DC/Fs and associate offices. This program will have reduced field budgets by over 15.9 million workhours when it is fully implemented.

Milestones

Complete deployment by March 2002

Metrics

Improved productivity in total flat sorting operation and a reduction in the amount of flat mail that is sorted manually.

Substrategy 2: Install automated flat feed and optical character reader (AFF / OCR) modifications on FSM 1000

Description

The Flat Sorting Machine (FSM) 1000 sorts mail that cannot be handled by the AFSM 100 or FSM 881. It has the ability to sort thick, hard-to-handle, flat-size pieces that used to be sorted manually, including newspapers and magazines. The feeder and OCR modifications will increase the machine's throughput and permit over 70 percent of the mail pieces fed into the FSM 1000 to be sorted automatically instead of keyed manually.

Trends / Supporting Data

The Postal Service is taking steps to move all machinable and FSM 1000 compatible flat volumes away from manual distribution to more efficient automated operations. The "up the ladder" approach, using tools developed during letter automation, will serve as a measure of operational efficiency. Incoming secondary operations (sortation to the carrier level) that process flats manually in both the processing centers and customer service units offer the greatest opportunity for reducing cost. Centralizing the distribution of machinable flats from associate offices, stations, and branches into locations that have the AFSM 100 will ensure that its use is maximized and that customer service workload is reduced.

The additional processing capacity of the AFSM 100 permits increased use of the FSM 1000 to process volumes traditionally sent to manual distribution operations.

Benefits

This strategy will improve flat sorting efficiency at P&DC/Fs. The Postal Service expects to reduce field budgets by over 870,000 workhours when the feeders and OCRs for FSM 1000s are fully deployed.

Milestones

- Complete First Article Test—April 2002
- Deployment—April 2002 through September 2002

Metrics

Increase in productivity, as measured by the Postal Service Management Operating and Data System.

Substrategy 3: Deploy automatic tray handling system

Description

Automatic Tray Handling System (ATHS) for the AFSM 100 would replace the takeaway conveyors on the original AFSM 100 with state-of-the-art fixed mechanization that would do the following automatically: 1) load the machine's 120 bins with empty tubs; 2) as individual tubs fill up, remove them, immediately insert an empty replacement into the vacated bin, and send the full tubs down a takeaway conveyor to the end of the machine; 3) label each full tub using information provided by the sorter's control system, and 4) read and validate the label entries against the source information.

Trends / Supporting Data

It is expected that not all AFSM 100s will be modified with ATHS. Only those machines which have sufficient runtime will be modified.

Benefits

It is expected that ATHS will reduce the sweep personnel assigned to an AFSM 100 team from two employees to one employee.

Milestones

Prototype testing is expected in 2002

Substrategy 4: Deploy semiautomatic tray take-away mechanism on the FSM 1000

Description

A system similar to the ATHS is planned for the FSM 1000. The Semiautomatic Tray Take-Away Mechanism (SATTAM) will remove full trays from the tray rack of the FSM 1000 and place them onto the machine's take-away belt. This mechanism will also move an empty tray into the place of the full tray to begin receiving flat mail.

Benefits

It is expected that this system will reduce the staffing of sweepers by one per FSM 1000.

Milestones

Prototype testing is expected in late 2003

Substrategy 5: Deploy flats remote encoding system

Description

The Flats Remote Encoding System (FRES) will consolidate flat keying operations at the remote encoding centers (RECs). It will also provide an infrastructure that supports remote keying activities, such as PARS and APPS, associated with future programs that may be used with other types of mail. The FRES program for the AFSM 100 will support the ongoing relocation effort of all AFSM 100 Video Coding Systems from the Postal Service's processing plants to the RECs.

Trends / Supporting Data

In today's plant-based, AFSM 100 keying environment, each plant must staff and manage the video coding systems they have for their respective AFSM 100s. The FRES program will allow the 'pooling' of video coding resources at the RECs and load balancing of video coding requirements among the processing plants in a particular area. Thus, the AFSM 100 keyers will be able to work more consistently and efficiently because FRES will manage and balance the workload among all keyers in the coding pool for a particular area.

Benefits

The implementation of FRES is expected to minimize the idle time experienced in flat keying operations at Postal Service RECs.

Milestones

- Contract Award — May / June 2002
- First Article Test — September 2002
- Deployment — October 2002 through June 2003

Strategy 3: Expand mechanization of material handling operations

Investments are planned for tray sorting machines to reduce the manual sorting of letter and flat trays as they enter and exit operations for processing and dispatch. Also in the future, there will be a physical integration of the handling of trays, bundles, packages, and sacks. The Postal Service will continue to work with customers and the mailing industry to explore product redesign and worksharing options that will reduce the number of tray and piece handlings and improve efficiency in postal operations.

Substrategy 1: Deploy low cost tray sorters

Description

A strategy recommendation for achieving savings in material handling operations is the deployment of Low Cost Tray Sorters (LCTS). LCTSs have helped reduce material handling workhours and have been deployed for inbound tray sorting operations and outbound dispatch operations. The cost of LCTSs can vary depending on configuration and the ability to scan barcodes on tray labels and/or dispatch and routing tags.

Trends / Supporting Data

In today’s processing environment, trays are collected from the mail processing machines and moved to the dispatch area manually requiring significant manual labor. LCTSs have been integrated with Tray Management Systems (TMS) and dispatch equipment components. Integration of tray transport material handling capabilities with TMS and dispatch equipment is required to ensure efficiencies of dispatch operations.

Benefits

LCTSs are custom designed depending on the plant’s needs allowing for greater flexibility. It is anticipated that the system can process up to 1,800 trays per hour throughput capacity.

Milestones

LCTSs are justified and deployed on a site-specific basis. LCTS are typically operational within 4 to 6 months of approval.

Metrics

Deployment of LCTSs will result in a reduction in allied workhours (Labor Distribution Code 17).

Substrategy 2: Develop universal tray system

Description

The Universal Tray System (UTS) is under development at the Integrated Processing Facility in Ft. Myers, Florida. In the future, the UTS will be the primary means for achieving physical integration within the plant. It will be equivalent to a tray management system, plus it will have the ability to handle bundles, parcels, and sacks.

Benefits

Expect to reduce the cost at this site while gaining operational experience with this type of system.

Milestones

Deployment end—mid-2002

Strategy 4: Improve delivery efficiency

Capital investment in equipment to improve delivery operations is also a priority. The Postal Service intends to continue seeking out and testing equipment and concepts that will enable it to automate the sorting of flats in Delivery Point Sequence (DPS). The long-term vision for delivery operations is a seamless operation that results in one bundle of mixed letters and flats for each delivery point.

In the near term, the Postal Service is actively deploying the Delivery Office Information System which provides timely data to delivery supervisors to enable them to make better decisions on a daily basis. The Postal Service is also pursuing several other productivity improvement initiatives in the near term.

The Postal Service is testing the Segway™ Human Transporter on a variety of routes, terrain, and climates. If proven to be successful this will reduce the carrier street time to service the route and expand the number of delivery points per route.

Substrategy 1: Delivery point sequence of flats mail

Description

Flats delivery point sequencing (DPS) would automate the walk sequencing of a portion of the flat mail. Flats that are to be delivered within one or more five-digit ZIP Codes and that satisfy several physical constraints (i.e., “machinable”), would be passed through a sorting machine twice, resulting in flats in delivery sequence for each carrier.

Trends / Supporting Data

The Postal Service has been successful in automating letter mail distribution for carriers, but the Postal Service has not yet been able to extend the benefits of automation to carrier flats operations. While letter operations have become more efficient, flats’ processing and delivery costs have been growing steadily.

Benefits

At present, each Postal Service carrier receives flats that are to be delivered from a variety of sources. This mail is not merged and much of it is in random order. The carrier manually sorts this mail into the delivery case, thereby merging it with letters and placing it into delivery sequence. The carrier then removes the flats from the case (pull-down), and takes them onto the street for delivery.

A better way to achieve this result is to process flat mail on a Flats Delivery Point Sequencer. As with the delivery sequencing of letters on the deployed delivery barcode sorter (DBCS), two passes across the Flats Delivery Point Sequencer will be needed to accomplish this result. The Postal Service will be replacing a two-step manual activity with a two-step automated activity, accompanied by major productivity improvements.

Milestones

A thirty-two month timetable could be pursued for the development and selection of a Flats Delivery Point Sequencer for the Postal Service:

- Design and Simulation of Competing Sorters;
- Fabrication and In-Plant Test of Competing Sorters;
- Competitive Field Test; and
- Deployment Planning and Approval.

Metrics

Net workhours reduced in Field Operations

Substrategy 2: Delivery point packaging (DPP)

Description

Delivery Point Packaging (DPP) is a less developed extension of the Flats DPS strategy discussed above. DPP technology would produce one package of mixed letters and flats for each delivery. The packages would be automatically sorted to the letter carrier in walk sequence. A key component of this new approach is a machine that can assemble a large range of letters and flats into delivery point packages and output those packages in walk sequence.

Benefits

With an operational delivery point packaging system, all flats and all letters for a delivery point will be provided to the carrier in packages that the carrier can take onto the street and deliver, as is. All of the manual sortation and removal from the case (pull-down) that each carrier currently does will no longer be needed. For many carriers, this work accounts for approximately half of the workday.

With a package concept in place, each carrier would report to work in the morning, pick up one package of mixed letters and flats plus any parcels and accountable mail for each delivery point on the route, and immediately go onto the street and start delivering mail.

Milestones

- The work described above for the Flats DPS takes advantage of existing work already underway in the vendor community, and therefore is comprised of development tasks only. For DPP technology, both research and development will be needed.
- A multi-phased evolution to packaging is under consideration, in which the Postal Service first would implement flats delivery point sequencing, followed by a 2-bundle method and a 1-bundle method, before finally implementing delivery point packaging.
- To minimize the amount of elapsed time before DPS technology is ready for deployment, a 4-year research and development effort is required, in parallel with the Flats DPS initiative described above. The end product of this Research and Development project would be prototypes that demonstrate technical and economic feasibility, but need to go through Production Design and Competitive Field Test stages before deployment can begin.

Metrics

- Percentage of the letters and flats workload that the technology can process.
- Percentage of the workload that can be processed via automation in a sufficiently timely manner.
- Net workhours reduced in field operations.

Substrategy 3: Deploy delivery operations information system

Description

Delivery Operations is actively deploying the Delivery Operations Information System (DOIS). DOIS is a Board of Governors approved project and replaces three existing stand-alone applications used by field managers. DOIS provides delivery supervisors with timely data, allowing them to make solid business decisions on a daily basis.

Benefits

The Postal Service is expecting a workhour reduction of approximately 2.9 million workhours upon final deployment.

Milestones

- Complete phase four deployment by September 2002.
- As of February 2002, DOIS has been deployed to 4,722 units and 15,210 employees have been trained.

Metrics

Productivity improvements to same period last year comparing DOIS vs non-DOIS sites.

Substrategy 4: Deploy managed service points

Description

The MSP program is intended to improve the consistency of mail delivery to customers. The program uses the Mobile Data Collection Device (MDCD) to scan bar codes at the delivery unit and along the carrier’s route of travel. This allows supervisors to know if routes are being traveled within the expected time frames, which leads to consistent time of delivery.

Trends / Supporting Data

A greater decrease in carrier workhours (street time) has been identified in MSP offices when compared to non-MSP offices. The results of preliminary analysis indicate that while carrier street workhours have decreased 0.72 percent in non-MSP locations, they have decreased 1.90 percent in MSP locations.

Benefits

Improvement in consistency of delivery time promoting customer satisfaction, reductions in workhours, and an increase in deliveries per route.

Milestones

MSP will be fully deployed by the end of 2002 to all city carrier routes.

Metrics

Number of routes scanning, scan-rates, increase in Customer Satisfaction Index, carrier workhour reductions (Labor Distribution Code 22); increase in deliveries per route; route reductions (or route avoidance where possible deliveries are growing).

Substrategy 5: Delivery performance achievement and recognition system (DPARS)

Description

A component of the Breakthrough Productivity Initiative (BPI), the Delivery Performance Achievment and Recognition System (DPARS) tool/process monitors workhour utilization and productivity increases and will ultimately become an earned workhour budgeting system for both city and rural delivery. Grouping like sized offices together and benchmarking the demonstrated performance within the peer group at the average of the top quartile will measure delivery operations against a standardized target. Good performance will be recognized. The targets are set based on offices that have demonstrated they are the “Best in Class” within their peer group. Good performance will be recognized for both “Best in Class” and “Most Improved” based on overall high levels of performance as well as improvements at lower performing offices.

Trends / Supporting Data

City delivery workhour avoidance based on productivity improvements for FY 2001 was 2.1 million or 0.4 percent improvement. To date, the workhour avoidance due to increased productivity is 1.1 million or 0.6 percent improvement. Rural delivery workhour avoidance based on productivity improvements for FY 2001 was 1.9 million or 1.1 percent improvement. As of FY 2002 AP 06 Week 2, the workhour avoidance due to increased productivity is 0.9 million or 1.2 percent.

Benefits

This system will drive proper decision-making by field managers, will lead to significant reductions in costs and complement, and will establish the basis for opportunity based budgeting.

Milestones

Include DPARS as part of the Human Capital compensation and rewards strategies.

Metrics

Workhour avoidance as measured by the percent change from the prior year to the current year for city and rural delivery operations.

Substrategy 6: Improve rural delivery

Description

Three initiatives are aimed at improving rural delivery:

- Rural Time Review is a process by which managers examine and analyze the entire rural delivery timekeeping / recording / reporting process. Managers will be better trained in their time recording processes. The review will also lead to better management decisions regarding the scheduling of overtime.

- Managing Rural Delivery is a training program designed to ensure managers understand the basic concepts of managing rural delivery, with a particular focus on utilizing the Rural Time Review.
- Operations articles gives managers a series of specific “quick hit” strategies for reducing rural workhours. It also serves the purpose of raising awareness of the need to focus on rural management.

Trends / Supporting Data

Rural delivery workhour avoidance as measured by DPARS (see Substrategy 5) is 0.9 million hours year-to-date as of FY 2002 AP 06 Week 2. This is a 1.2 percent improvement. The National Payroll Summary Report shows increased rural regular and overtime paid hours despite reduced volume.

Benefits

This strategy will result in an overall reduction in the use of rural delivery workhours.

Milestones

- Deploy a new rural route workhour usage report by March 2002 to automate the current manual process of determining where the overrun to standard hours occurs.
- Revisit and reissue the BPI Rural Timecard Audit booklet in March 2002.

Metrics

Workhour avoidance as measured by percent change in DPARS from year-end 2002 compared to year-end 2001 (target is 0.3 percent and currently 1.2 percent). Monitor improvements in National Payroll Summary Report overtime and regular paid hours.

Substrategy 7: Carrier optimal routing

Description

This project is designed to test city carrier routing and travel path optimization algorithms. Route design based on optimization modeling is currently employed by major delivery and pickup companies in private industry. The Postal Service expects the outcome of this effort to be more efficient and safe routes along with lower cost of vehicle use.

Trends / Supporting Data

Preproduction software demonstrated a 10 percent vehicle mileage reduction and a 3 percent workhour reduction in city carrier street processes (LDC 22). Production software award (January 2002), subsequent alpha testing, and national training / deployment indicate achievable savings for the first quarter of 2003.

Benefits

Benefits include reduced workhours and vehicle costs, improved customer relations (more efficient route layout and subsequent service), and improved carrier safety (more compact, contiguous routes which minimize unnecessary travel).

Milestones

- Production software award—March, 2002
- Alpha testing will be conducted from July to September, 2002
- Field training and deployment is anticipated upon completion

Substrategy 8: Segway™ Human Transporter (Segway HT)

Description

The Segway HT is a self-balancing, pollution-free, environmentally friendly, battery-powered transportation device. It has a footprint no larger than the human body, uses the same space as a pedestrian, and can go wherever a person can walk. The Segway HT will allow carriers to travel more quickly while reducing the physical burden of carrying the mail.

Benefits

The Segway HT has the potential to increase carrier efficiency and decrease delivery costs. Injury compensation costs may also be reduced as the weight of the mail is transferred from the carrier to the HT, thereby improving the ergonomics of carrier daily work activities.

Milestones

- Feasibility Testing—March 2002
- Alpha Testing—July 2002
- Beta Test—Quarter one of fiscal year 2003

Metrics

Carrier street workhour reductions as a consequence of reduced park points, fewer relays, and expanded delivery loops with increased delivery points.

Strategy 5: Deploy next generation package sorting equipment

To improve the Postal Service’s ability to handle packages, equipment projects are planned to improve productivity, sort accuracy, the singulation process, and automatic induction of barcoded parcels. Also the next generation of sorting machines for small parcels and bundles of mail will replace the older labor-intensive machines in larger offices.

Substrategy 1: Deploy singulate, scan, induction unit

Description

The Singulate, Scan, Induction Unit (SSIU) equipment is being deployed to nineteen of the twenty-one bulk mail centers (BMCs) and will improve productivity and sort accuracy. Each BMC will receive two SSIUs that will improve the singulation process and automate induction of barcoded parcels onto the BMC sortation equipment. The device will allow parcels to be sent, one at a time, through a dimensioning unit, a weigh-in-motion scale, and then through a scanning tunnel that will read the package barcode. Packages will then be automatically inducted onto the sorter. Deployment began in January 2001 and is expected to end in the fall of 2002.

Trends / Supporting Data

BMCs handle a variety of mail products including packages, sacks, and trays. The BMC network came into operation during the early 1970's to mechanize both parcel and bulk mail processing. The building of the BMC network is characterized by extensive fixed mechanization under computer control. The SSIUs are being installed on BMC parcel sorters to improve their efficiency.

The SSIU has the ability to convert the source stream of bulk loaded parcels into a single, spaced line of separated parcels. These parcels are then passed through a six-sided scan tunnel that records their dimensions and weight and reads their barcode. The SSIU then feeds the parcel onto the sorting machine, which uses the barcode information to sort the mail piece.

Benefits

Increased throughput and improved productivity due to automatic read and induction. Reduction in workers' compensation costs due to less manual handling,

Milestones

Deployment began in January 2001 and is expected to end in the Fall of 2002.

Metrics

Reduced labor budget and improved performance as reported in the BMCs' Plant Information Management System (PIMS).

Substrategy 2: Deploy automated package processing systems

Description

The Automated Package Processing System (APPS) is the Postal Service's next generation of sorting machines for parcels and bundles of mail. It is designed to replace the older labor-intensive Small Parcel and Bundle Sorters (SPBS) in larger offices. APPS will have enhanced features over the existing system such as singulation, camera tunnel with Optical Character Reader / Barcode Reader / Video Coding System (OCR / BCR / VCS) and a carousel type sorter. APPS has a large processing capacity and will introduce optical character reading (OCR) and other advanced technologies to the small parcel and bundle operation in processing plants. This will improve productivity and sort accuracy.

Trends/Supporting Data

Bundles are in the mailstream, because the Postal Service gives rate incentives to mailers to presort mail. Mailers taking advantage of presort rates enter full pallets, trays, tubs, and sacks of mail into the Postal Service. Within each of those pallets, trays, tubs, or sacks are bundles, which the receiving facility must sort to smaller facilities or to individual letter carriers within the facility's service area. Today, this work is done on an SPBS if available, or manually.

The other major workload on the SPBS is parcels. The Postal Service delivers more than 1.6 billion parcel-shaped mailpieces per year. APPS will enable the Postal Service to increase throughput of the parcel-shaped mail.

Approximately eighty systems are currently planned for a deployment starting in 2003.

Benefits

Increased throughput and increased productivity due to Auto OCR induction, improved accuracy, reduced labor.

Metrics

Reduced labor and increased throughput, as reported via the Management Operating and Data System.

Strategy 6: Optimize transportation and distribution networks

To address the challenges of rising transportation costs, the Postal Service has implemented several tactical measures for containing costs and improving service. Also the Postal Service will use information systems to measure performance, optimize network design, improve transportation efficiencies, and speed service.

The Postal Service has initiated a network optimization effort, the Network Integration and Alignment initiative, with a charter to create a flexible logistics network that reduces the Postal Service's and customers' costs, increases overall operational effectiveness, and improves consistency of service. The new network design will offer the mailing industry an opportunity to identify impacts of alternative workshare concepts. By jointly improving business practices, the Postal Service can move aggressively to become more efficient thus minimizing rate increase requests. Further network redesign will provide an opportunity for new business development strategies.

Substrategy 1: Deploy surface air management system

Description

The Surface Air Management System (SAMS) is the mail assignment engine that provides the transportation assignment to indexed surface and air routes for sacks, trays, large parcels, and containers. SAMS also provides the ability to allocate capacity by mail classes and track manifests on-line. The system provides an individual routing assignment, with unique serial identification for each handling unit. The routing assignment and serial number are barcode printed on a self-adhesive dispatch and routing tag, which is applied to the handling unit being dispatched. The dispatch and routing tags are scanned providing "visibility" for sacks, trays, large parcels, and containers, as they are handed off to transportation suppliers until delivery back to the Postal Service at destination.

Benefits

- Sustainable, supportable mail assignment system, replacing legacy Air Contract Data Collection System (ACDCS)
- Improve office productivity and reporting accuracy
- Unique serial identification
- Mail assignment for both air and surface transportation
- Mail assignment engine for PostalOne!

Metrics

- Reduced commercial air transportation costs
- Reduced maintenance costs of legacy system

Substrategy 2: Develop transportation optimization planning and scheduling

Description

The Transportation Optimization Planning and Scheduling (TOPS) tool will optimally align transportation requirements with the available resources and develop routing plans that minimize costs and maintain service standards. TOPS will introduce a more dynamic, industry standard, optimization engine for all modes of transportation.

Benefits

TOPS will advance the shared network approach to include all modes of transportation. It will reduce the time required of area staff to build and maintain surface transportation schedules.

Reduced air and surface transportation costs through better utilization.

Milestones

The Postal Service will begin implementation in 2003

Metrics

- Reduction of contracted transportation dollars
- Improved cube utilization
- Improved consistency of service

Substrategy 3: Deploy surface air support system (SASS)

Description

With the Surface Air Support System (SASS), the Postal Service has created a central ‘visibility’ database to receive assignment data from the Surface Air Management System (SAMS) and scanning data from the Postal Service and transportation suppliers. This scanning data provides both service and security benefits giving the Postal Service better data regarding service performance for transportation suppliers, ensuring accurate payment verification, as well as information regarding mail transported on a specific flight, truck or train.

Trends / Supporting Data

Transportation utilization and efficiency data is not readily available on a wide scale.

Benefits

- Data routinely recorded can add great value if collected in a timely manner from both postal and supplier sources and used in planning as well as operational cycles.
- Alignment of transportation resources, reducing unnecessary expense while increasing value of needed trips.
- Greater accountability of transport suppliers.

Milestones

- LinkScan system created to capture scan data at transition points. Deployed initially to support FedEx alliance, February 2002.
- Establish standard transport supplier interface (using Electronic Data Interchange – “EDI”) for shipment status. To be deployed initially with Amtrak, April 2002.
- Expand EDI requirement to commercial airlines and freight rail. Pilot test with two airlines, May 2002.
- Pilot test freight rail, June 2002.
- Implement in national contracts, September 2002.
- Develop and establish unified truck management system, leveraging existing systems by providing better user interfaces and tools.
- Develop logistics data warehouse and ad-hoc reporting tool, July 2002.

Metrics

- Network performance assessment
- Elimination of Air Contract Tags (ACT)
- Reduction / elimination of non-readable distribution and routing (D&R) tags at origin
- Elimination of missorted handling units in bypass containers

Substrategy 4: Develop transportation contract support system

Description

Transportation Contract Support System (TCSS) is a replacement system for the Highway Contract Support System (HCSS). HCSS is a legacy system that currently supports the solicitation, award, and administration of 17,000 highway contracts nationwide. TCSS is a DAR justified project categorized as a sustaining capital investment.

Trends / Supporting Data

- Unstable environment both hardware and software
- Unsupported software
- Reaching capacity of current hardware
- Inadequate reporting capabilities

Benefits

- Web-based system versus distributed system
- Reduced downtime and system maintenance costs
- Improved system performance increasing specialist productivity
- Workload savings through automated versus manual processing of contract functions
- Electronic interface with NASS / SAMS
- Transportation Data Warehouse
- Reliable data
- Improved user reporting capabilities

Milestones

- Complete application development by August 2002.
- Complete system testing by September 2002.
- Complete customer acceptance testing by November 2002.
- Complete full deployment by March 2003.

Metrics

- Implementation on time (see above)
- Development within budget - $4.6 million

Substrategy 5: Increase utilization of mail transport equipment (MTE)

Description

- Mail Transport Equipment Service Center (MTESC) network keeps more MTE serviceable and circulating, thus reducing the requirement to buy new MTE or cardboard boxes and minimizing customer complaints.
- Use empty highway and rail backhaul trips to redistribute MTE nationwide.
- Optimize existing highway transportation to distribute MTE locally.
- MTE engineered to be made of recyclable materials, and substantial recycling revenue has been realized.

MTESC Network provides historical, trend, and performance data for better overall MTE management.

- Too many types of MTE keep demand variability high and cause overspending for purchasing, handling, storing, and transporting; plans are being implemented to reduce the number and types of MTE.

Trends / Supporting Data

Spending for new MTE was reduced by $13 million, or 8.3 percent, from 1999 to 2000. Likewise, $28 million, or 18.9 percent less, was spent in 2001 than in 2000. Spending for commercial MTE warehouses was reduced by $28 million from 1999 to 2001.

Benefits

Improved supply chain management of MTE has reduced new purchases of MTE and cardboard boxes as well as MTE commercial warehouse spending.

The independent and externally administered Customer Satisfaction Measurement system consistently shows high marks, from both premier and national accounts, for the availability of serviceable MTE from the MTESC Network.

Reducing the number and types of MTE can be accomplished by taking advantage of the plastic mailbag cost advantage over cloth mail bags. The plastic price of a new mailbag is 10 percent or less of the cloth price, and the processing cost is lower too. Denser packaging of plastic also yields savings for storing and transporting.

Milestones

- New equipment, cardboard boxes, and transportation savings are fiscal year based.
- The conversion from cloth mail bags to plastic mail bags, for five mail bag types, entails transitioning the demand, transitioning the production, and determining inventory disposition which will occur from Quarter III 2002 through Quarter II 2003.

Metrics

- Declining expense for new MTE and for processing / storing / transporting plastic mailbags in lieu of cloth ones
- Recycling revenue from condemned MTE
- Tracking by the Consumer Advocate’s Customer Satisfaction Measurement (CSM) system

Substrategy 6: Network Integration and Alignment

Description

The Network Integration and Alignment (NIA) strategy will create a flexible logistics network that reduces the Postal Service’s and customers’ costs, increases overall operational effectiveness, and improves consistency of service. The NIA strategy will provide the Postal Service with the analytical means to drive the necessary redesign of the existing network and provide rapid response capability. To achieve the objectives of network optimization, the Postal Service is investing in the development of a network integration and alignment strategy. The output of this process will produce a set of network optimization and simulation models that will enable the Postal Service to analyze a variety of network alternatives that address the complexities and uncertainties of the organization’s operating environment.

Trends / Supporting Data

- Fixed infrastructure inhibits the organization’s ability to adapt to changing business requirements.
- Transportation costs have increased disproportionately over the past decade.

- Evolution of the distribution network has resulted in a lack of standardization across operating procedures.
- Differing and inconsistent preparation and entry standards exist between classes and subclasses of mail.

Benefits

- Reduced total costs for the Postal Service and mailers
- Consolidation of plants
- Redefined roles and functions of plants
- Improved consistency of service
- Reduced transportation costs
- Standardized mailer preparation and entry standards
- Streamlined networks resulting in reduced workhours

Milestones

- Develop network model and strategy – September 2002
- Develop implementation plan – December 2002

Metrics

The NIA strategy will form the basis of a business case that determines the extent of cost savings and revenue generation resulting from streamlining the processing and transportation networks.

Interdependencies

Postal Rate Commission process if service standard changes are needed.

Strategy 7: Increase retail / customer service productivity

The Postal Service will continue its efforts to implement processing equipment and best practices that standardize operations to increase productivity and reduce costs. These improvements will occur in both post office and mail forwarding operations. Detailed retail transaction data from Point of Service One equipment will be used to determine customer demand at counters for staffing purposes as well as determining the number and types of transactions that can be shifted from the full service counter to other alternatives. The Postal Service will also review the design of its post offices to determine the best way to provide access to postal services 24 hours a day, seven days a week while reducing construction costs.

Substrategy 1: Retail / customer service productivity improvement

Description

Customer service productivity improvement includes:

- Operational standardization to ensure optimal efficiency throughout the postal network; and

- Continued automation of mail processing operations that occur in the backrooms of post offices.

The Postal Service has made significant progress in automating the processing of mail in recent years. However, there are still opportunities to move more mail to automation. A major focus will be to move even more mail to automation.

An effort was begun within the last few years to accomplish Breakthrough Productivity Improvements (BPI) in all operations of the Postal Service. BPI improvements in work processes will be achieved through the use of a standardized Function 4 Review Process and the nationwide implementation of best practices. The office improvement process encompasses four distinct steps that include review, establishing an office baseline, implementing standardized proven-practice methods, and ongoing follow-up and monitoring. This process will lead all Function 4 automated and manual distribution facilities toward effective and ongoing performance achievement. It has been demonstrated that the implementation of proven work methods results in productivity improvements.

The forwarding of mail is a major source of customer complaints and entails very costly handling processes. A person can move from one city to another and in most cases the mail goes all the way to the old address before being identified and redirected to the new address. This automation effort will focus on identifying the mail when it is entered into the mail stream and redirected to the new address rather than going all the way to old address before being identified. This will eliminate handling and transportation costs and provide much improved service times in getting forwarded mail to the customer. See also PARS in Strategy 1.

Trends / Supporting Data

The national trends in Function 4 workhours show a downward trend in response to migration of manually distributed mail into the automated mailstream. This includes a reduction of mail distribution workhours in the back room of post offices. Current reviews show there are opportunities for additional savings in locations that have not yet reevaluated the full impacts of deploying delivery barcode sorters (DBCS) and Carrier Sequence Barcode Sorter (CSBCS) machines as well as the Automated Flat Sorting Machine (AFSM) 100.

Benefits

The combination of these activities to improve productivity will result in the savings of approximately 19,000 full time equivalent employees.

Milestones

- Continued automation of back office
- Implementation of Automation for the forwarding of mail beginning in 2004
- Ongoing Operational reviews and implementation of standard operating procedures

Metrics

Change in full-time equivalent employees and operating budgets

Substrategy 2: Facility design changes

Description

Design new facilities and retrofit current facilities with twenty-four hours a day, seven days a week access to critical products and service, where feasable.

Benefits

- Increased customer convenience
- Reduce construction costs

Metrics

CSM scores

Strategy 8: Improving performance management

In addition to capital investment to drive down operating costs and network modeling to ensure an optimal distribution and transportation structure, the Postal Service will continue its focus on improving productivity by standardizing and monitoring performance.

Best practices have been identified and operations are being standardized around these best practices. Numerous tools have been developed to assist the field operations managers in monitoring their performance, planning their complement, and properly scheduling their people.

Substrategy 1: Area mail processing consolidation

Description

Headquarters is conducting extensive reviews and will be implementing Area Mail Processing (AMP) consolidations. The Postal Service is currently undertaking an effort to consolidate Mail Processing activities and centralize or relocate these activities within and among clusters.

Trends / Supporting Data

This effort was initiated based on an expectation of complement reductions.

Benefits

The projected savings from AMP consolidations (23 in phase one) are projected to average slightly less than $1 million each.

Milestones

Overall program in review at this time.

Metrics

- Projected first year savings of each proposal
- Service performance of First-Class Mail and Priority Mail remains at same level or better

Substrategy 2: Other direct labor reviews and standardization

Description

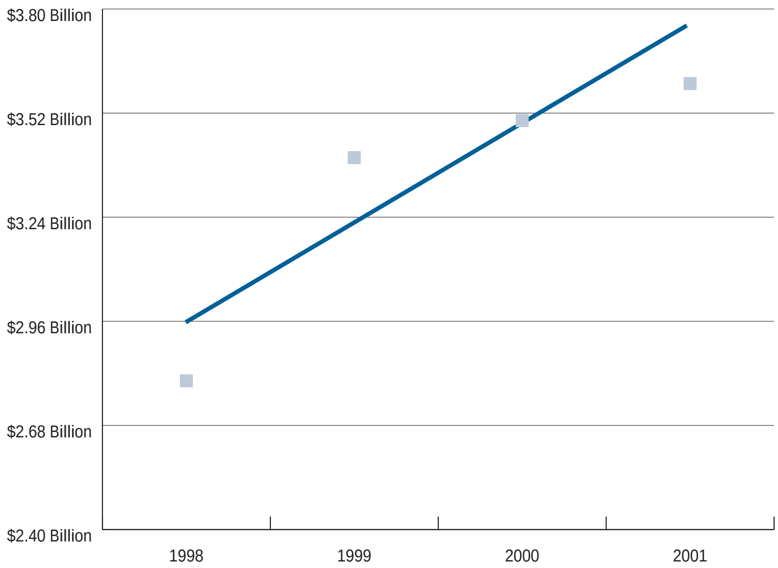
Other direct processing operations—Labor Distribution Code 17—is currently one of the segments with the highest cost. Standardizing processes will ensure the consistent workhour recording of all LDC 17 activities at mail processing facilities. Standardized processes will enable the organization to more precisely stratify and develop specific measures of performance and national targets for each activity with LDC 17. It is the objective of this project to:

- Identify and realign operations within LDC 17 and establish standardized work centers;
- Develop workload measures for each operation; and
- Establish performance targets and indicators for work centers.

Trends / Supporting Data

In 2001, the cost of LDC 17 workhours reached $3.6 billion. LDC 17 workhours increased approximately $113 million over 2001. In fact, LDC 17 is the largest and fastest growing mail processing work center.

NATIONAL LDC 17 SALARY AND BENEFITS



Benefits

Improvements in the efficiency of LDC 17 operations and work centers are expected. Standardized processes will reduce the variability in current operations and provide plants with stable operations that are based on best practices.

Low cost, high return material handling projects identified by LDC 17 review teams along with recommended improvements in management processes will provide the foundation for LDC 17 workhour reductions.

Review teams will provide local plant management with an LDC 17 review report that highlights expected savings and full-time equivalent employees so that savings can be captured.

Milestones

- Identify requirements and develop plans for LDC 17 standardization (Quarter III 2002).
- Complete LDC 17 reviews in seven Processing and Distribution Centers with the greatest opportunities for LDC 17 workhour reductions. Begin field testing of standardization approach towards selected LDC 17 work centers (Quarter IV 2002).
- National roll out of standardization and certification of selected LDC 17 work centers (Quarter I 2003).

Metrics

- Reductions in LDC 17 workhours nationally
- Reductions in LDC 17 costs nationally

Substrategy 3: Priority Mail standardization

Description

The Postal Service is undertaking a major effort to improve Priority Mail processing. The primary objective is to obtain nationwide improvement of Overnight and 2-Day Priority Mail service and establish a standard process for the end-to-end actions required to provide customers with a time-sensitive, Priority Mail product. The Postal Service distribution processes are being standardized to increase productivity, reduce missorts, and control costs. To help achieve operational objectives, procedures and work instructions have been developed for Priority Mail operations that have been proven to enable the Postal Service to achieve its performance targets. This approach is based on proven practices used in field organizations that are shown to provide the level of performance necessary to meet aggressive targets for Priority Mail service.

Trends / Supporting Data

Priority mail service performance needs to improve.

Benefits

This effort is focused on achieving Priority Mail goals of 95 percent overnight and 91 percent for 2-day service performance.

Milestones

- Training package completion — July 2002
- Web site completion — August 2002

Metrics

- Productivity Goals for Priority Mail with missort rates of less than 1 percent
- Priority Indicators from Mail Condition Reporting System

Substrategy 4: Implement complement planning, tracking and management (CPTM)

Description

To help achieve operational objectives, national standard procedures and work instructions have been developed for complement planning, tracking, and management. By using these processes, field management will determine appropriate complement plans by installation and function. Once these plans have been converted to authorized staffing levels by unit, the local CPTM process will monitor and adjust the complement to meet these plans. Enhanced planning and tracking tools are included in this standardization effort to aid in the management decision making process of the local complement committees.

Tools used in the Process

Business Management Guide (BMG) determines complement or workhours based on planned budget. It has the capability of using the improvement opportunities identified by the Plant Performance Achievement System (F1 PAS) to plan complement in a facility impacted by changes in volume, product mix, and automation or productivity improvements. BMG is the complement tool used to manage costs by planning complement based on budget requirements, the first step in the complement process. However, BMG is also used throughout the process to monitor and adjust complement plans.

Job Information Monitoring System (JIMS) is used to monitor and to determine adjustments to work assignments in plants, post offices, and larger associate offices. Initially, JIMS is used to identify vacant job positions and to verify current jobs with employees. In later phases of the process, JIMS is used as an ongoing monitoring tool.

Complement Information System (COINS) is designed to provide local management with timely and accurate complement information to support the management of this critical resource. COINS tracks on-rolls complement against authorized complement levels or targets. At start up, COINS helps to identify the gap between on-rolls and authorized complement, thus giving management a starting point in managing the complement. As the process advances, COINS continues to help managers identify areas requiring greater attention.

Complement Accounting System (CAS) is the Human Resources system that will provide current information on the status of all hiring and losses in process. This application is still under development at this time.

Machine Scheduler is a simple-to-use spreadsheet model: the daily scheduler can be used for any operation that has an expected throughput rate or work rate, end time, and quantifiable resources (number of machines, cases, etc.). Limitations are that the scheduler only does one operation for one day at a time. Multiple equipment types or operations cannot be scheduled using a single model.

Employee Scheduler 2.8 takes a similar approach to that of the machine scheduler. It too is a relatively simple spreadsheet model that uses volume data, productivity rates and clearance times to plan weekly employee schedules. Differentiating this model from the machine scheduler is the ability to schedule up to six complementary operations. The Employee Scheduler can be used in the plant (F1) and post office (F4) environment.

Trends / Supporting Data

While the number of on-rolls employees is trending downward, it is still the area of biggest impact, therefore requiring the most attention.

Benefits

The CPTM Process enables managers to adjust their complement based upon changing workloads, because it gives managers the ability to plan rather than react. Used properly, these procedures and tools will improve the organization’s ability to match complement to workload so that the right people are in the right place at the right time and will lead to improvements in productivity and performance.

Milestones

Deployment end of 2003.

Metrics

Existing metrics, such as Total Operating Expense, F1 PAS, will be used to measure results.

Strategy 9: Manage realty assets

The Postal Service is one of the nation's largest institutional holders of real estate. A systematic internal approach is used to identify, analyze, maximize the return on, and reduce the costs associated with, postal real property assets. Facilities management strategies are designed to ensure that the disposition, by sale or lease, of excess or underutilized real estate assets held by the Postal Service is conducted in a manner consistent with the best interests of the organization. Funds derived from such actions become available for redeployment across the full spectrum of identified postal operational priorities. Realty management procedures include utilization of internal and external expertise to market and develop these properties, as well as public / private partnerships to position and develop unique properties.

Because of their unique position in the marketplace, a relatively small subgroup of these assets may hold the potential for significant value appreciation, if positioned correctly. Unless it is in the best interests of the Postal Service to retain a long term interest in a property due to postal co-occupancy, historical considerations or fiduciary circumstances, expeditious disposition is the principal goal.

Revenues generated by the Realty Asset Management (RAM) program come principally from:

- The sale of fee simple, leased fee and leasehold interests (these include excess land, buildings, and air rights / other developmental rights);
- The short-term leasing of excess space in postal owned buildings to the private sector (outleasing) and GSA;
- The long term leasing of excess space and development rights via a third party developer; and
- Enhancing the value of select Postal Service properties by incorporating disposition strategies (developmental added value properties).

Substrategy 1: Postal Service properties for sale

Description

The Postal Service has an inventory of properties for sale of approximately $360 million, consisting of nearly 125 properties. The inventory of properties for sale is largely influenced by the construction of replacement postal facilities. The time necessary to dispose of individual properties varies, depending on the property itself and the local market. Gross sales in 2002 are projected to be $30 million.

Substrategy 2: Short-term leasing

Description

In 2001, outleasing to third parties and leasing of space to GSA produced $39.8 million in revenue to the Postal Service from approximately 700 properties. It is anticipated that this income stream will remain stable over the next several years.

Substrategy 3: Developmental leasing

Description

The developmental program entails the long-term leasing of excess space and development rights to a third party, usually a developer who improves the building by renovation and new construction. Typically, the income is received in the form of annual rent. Such actions take several years to develop and implement. In 2001 rent proceeds were $24.2 million from the properties involved.

Substrategy 4: Developmental added value properties

Description

In addition to the above, the Postal Service is enhancing the asset potential of selected properties. These are typically larger, high visibility properties with commercial development potential. Their unique position in the marketplace holds the potential for value appreciation by such actions as securing development entitlements and marketing. Due to the complexity of maximizing their potential for disposition, these activities may take five to six years to reach fruition.

Substrategy 5: Other programs

Description

The Postal Service also has instituted a national tax appeal program in association with the accounting firm of Deloitte & Touche, which identifies and appeals over assessed properties. Further, the Postal Service pursues the acquisition of properties with favorable rents and purchase options.

In the future, it is expected that the inventory of excess properties will change. With fewer new facilities, there will be fewer former postal facilities to replace. However, any consolidation of processing may generate excess space or excess buildings for disposal.

International Air Transportation Deregulation

Overarching Objective

Study deregulation of air transportation rates for the transportation of international and military mail and convey to the Postal Service the authority to competitively contract for such transportation in the open market.

Description

Current law, under Titles 39 and 49 of the *United States Code*, regulates the establishment of transportation rates for the carriage of U.S. mail internationally. Under this process, the Department of Transportation (DOT) sets the rates based on a formula of cost allocation established in the 1970s and periodically updated (currently annually) utilizing current cost data provided by the American flag air carriers. Each newly established set of rates is not a new calculation, but rather an incremental adjustment to the original 27-year-old base rate. It is doubtful that the formula establishing the base rates is representative of current operations in that air carriers, aircraft type, associated costs, fuel efficiency, crew requirements, terminal handling operations, routes and markets served etc. are all dramatically different in today's environment. Furthermore, the rates are segmented by broad geographic region (Atlantic, Pacific, Latin America and Transborder) resulting in identical rates (other than the variable of distance) to major destinations like Frankfurt or London, where there is significant competition, and minor markets like Helsinki or Kiev.

The Postal Service is compelled to give preference to certificated (i.e., American flag) air carriers and the American air carriers are required to carry mail behind passengers and their baggage. Except in those origin / destination pairs where there is inadequate service by the certificated carriers, the existing authority to contract for air transportation is limited to segments where at least 750 pounds is tendered per flight and no more than 5 percent of the mail under the contract can be letters. All contracts are subject to approval by DOT following solicitation of input from the air carrier industry on each individual contract.

Trends / Supporting Data

In separate studies conducted in 1997 and 1998 on the comparison of the DOT mail rates to the rates paid in the market place for the carriage of freight, a significant differential was identified reflecting potential cost savings if mail was competitively contracted rather than tendered under the current regulated environment. There would likely be some segments were the costs might actually increase. The most recent consultant studies are several years old and should be updated to better identify current savings opportunities. An offset to any potential cost reductions would be in an increase in contract and traffic management resources.

Interdependencies

Any form of deregulation will require legislative action by the Congress. Previous postal reform legislation has included language to this effect and that language, with proposed Postal Service amendments, could serve as the basis for deregulating the rate setting process and granting authority to the Postal Service to contract for international transportation services. The Department of Transportation has long sought deregulation of international mail transportation rate setting and has indicated support of any new initiatives.

Appendix N

APPENDIX N — Procedures for Closing Postal Facilities

This Appendix explains the legal requirements for post office closings and details the internal procedures the Postal Service has adopted to consolidate operations. It also explains requirements for nationwide changes in postal services.

Under the Postal Reorganization Act, the Postal Service may not close post offices solely for economic reasons. Also, postal patrons have the right to appeal post office closings to the Postal Rate Commission. Further, pursuant to the Reorganization Act, the Postal Service must seek an Advisory Opinion from the Postal Rate Commission if it intends to change postal services on a nationwide basis. These external legal requirements, when combined with internal guidelines for plant consolidations, help determine next steps to improve operational efficiency and customer service.

Post Office Closings and Consolidations

Certain regulations based on federal law apply when postal managers propose to replace a post office with an alternate form of postal service. These regulations are designed to ensure that the reasons for proposing such changes in postal service are fully disclosed at a stage when customers can make helpful contributions toward a final decision. The full text of the statutory provisions appear in Title 39, United States Code, Section 404(b). The Postal Service's implementing regulations appear in Title 39, Code of Federal Regulations, Part 241.3.

Under postal regulations an initial investigation and any subsequent formal proposal to discontinue a post office originate with postal field managers responsible for post offices in their area. The proposal explains the services recommended as substitutes and the rationale that supports this recommendation. The written proposal is prominently posted for 60 days at affected post offices, along with an "Invitation for Comments," which formally invites customer comments. At the end of the 60-day comment period, additional review is made at lower and upper levels of postal management.

When a final decision is made at Postal Service Headquarters in Washington, DC, that decision is posted in affected post offices for 30 days, during which customers may appeal the decision to the Postal Rate Commission in Washington, DC. The Postal Rate Commission has 120 days to consider and decide an appeal. It may affirm or remand. Even without an appeal, postal regulations specify that a post office may not be closed sooner than 60 days after the public posting of the final decision.

The Postal Reorganization Act's promise of a more businesslike approach to providing the nation's mail service prompted considerable concern over the fate of small post offices, particularly rural ones. Section 101(b) of the Postal Reorganization Act reflects this concern by providing that:

> "No small post office shall be closed simply for operating at a deficit, it being the specific intent of the Congress that effective postal services be ensured to residents of both urban and rural communities."

The Act as originally approved did not provide any role for the Commission in small post office closings. It contemplated only Postal Service involvement. However, the early-to-mid seventies saw mounting concern over Postal Service administrative proposals to close small post offices, and in 1976 Congress amended the Postal Reorganization Act of 1970 to provide for Commission review of appeals of post office closings or consolidations brought to it by affected persons.

The Commission makes its review based on statutory standards that evaluate the legal sufficiency of the Postal Service's treatment of the statutory criteria. This involves determining i) whether procedural requirements, such as providing adequate notice to patrons, were satisfied, ii) whether the Postal Service has made, on the record, the statutory findings it is required to make, and iii) whether they are supported by substantial evidence.

The Commission must affirm the determination to close or consolidate a post office unless its inquiry discloses inconsistency with the law or the Postal Service's failure to comply with due process requirements. If inconsistencies exist, the Commission cannot disapprove the closing or consolidation proposal. Rather, it must remand the case to the Postal Service for reconsideration of the criteria in question. In other words, returning a determination to the Postal Service does not mean that the Postal Service may not eventually close the office, only that it first must take further action to address the matters raised by the Commission, and may face another appeal.

In 1998 the Postal Service placed a moratorium on the closure of small post offices. This moratorium remains in place. Should the moratorium be lifted, the following closure procedures adopted by the Postal Service prior to 1998 would likely be implemented once again.

Procedures for Discontinuance of Independent Post Offices

A. Initial Review (0-10 Days)

- Postmaster vacancy.
- Emergency suspension.
- Decision to study post office for discontinuance or fill postmaster vacancy.

B. Review / Investigation Study (10 days – 2 months)

- Gather information on community.
- Contact county and city officials for community demographics and growth trends.
- Conduct window transaction and mail volume surveys to evaluate office workload.
- Analyze service alternatives.
- Analyze data gathered during investigation.
- Decision made to proceed with discontinuance study.

C. Community Input (2-6 months)

- Questionnaires sent to affected communities and/or community meeting held.
- Customer input analyzed.
- Decision made to proceed with discontinuance study.

D. Proposal (6-12 months)

- Written proposal prepared that provides a description and analysis detailing the nature and cause of change.
- Proposal addresses the following: Responsiveness to Community Postal Needs; Effect on Community; Effect on Employees; Economic Savings; Other Factors; Summary; and Notice.
- Proposal and invitation for customer comments are posted at affected post office(s) for 60 days.
- Written analysis of customers' concerns prepared.
- Revised proposal prepared and re-posted for an additional 60 days if significant changes are made to the original proposal.
- Decision made to proceed with discontinuance study.

E. Final Determination (12-24 months)

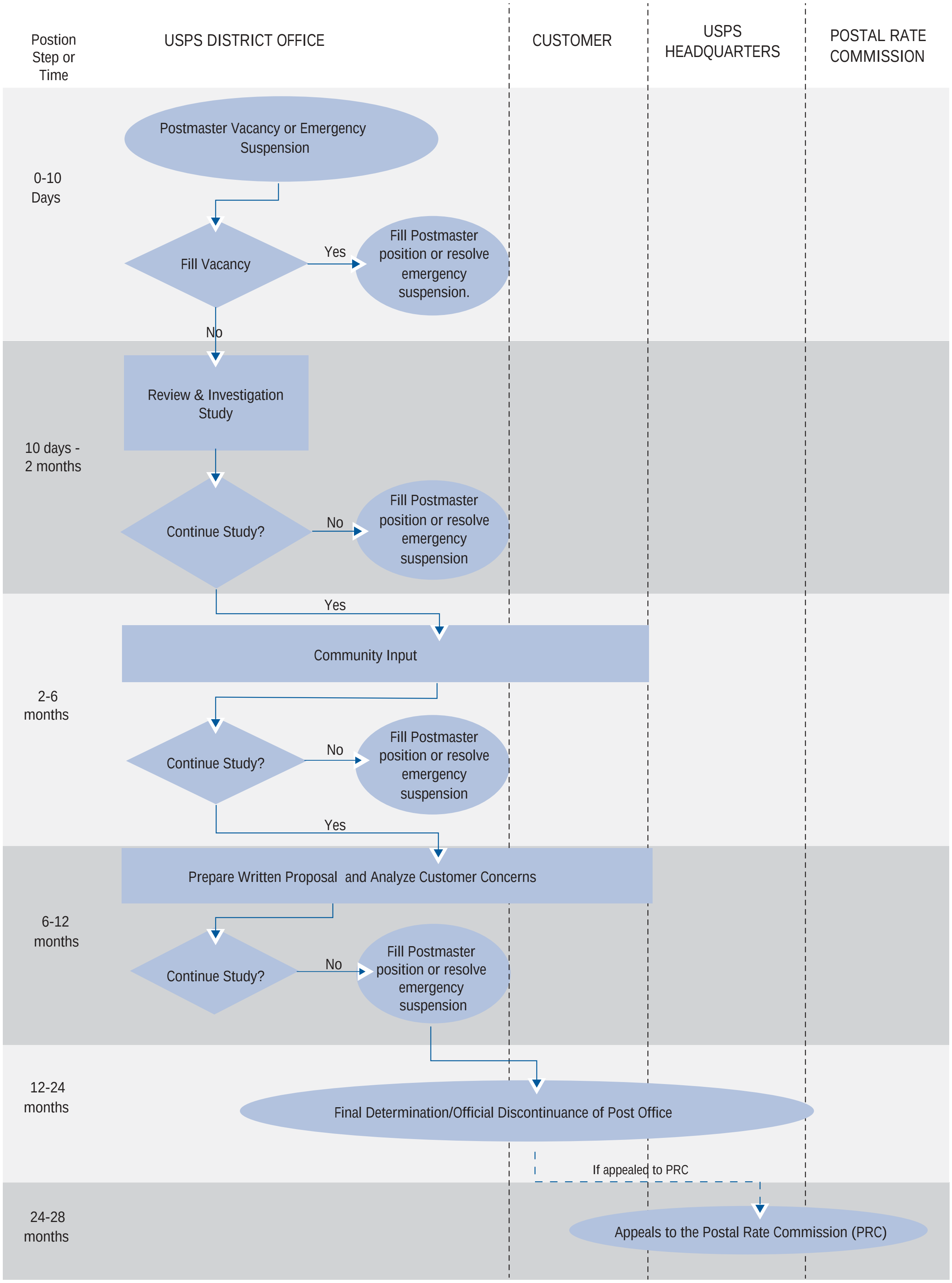
- Discontinuance study reviewed by Headquarters.
- Written final determination prepared providing customers with information on appeal rights to Postal Rate Commission.
- Final determination posted at affected post office(s) for 30 days.
- Affected post office is officially discontinued 60 days after the posting of the Final Determination (if no appeals).
- Financial close out of post office / establishment of alternate service.

F. Appeals to the Postal Rate Commission (24-28 months)

- Discontinuance study reviewed by Headquarters General Counsel and decision made to either proceed with discontinuance or withdraw study.
- Postal Rate Commission has 120 days to make decision on appeal.
- Postal Rate Commission either remands or affirms Postal Service decision.

The chart on the following page illustrates graphically the process explained above.

PROCEDURES FOR DISCONTINUANCE OF INDEPENDENT POST OFFICES



Revenue-Losing Small Post Offices: Some Examples

A few examples of rural post offices that operate less than 40 hours a week and are not self-sustaining highlight the Postal Service's inability to make business decisions regarding retail outlets.

Post Office A. This office is currently located in the Postmaster's home. It makes no deliveries and has no post office box customers. Its annual walk-in revenue is $600, while its annual costs reach about $11,000. There is one post office located within three miles of Post Office A. This post office is open 10 hours a week.

Post Office B. This office, which is open 24 hours a week, has no deliveries but does have 45 post office box customers. Its annual walk-in revenue is approximately $6,000; its annual costs are around $19,000. There are two post offices located within three miles of Post Office B.

Post Office C. This office is currently located in a "coal shed" leased by the Postal Service. Its annual walk-in revenue is approximately $1,400, while its annual costs are around $22,000. Open 10 hours a week, there is another post office located within four miles of Post Office C.

Post Office D. Located in an old farm house, this 10-hour-a-week office makes no deliveries and has nine post office box customers. Annual walk-in revenue amounts to about $2,000, while annual costs are around $19,000. There is one post office located within four miles of Post Office D.

Post Office E. This office makes 68 deliveries daily, is open 39 hours a week, and has 64 post office box customers. Its annual walk-in revenue is about $15,000; its annual costs are around $60,320. There are two post offices located within one mile of Post Office E.

Consolidations — Implementation of Area Mail Processing Procedures

In addition to restrictions on closing post offices, when considering streamlining operations the Postal Service also looks to facility consolidations. The following describes the procedures for consolidating operations under Area Mail Processing (AMP) concepts. This is an internal procedure that is used to ascertain if operational efficiencies are available by consolidating operations that are geographically adjacent.

A. Pre-Implementation Review (0-60 Days)

- Consider impact on service
- Identify possible service commitment changes
- Forecast community impacts
- Forecast employee impacts
- Identify transportation, Highway Contract Route, and network concerns
- Identify operating plan changes
- Firm up future equipment deployments
- Consider impact on new and existing facilities
- Quantify productivity impacts and other costs

B. Decision to study and quantify impacts of Area Mail Processing action on operating environment

- Notify Area Office (1 day)
- Provide notification that AMP study will be conducted
- Request assistance if needed

C. Decision to proceed with Area Mail Processing study and proposal

- Complete Area Mail Processing study
- Identify which offices will be consolidated (0-6 months)
- Quantify volume of mail to be shifted
- Prepare narrative listing reasons for consolidation
- Validate impacts on service commitments, employees, and transportation
- Validate impacts on cost / productivity
- Identify changes that will affect operating plans at all facilities involved in the consolidation
- Identify redundant equipment
- Provide anticipated implementation date
- Identify probable effects on the community
- Create file for supporting documentation
- Notify area of results

D. Decision submitted to Area recommending implementation of Area Mail Processing or cancellation of the study

- Area evaluation of AMP proposal; validate transportation routings (30 days)
- Address workhour, cost, and budget adjustments
- Document customer satisfaction, community impacts, while exploring operational feasibility
- Document contacts with all respective local government officials and Congressional representatives
- Administer human resource and employee contingency issues

E. Decision by Area to notify initiating office to cancel study or to Headquarters to recommend AMP implementation

- Headquarters evaluation of AMP proposal; coordinate final arrangements with Legislative Affairs, Consumer Affairs, Inspection Service, Transportation, and Operations Support. (30 days)
- Arrange for any changes to service commitments

F. Decision by Headquarters approving implementation of Area Mail Processing study

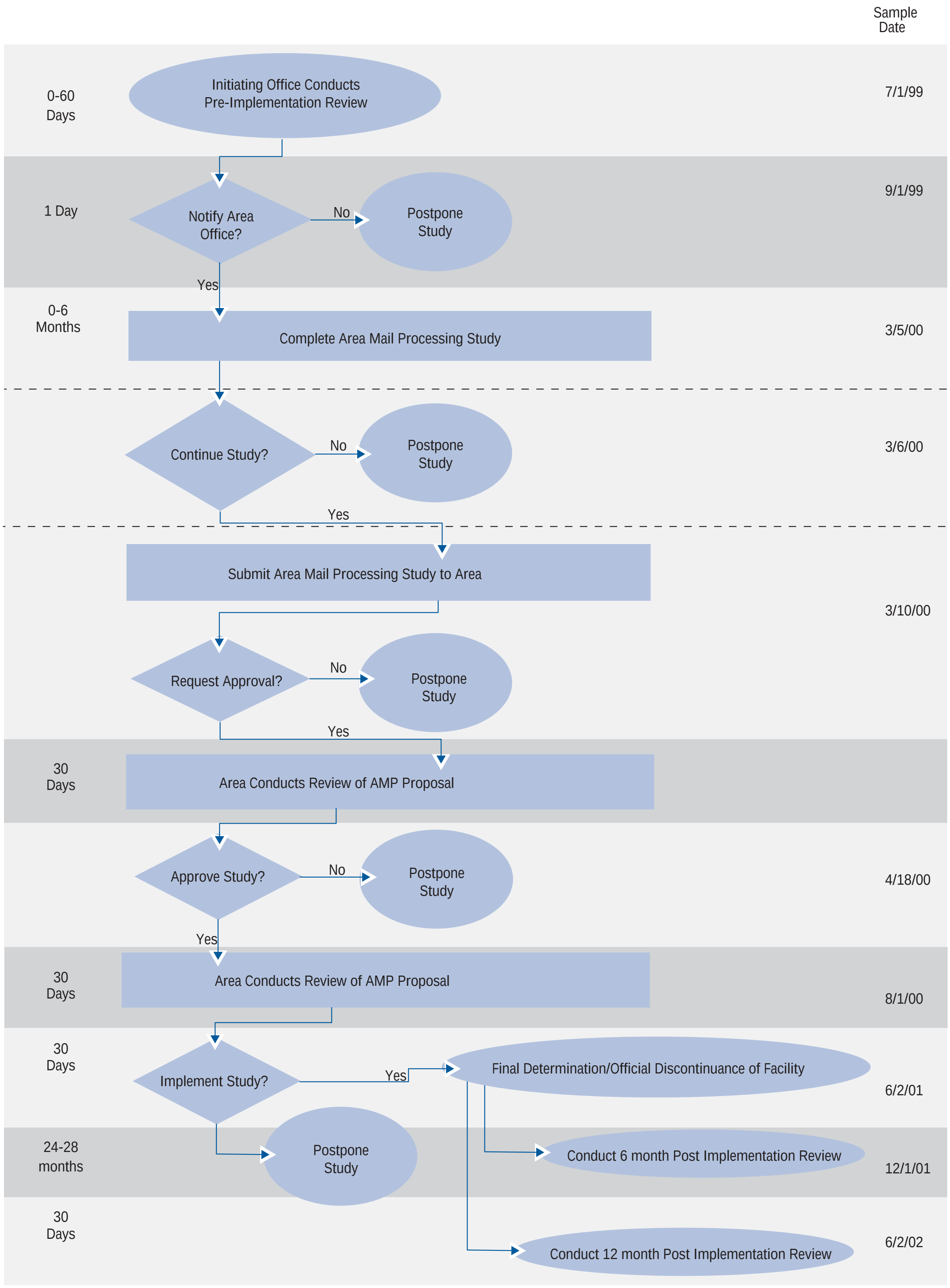
- Implement date assigned (1 day)
- Headquarters will assign an implementation date
- Headquarters notification of official AMP
- Postmaster or designee will brief local union representatives prior to implementation

G. Decision by Headquarters assigning Area Mail Processing implementation date

- Implement Area Mail Processing (0-365 days)
- Conduct semi-annual Post-Implementation Review (PIR)
- Conduct a PIR within 30 days after the second full quarter following implementation (30 days)
- Identify proposed versus actual expectations
- Identify accountability
- Evaluate performance against corporate / local goals and objectives
- Conduct annual PIR (30 days)
- During the first year after implementation an annual PIR will be conducted by the initiating office and the Area.
- Evaluate the Semi and Annual Post-Implementation Reviews; Headquarters will evaluate the PIRs (30 days each)
- If necessary, decision made to reverse a current implementation of an AMP plan

The chart on the following page illustrates graphically the process explained.

PROCEDURES FOR AREA MAIL PROCESSING CONSOLIDATIONS



Efforts to Close a Larger Facility

An example of the difficulty inherent in attempting to close a postal facility is described below.

In order to streamline operations and minimize redundancy, the Postal Service developed a plan to close a facility. In this plan, the Postal Service offered to provide jobs to all bargaining unit employees at another facility and to cover basic relocation costs. For EAS employees, the plan called for some positions to be transferred and others to be eliminated. An organization functioning within a more businesslike, commercial model would have encountered minimal resistance in implementing such a plan. However, implementation of the Postal Service's plan has been delayed by legal and regulatory constraints.

The Postal Service itself conducts studies prior to deciding to close a facility, and only pursues those that will benefit the rate payer through lower costs. Although the closure of the facility was found to result in greater efficiency and reduced fixed cost, by request of the House of Representatives a study of the proposal to close the facility was initiated. As part of the study, a questionnaire was not only sent to employees to be impacted by this closure, but also included former employees of another facility that was closed in 1993. A copy of the questionnaire sent to employees can be found at the end of this Appendix.

This is but one example of Congressional oversight. Attempts to close facilities often generate files that are thousands of pages thick. Cost avoidance and network optimization, demanded by customers and other postal stakeholders, are difficult to achieve in such a restricted, regulated environment.

Advisory Opinions

A final consideration for operational efficiency is the statutory requirement that the Postal Service obtain Advisory Opinions for nationwide changes of service. The Postal Reorganization Act directs the Postal Service to develop and promote efficient postal services. It also provides a role for the Postal Rate Commission whenever the Postal Service intends to change, on a nationwide or substantially nationwide basis, the postal services offered. The Act states:

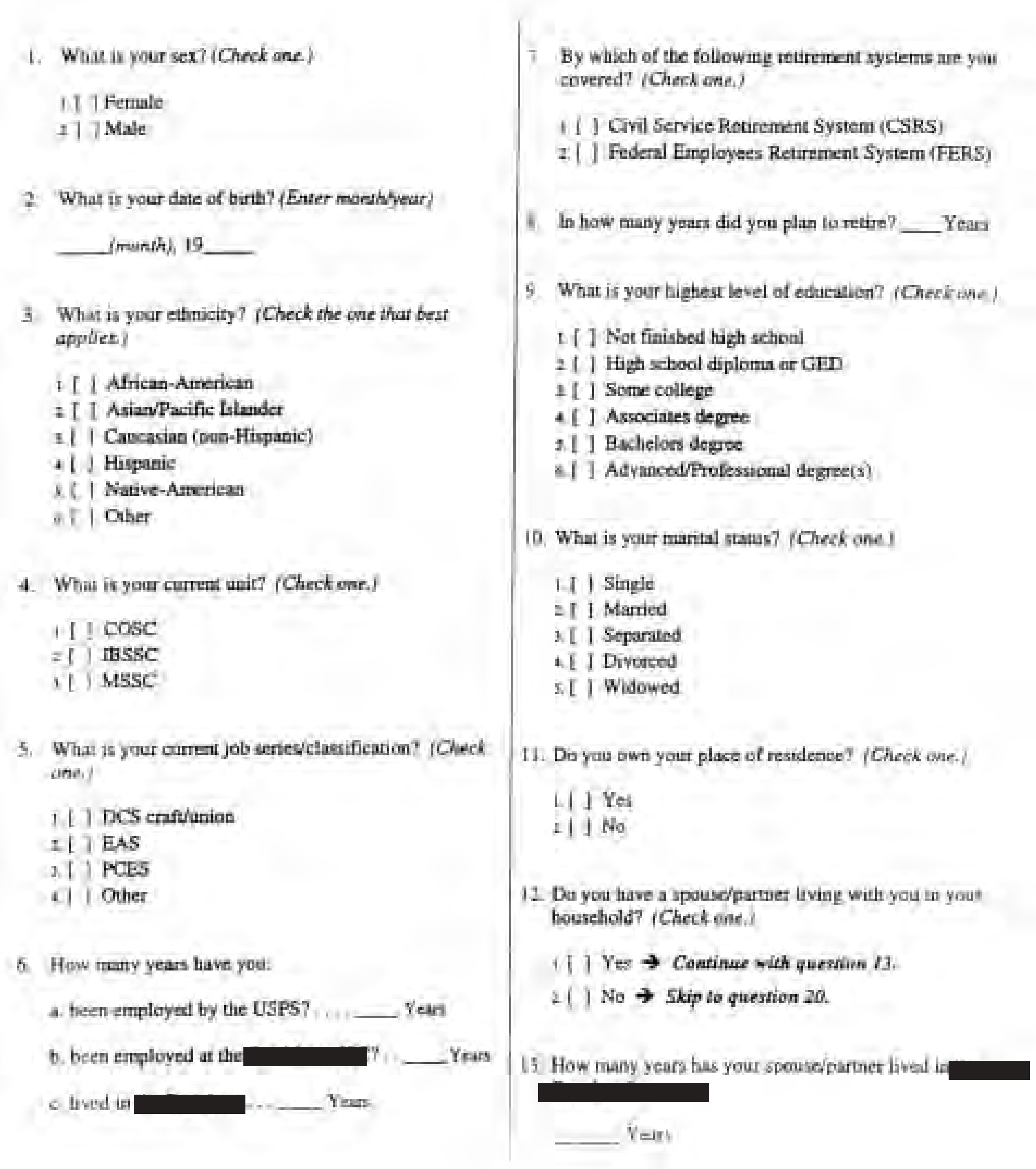
> "When the Postal Service determines that there should be a change in the nature of postal services which will generally affect service on a nationwide or substantially nationwide basis, it shall submit a proposal, within a reasonable time prior to the effective date of such proposal, to the Postal Rate Commission requesting an advisory opinion on the change."

The Commission has stated that in deciding whether to file a request for an advisory opinion, the Postal Service should be governed by a good faith judgment whether a jurisdictional issue could be raised which is so difficult, doubtful, serious, or substantial as to make it a fair ground for litigation.

Upon receiving a request for an advisory opinion, the Commission must allow interested parties, the Office of the Consumer Advocate, and the Postal Service an opportunity for a hearing on the record. The Commission will then render a written advisory opinion as to whether the change conforms to the policies of the Act.

The nature of the Commission's role is truly advisory. Thus, although the Postal Service must ask the Commission for an advisory opinion *and* the Commission must offer to hold hearings, the Commission's advice is not binding. To date, the Postal Service has requested four advisory opinions on changes in the nature of Postal Services. These have involved a retail analysis program, the provision of airmail services to First-Class Mail, payment provisions for Collect on Delivery Service, and realignment of First-Class Mail delivery standards.

QUESTIONNAIRE THAT WAS SENT TO POSTAL SERVICE EMPLOYEES



1. What is your sex? *(Check one.)*

1 [ ] Female
2 [ ] Male

2. What is your date of birth? *(Enter month/year)*

_____*(month)*, 19_____

3. What is your ethnicity? *(Check the one that best applies.)*

1 [ ] African-American
2 [ ] Asian/Pacific Islander
3 [ ] Caucasian (non-Hispanic)
4 [ ] Hispanic
5 [ ] Native-American
6 [ ] Other

4. What is your current unit? *(Check one.)*

1 [ ] COSC
2 [ ] IBSSC
3 [ ] MSSC

5. What is your current job series/classification? *(Check one.)*

1 [ ] DCS craft/union
2 [ ] EAS
3 [ ] PCES
4 [ ] Other

6. How many years have you:

a. been employed by the USPS? . . . . _____ Years

b. been employed at the [redacted]? . . _____ Years

c. lived in [redacted] . . . . _____ Years

7. By which of the following retirement systems are you covered? *(Check one.)*

1 [ ] Civil Service Retirement System (CSRS)
2 [ ] Federal Employees Retirement System (FERS)

8. In how many years did you plan to retire? _____ Years

9. What is your highest level of education? *(Check one.)*

1 [ ] Not finished high school
2 [ ] High school diploma or GED
3 [ ] Some college
4 [ ] Associates degree
5 [ ] Bachelors degree
6 [ ] Advanced/Professional degree(s)

10. What is your marital status? *(Check one.)*

1 [ ] Single
2 [ ] Married
3 [ ] Separated
4 [ ] Divorced
5 [ ] Widowed

11. Do you own your place of residence? *(Check one.)*

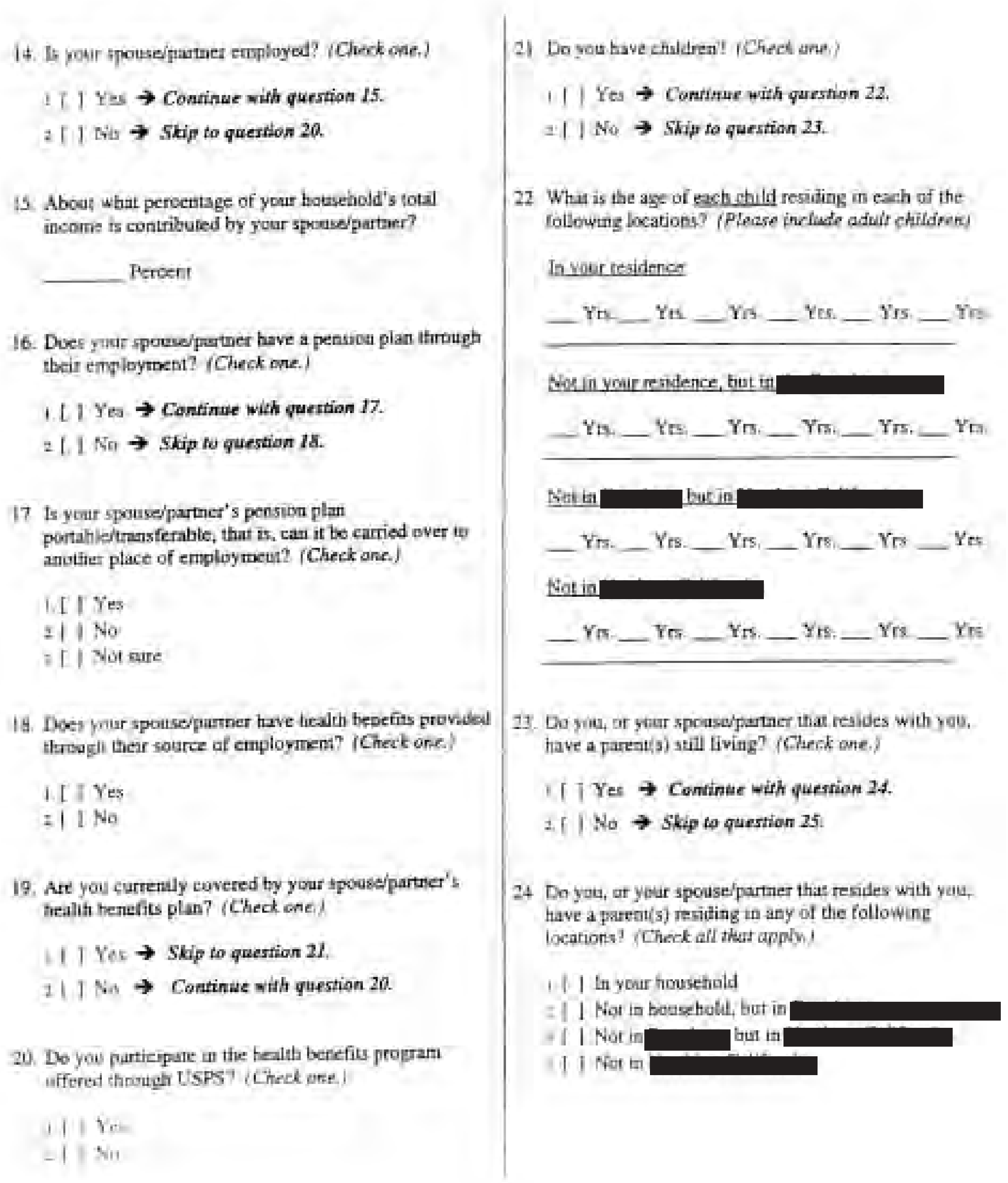
1 [ ] Yes
2 [ ] No

12. Do you have a spouse/partner living with you in your household? *(Check one.)*

1 [ ] Yes ➔ ***Continue with question 13.***
2 [ ] No ➔ ***Skip to question 20.***

13. How many years has your spouse/partner lived in [redacted]

_______ Years



14. Is your spouse/partner employed? *(Check one.)*

1 ☐ Yes ➔ ***Continue with question 15.***
2 ☐ No ➔ ***Skip to question 20.***

15. About what percentage of your household's total income is contributed by your spouse/partner?

________ Percent

16. Does your spouse/partner have a pension plan through their employment? *(Check one.)*

1 ☐ Yes ➔ ***Continue with question 17.***
2 ☐ No ➔ ***Skip to question 18.***

17. Is your spouse/partner's pension plan portable/transferable, that is, can it be carried over to another place of employment? *(Check one.)*

1 ☐ Yes
2 ☐ No
3 ☐ Not sure

18. Does your spouse/partner have health benefits provided through their source of employment? *(Check one.)*

1 ☐ Yes
2 ☐ No

19. Are you currently covered by your spouse/partner's health benefits plan? *(Check one.)*

1 ☐ Yes ➔ ***Skip to question 21.***
2 ☐ No ➔ ***Continue with question 20.***

20. Do you participate in the health benefits program offered through USPS? *(Check one.)*

1 ☐ Yes
2 ☐ No

21. Do you have children? *(Check one.)*

1 ☐ Yes ➔ ***Continue with question 22.***
2 ☐ No ➔ ***Skip to question 23.***

22. What is the age of <u>each child</u> residing in each of the following locations? *(Please include adult children)*

<u>In your residence</u>

___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs.

<u>Not in your residence, but in</u> [redacted]

___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs.

<u>Not in</u> [redacted] <u>but in</u> [redacted]

___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs.

<u>Not in</u> [redacted]

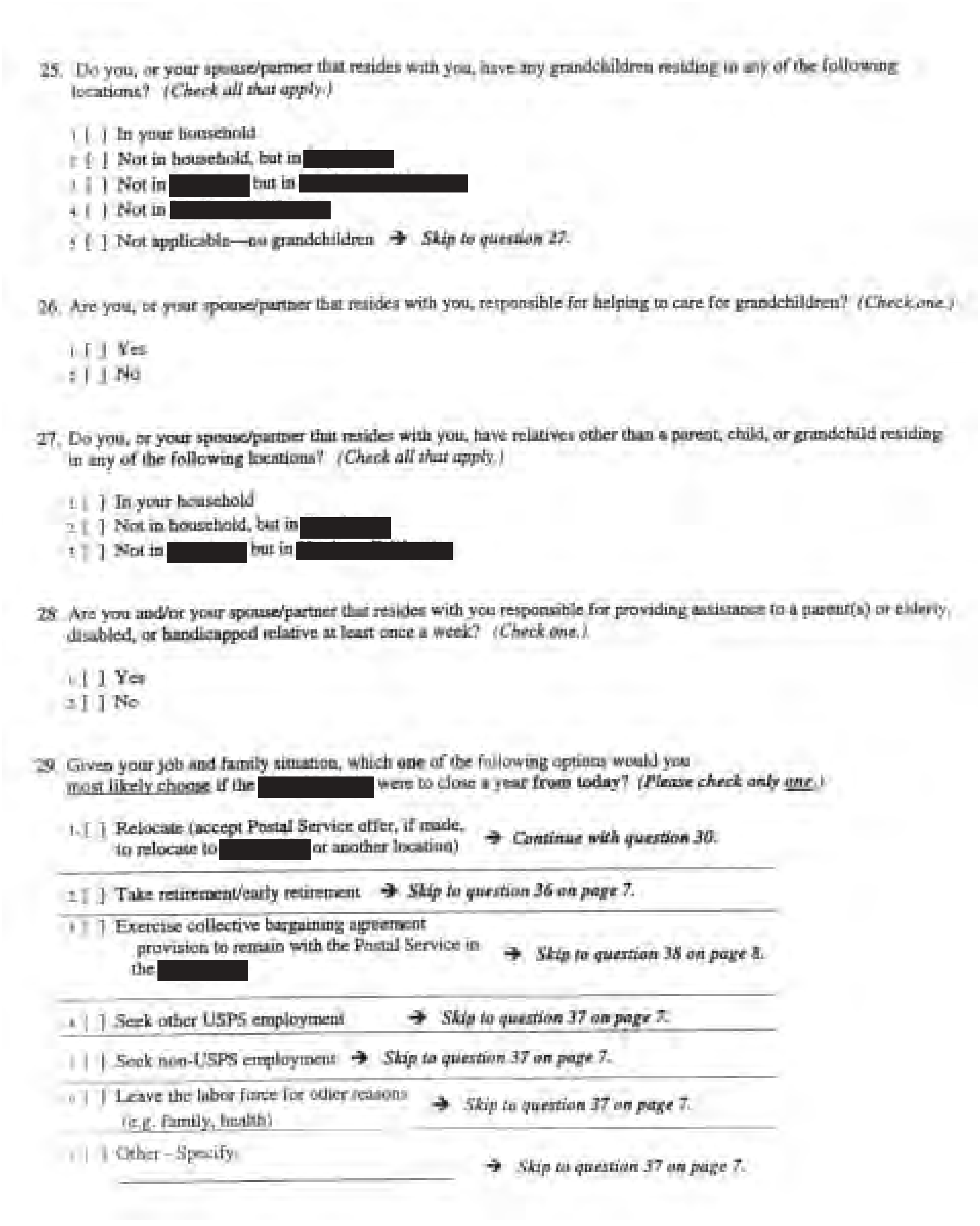
___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs. ___ Yrs.

23. Do you, or your spouse/partner that resides with you, have a parent(s) still living? *(Check one.)*

1 ☐ Yes ➔ ***Continue with question 24.***
2 ☐ No ➔ ***Skip to question 25.***

24. Do you, or your spouse/partner that resides with you, have a parent(s) residing in any of the following locations? *(Check all that apply.)*

1 ☐ In your household
2 ☐ Not in household, but in [redacted]
3 ☐ Not in [redacted] but in [redacted]
4 ☐ Not in [redacted]



25. Do you, or your spouse/partner that resides with you, have any grandchildren residing in any of the following locations? *(Check all that apply.)*

1 [ ] In your household
2 [ ] Not in household, but in [redacted]
3 [ ] Not in [redacted] but in [redacted]
4 [ ] Not in [redacted]
5 [ ] Not applicable—no grandchildren ➔ ***Skip to question 27.***

26. Are you, or your spouse/partner that resides with you, responsible for helping to care for grandchildren? *(Check one.)*

1 [ ] Yes
2 [ ] No

27. Do you, or your spouse/partner that resides with you, have relatives other than a parent, child, or grandchild residing in any of the following locations? *(Check all that apply.)*

1 [ ] In your household
2 [ ] Not in household, but in [redacted]
3 [ ] Not in [redacted] but in [redacted]

28. Are you and/or your spouse/partner that resides with you responsible for providing assistance to a parent(s) or elderly, disabled, or handicapped relative at least once a week? *(Check one.)*

1 [ ] Yes
2 [ ] No

29. Given your job and family situation, which one of the following options would you most likely choose if the [redacted] were to close a year from today? ***(Please check only one.)***

1 [ ] Relocate (accept Postal Service offer, if made, to relocate to [redacted] or another location) ➔ ***Continue with question 30.***

2 [ ] Take retirement/early retirement ➔ ***Skip to question 36 on page 7.***

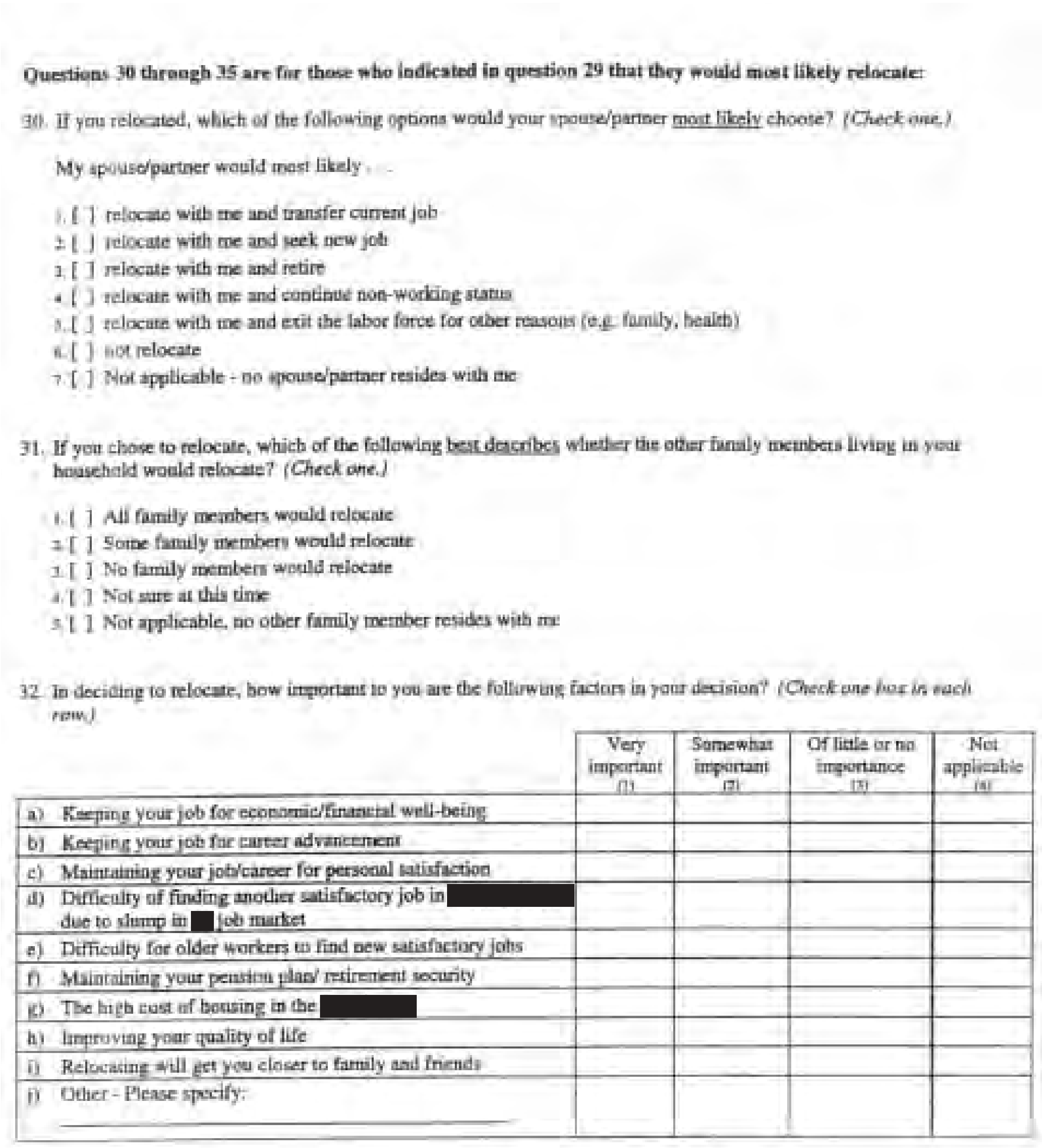
3 [ ] Exercise collective bargaining agreement provision to remain with the Postal Service in the [redacted] ➔ ***Skip to question 38 on page 8.***

4 [ ] Seek other USPS employment ➔ ***Skip to question 37 on page 7.***

5 [ ] Seek non-USPS employment ➔ ***Skip to question 37 on page 7.***

6 [ ] Leave the labor force for other reasons (e.g. family, health) ➔ ***Skip to question 37 on page 7.***

7 [ ] Other – Specify: ______________________ ➔ ***Skip to question 37 on page 7.***



Questions 30 through 35 are for those who indicated in question 29 that they would most likely relocate:

30. If you relocated, which of the following options would your spouse/partner most likely choose? *(Check one.)*

My spouse/partner would most likely . . .

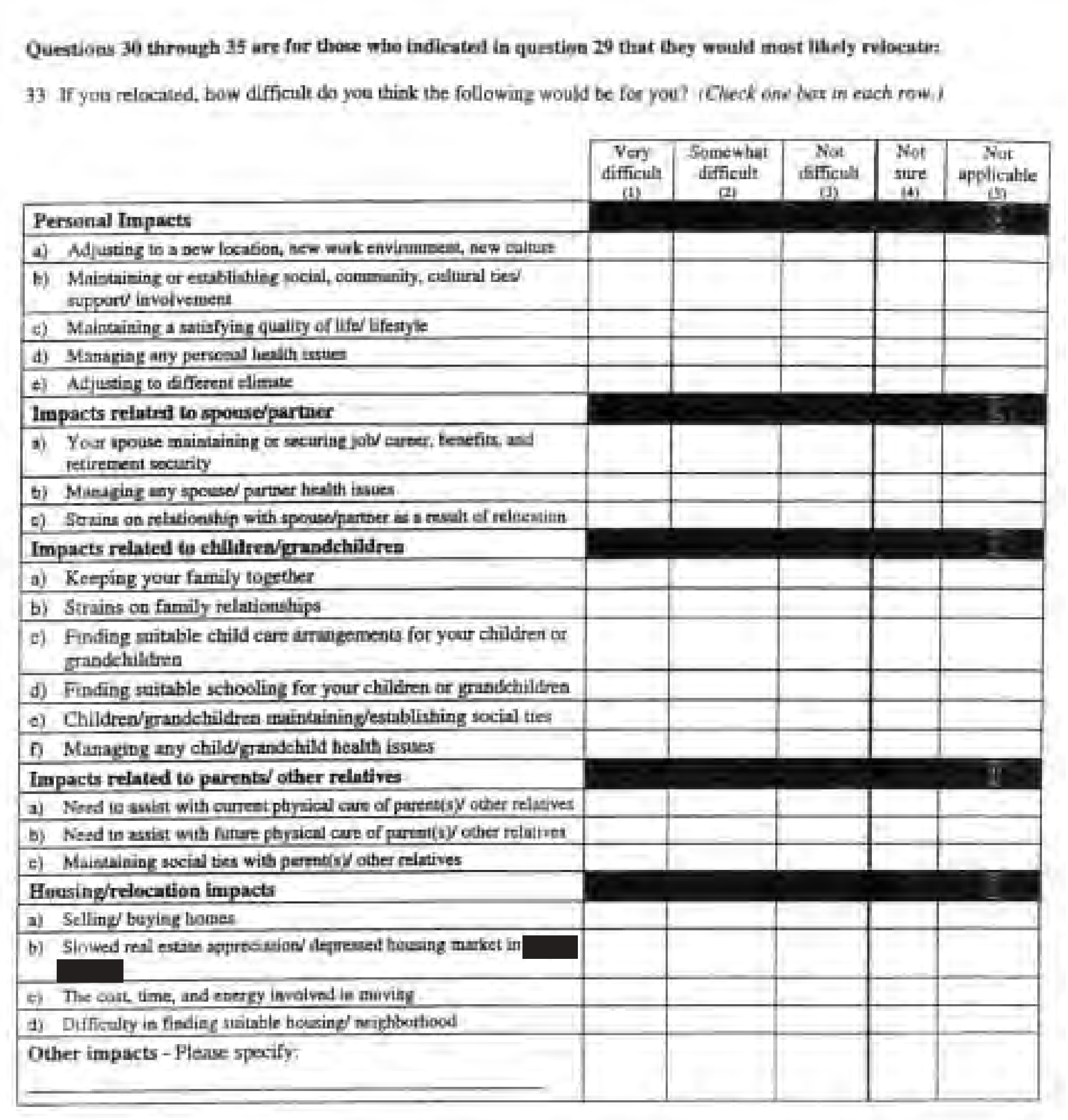
1. [ ] relocate with me and transfer current job
2. [ ] relocate with me and seek new job
3. [ ] relocate with me and retire
4. [ ] relocate with me and continue non-working status
5. [ ] relocate with me and exit the labor force for other reasons (e.g. family, health)
6. [ ] not relocate
7. [ ] Not applicable - no spouse/partner resides with me

31. If you chose to relocate, which of the following best describes whether the other family members living in your household would relocate? *(Check one.)*

1. [ ] All family members would relocate
2. [ ] Some family members would relocate
3. [ ] No family members would relocate
4. [ ] Not sure at this time
5. [ ] Not applicable, no other family member resides with me

32. In deciding to relocate, how important to you are the following factors in your decision? *(Check one box in each row.)*

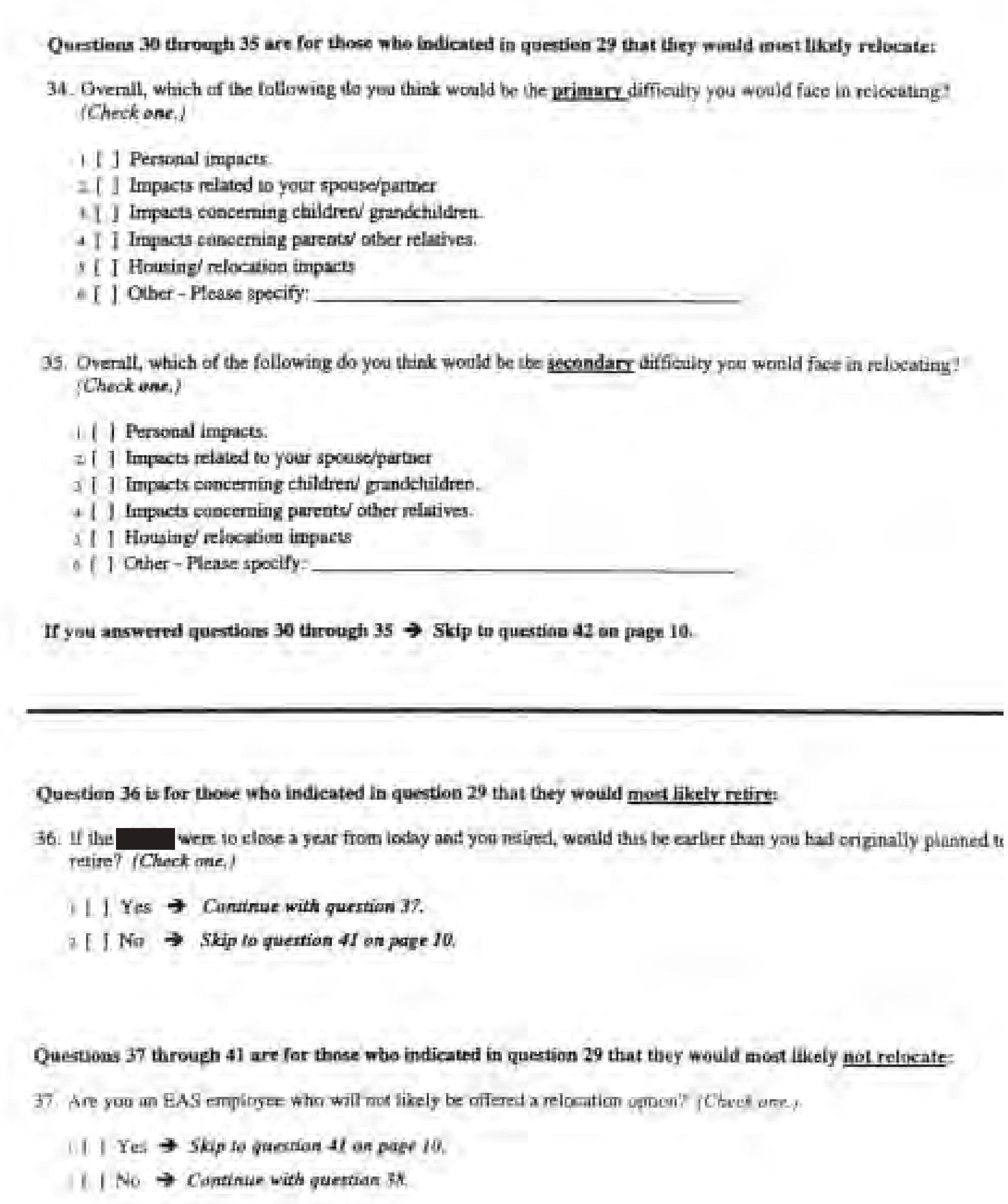
	Very important (1)	Somewhat important (2)	Of little or no importance (3)	Not applicable (8)
a) Keeping your job for economic/financial well-being				
b) Keeping your job for career advancement				
c) Maintaining your job/career for personal satisfaction				
d) Difficulty of finding another satisfactory job in [redacted] due to slump in [redacted] job market				
e) Difficulty for older workers to find new satisfactory jobs				
f) Maintaining your pension plan/ retirement security				
g) The high cost of housing in the [redacted]				
h) Improving your quality of life				
i) Relocating will get you closer to family and friends				
j) Other - Please specify: ______________________				



Questions 30 through 35 are for those who indicated in question 29 that they would most likely relocate:

33 If you relocated, how difficult do you think the following would be for you? *(Check one box in each row.)*

	Very difficult (1)	Somewhat difficult (2)	Not difficult (3)	Not sure (4)	Not applicable (5)
Personal Impacts					
a) Adjusting to a new location, new work environment, new culture					
b) Maintaining or establishing social, community, cultural ties/ support/ involvement					
c) Maintaining a satisfying quality of life/ lifestyle					
d) Managing any personal health issues					
e) Adjusting to different climate					
Impacts related to spouse/partner					
a) Your spouse maintaining or securing job/ career, benefits, and retirement security					
b) Managing any spouse/ partner health issues					
c) Strains on relationship with spouse/partner as a result of relocation					
Impacts related to children/grandchildren					
a) Keeping your family together					
b) Strains on family relationships					
c) Finding suitable child care arrangements for your children or grandchildren					
d) Finding suitable schooling for your children or grandchildren					
e) Children/grandchildren maintaining/establishing social ties					
f) Managing any child/grandchild health issues					
Impacts related to parents/ other relatives					
a) Need to assist with current physical care of parent(s)/ other relatives					
b) Need to assist with future physical care of parent(s)/ other relatives					
c) Maintaining social ties with parent(s)/ other relatives					
Housing/relocation impacts					
a) Selling/ buying homes					
b) Slowed real estate appreciation/ depressed housing market in [redacted]					
c) The cost, time, and energy involved in moving					
d) Difficulty in finding suitable housing/ neighborhood					
Other impacts - Please specify: ____________________					



Questions 30 through 35 are for those who indicated in question 29 that they would most likely relocate:

34. Overall, which of the following do you think would be the **primary** difficulty you would face in relocating? *(Check **one**.)*

1 [ ] Personal impacts.
2 [ ] Impacts related to your spouse/partner
3 [ ] Impacts concerning children/ grandchildren.
4 [ ] Impacts concerning parents/ other relatives.
5 [ ] Housing/ relocation impacts
6 [ ] Other - Please specify: ______________________________

35. Overall, which of the following do you think would be the **secondary** difficulty you would face in relocating? *(Check **one**.)*

1 [ ] Personal impacts.
2 [ ] Impacts related to your spouse/partner
3 [ ] Impacts concerning children/ grandchildren.
4 [ ] Impacts concerning parents/ other relatives.
5 [ ] Housing/ relocation impacts
6 [ ] Other - Please specify: ______________________________

If you answered questions 30 through 35 ➔ Skip to question 42 on page 10.

Question 36 is for those who indicated in question 29 that they would most likely retire:

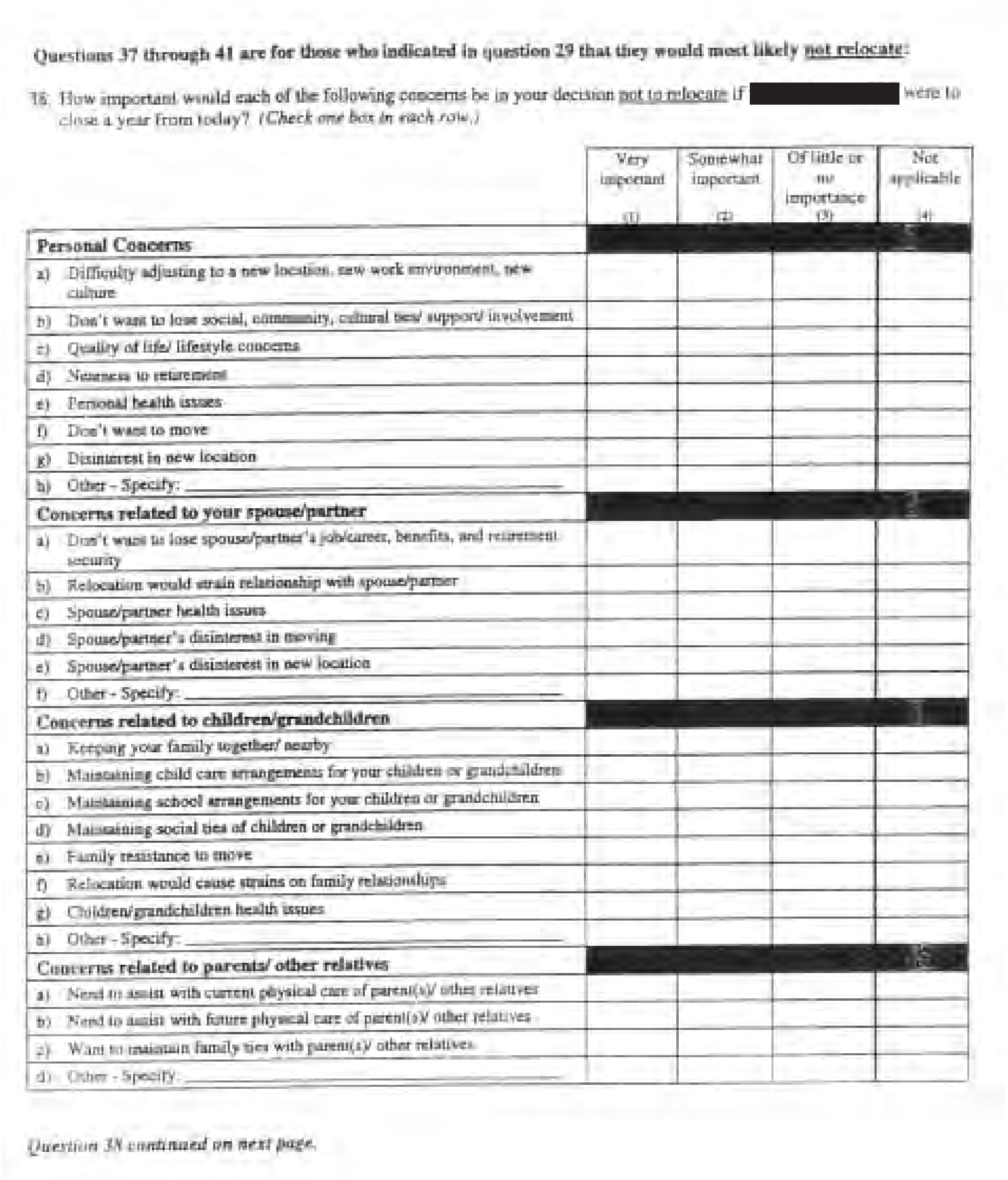
36. If the [redacted] were to close a year from today and you retired, would this be earlier than you had originally planned t retire? *(Check one.)*

1 [ ] Yes ➔ ***Continue with question 37.***
2 [ ] No ➔ ***Skip to question 41 on page 10.***

Questions 37 through 41 are for those who indicated in question 29 that they would most likely not relocate:

37. Are you an EAS employee who will not likely be offered a relocation option? *(Check one.)*

1 [ ] Yes ➔ ***Skip to question 41 on page 10.***
2 [ ] No ➔ ***Continue with question 38.***

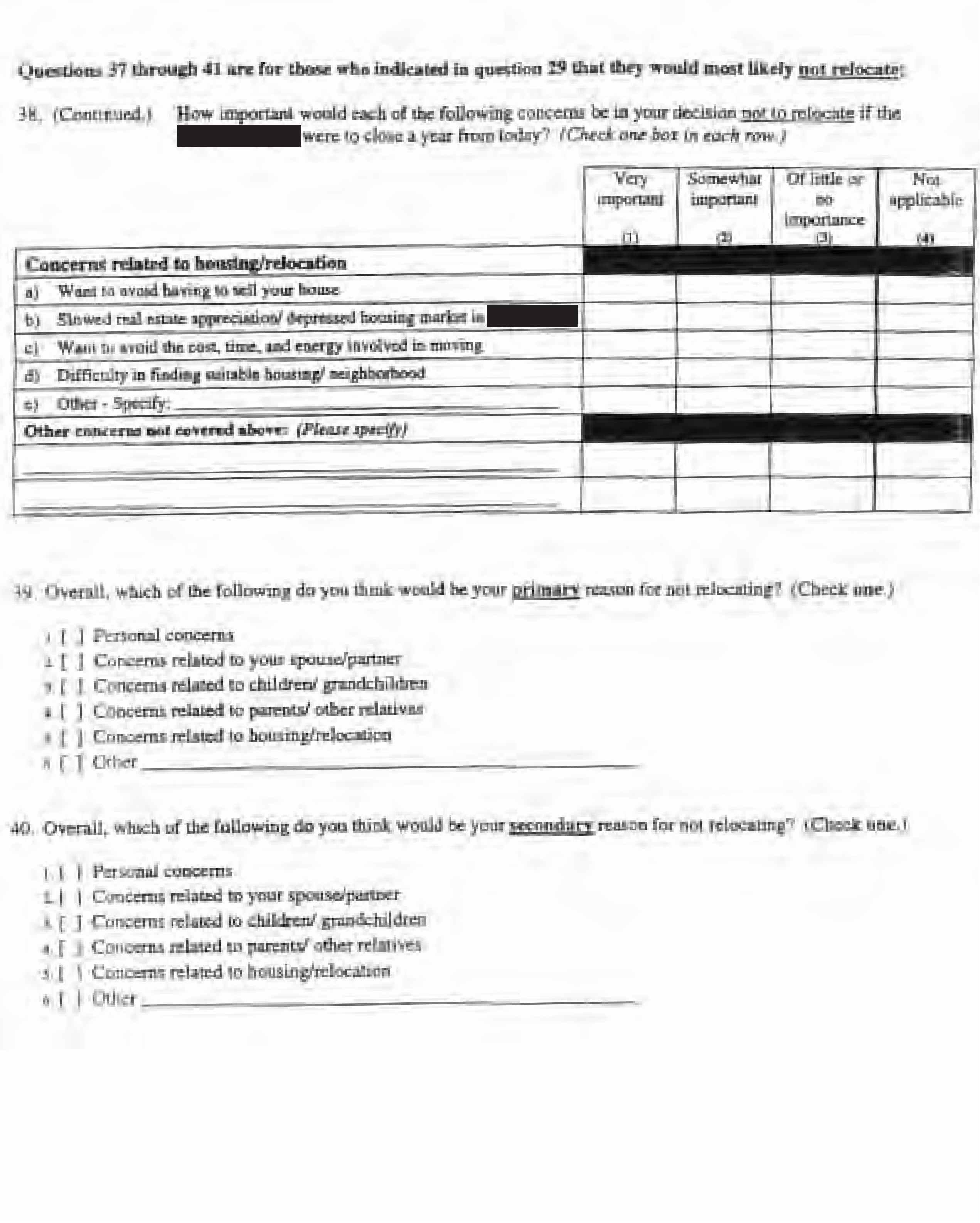


Questions 37 through 41 are for those who indicated in question 29 that they would most likely not relocate:

38. How important would each of the following concerns be in your decision not to relocate if [redacted] were to close a year from today? *(Check one box in each row.)*

	Very important (1)	Somewhat important (2)	Of little or no importance (3)	Not applicable (4)
Personal Concerns				
a) Difficulty adjusting to a new location, new work environment, new culture				
b) Don't want to lose social, community, cultural ties/ support/ involvement				
c) Quality of life/ lifestyle concerns				
d) Nearness to retirement				
e) Personal health issues				
f) Don't want to move				
g) Disinterest in new location				
h) Other - Specify: ____________				
Concerns related to your spouse/partner				
a) Don't want to lose spouse/partner's job/career, benefits, and retirement security				
b) Relocation would strain relationship with spouse/partner				
c) Spouse/partner health issues				
d) Spouse/partner's disinterest in moving				
e) Spouse/partner's disinterest in new location				
f) Other - Specify: ____________				
Concerns related to children/grandchildren				
a) Keeping your family together/ nearby				
b) Maintaining child care arrangements for your children or grandchildren				
c) Maintaining school arrangements for your children or grandchildren				
d) Maintaining social ties of children or grandchildren				
e) Family resistance to move				
f) Relocation would cause strains on family relationships				
g) Children/grandchildren health issues				
h) Other - Specify: ____________				
Concerns related to parents/ other relatives				
a) Need to assist with current physical care of parent(s)/ other relatives				
b) Need to assist with future physical care of parent(s)/ other relatives				
c) Want to maintain family ties with parent(s)/ other relatives				
d) Other - Specify: ____________				

Question 38 continued on next page.



Questions 37 through 41 are for those who indicated in question 29 that they would most likely not relocate:

38. (Continued.) How important would each of the following concerns be in your decision not to relocate if the [redacted] were to close a year from today? *(Check one box in each row.)*

	Very important (1)	Somewhat important (2)	Of little or no importance (3)	Not applicable (4)
Concerns related to housing/relocation				
a) Want to avoid having to sell your house				
b) Slowed real estate appreciation/ depressed housing market in [redacted]				
c) Want to avoid the cost, time, and energy involved in moving				
d) Difficulty in finding suitable housing/ neighborhood				
e) Other - Specify: ______				
Other concerns not covered above: *(Please specify)*				
______				
______				

39. Overall, which of the following do you think would be your primary reason for not relocating? (Check one.)

1 [ ] Personal concerns
2 [ ] Concerns related to your spouse/partner
3 [ ] Concerns related to children/ grandchildren
4 [ ] Concerns related to parents/ other relatives
5 [ ] Concerns related to housing/relocation
6 [ ] Other ______

40. Overall, which of the following do you think would be your secondary reason for not relocating? (Check one.)

1 [ ] Personal concerns
2 [ ] Concerns related to your spouse/partner
3 [ ] Concerns related to children/ grandchildren
4 [ ] Concerns related to parents/ other relatives
5 [ ] Concerns related to housing/relocation
6 [ ] Other ______

41. If you retired, chose not to relocate, or were not offered a relocation option, how difficult do you think each of the following would be for you? *(Check one box in each row.)*

	Very difficult (1)	Somewhat difficult (2)	Not difficult (3)	Not sure (4)	Not applicable (5)
a) Finding a job that would adequately support your family					
b) Finding a job that would provide personal satisfaction					
c) Being able to achieve retirement security					
d) Maintaining adequate health care coverage					
e) Maintaining or finding adequate housing					
f) Potential increase in commute time and distance					
g) Other - Specify: ____________					

Open-ended questions for all respondents:

42. (Optional) Please explain any additional specific circumstances that would impact you or your family if [redacted] were closed.

43. (Optional) What idea or alternatives do you see for helping the USPS save money in different ways?

Thank you very much for your participation.

Appendix O

APPENDIX O — Performance-Based Strategies

One of the key components for any transformation effort is the culture of the organization. Continuing to improve operational efficiency and customer value is contingent upon exceptional performance by the Postal Service’s employees. The Human Capital Strategies will move the organization toward a more performance-based culture.

This Appendix to the *Transformation Plan* contains additional explanation, detail and examples of short-term strategies that are employee focused. This is not meant to be a comprehensive list of postal projects, but is meant to outline those that will contribute to the success of enhancing the postal culture.

Strategies in this Appendix include:

- Focus on Retention and Recruitment
- Utilize Succession Planning to Identify, Develop, and Select Current and Future Leaders
- Ensure that a Dynamic Training Continuum is Available to Develop a Pool of Talent to Fill Leadership Positions
- Create a Performance Based Pay System
- Build a Highly Effective and Motivated Workforce
- Build the Labor / Management Relationship
- Improve Workforce Planning
- Expand Shared Services / Explore Outsourcing
- Improve Collective Bargaining Interest Arbitration Process
- Reduce Workers Compensation Costs

Create a Performance Driven Culture

Overarching Objective

Continuing to improve operational efficiency and customer value is contingent upon exceptional performance by the Postal Service's employees. The Human Capital Strategies will move the organization toward a more performance-based culture.

Strategy 1: Focus on retention and recruitment

Substrategy 1: Retain employees with skills critical to the success of the Postal Service

Background

Changing business needs are altering the skill requirements for current employees. Additionally, the Postal Service must compete fiercely with private industry to retain and recruit job candidates in many parts of the organization, from lower skilled positions to essential technical and professional positions. This competition comes as the workforce is aging. By 2006, 55 percent of executives and officers, 36 percent of managers and supervisors, and 19 percent of career employees will reach eligibility for regular retirement.

Failure to address these attrition trends will have an adverse impact on the Postal Service's ability to both retain its current talent and attract external talent. A full analytical effort is currently underway to uncover the attrition trend data by both geographic area and job category. This data will provide turnover trends that will serve as a baseline for recommending any new pay and benefit incentives.

An additional factor constraining the Postal Service's ability to provide compensation that is comparable to the private sector is the statutory salary cap. Current salary compression for selected manager, executive, and officer positions makes it more difficult to retain and recruit key talent. Legislative relief will be necessary to assist with this constraint.

Milestones

- Review current pay, local demographic, and labor market issues to determine root cause factors affecting retention rates (2003).
- Incorporate data on workforce / labor trends and demographics into the strategic retention and recruitment plans (2003).
- Conduct a retention study with former employees to understand not only who is leaving the organization, but also all the issues that have contributed to an employee's decision to leave (2003).
- Use data to evaluate how salary and benefit packages can best be enhanced. Suggest the types of retention and recruitment incentives that will allow the Postal Service to compete for talent (2003).
- Develop the business case to address expanded pay and benefit initiatives as appropriate (2003).

Metrics

- Annual attrition trends by geographic area and job category.
- Voice of the Employee Survey data – key questions on workplace environment as a measure of retention.

Substrategy 2: Concentrate recruitment efforts on bringing talent, skills, and experience from within the organization and from the outside labor market to address potential loss of Postal leadership

Background

The Postal Service will need to consider a variety of recruitment alternatives to attract qualified candidates from both within the organization and outside. Unlike the past, recruitment strategies must include active searching for sources of qualified applicants, and attracting those applicants to the organization. The Postal Service will push for process and technology changes that will not only lead to improving its position when it comes to competing for talent, but will also reduce the reliance on labor intensive and cumbersome manual recruitment and hiring processes. Technology will become the organization’s key tool to reengineering the recruiting, hiring, and development processes.

Additionally, an industry best practice is to move to a centralized recruitment concept. This is particularly true when seeking candidates who possess specialized skills critical to the Postal Service. A centralized approach would allow field personnel offices to focus on the high volume local hires, while other recruitment efforts focus on attracting and screening candidates for specialized skilled positions. By piloting new recruitment concepts, the Postal Service can measure resulting reductions in hiring costs, improvements in applicant flows and can establish necessary protocols with third parties interested in being outsource suppliers. Two new programs will be introduced that are designed to infuse the organization with leadership talent for the future. Specifically, by introducing a new Management Intern (MI) program as well as a Professional Specialist Intern (PSI) program, the Postal Service will recruit individuals with advanced degrees to participate in these two-year training programs. Successful completion of the programs will result in skilled candidates capable of assuming critical vacancies within the organization.

Milestones

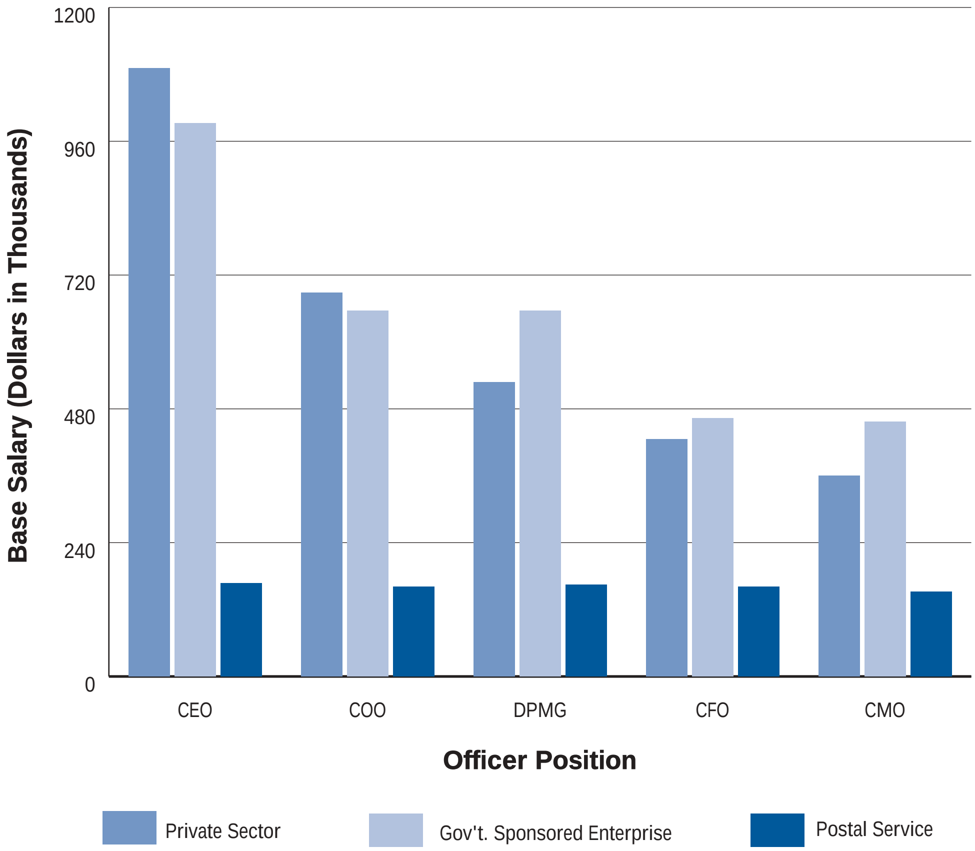
- Focus on the Associate Supervisor Program as the standard for recruiting and developing both internal and external talent to fill critical initial level supervisor vacancies (2002)
- Introduce two intern programs designed to build a “strong” bench of individuals, both internal and external, capable of assuming higher level operations and/or specialized skill positions (Management Intern program which was introduced in 2002 and Professional Specialist Intern program to be introduced in 2003).
- Expand alternative recruiting sources: use of third parties to perform the marketing and attracting activity necessary to identify interested and qualified candidates for specialized skill positions (2003).
- Pilot enhanced automated screening process to support improvements in the hiring process (2003).

- Pilot centralized recruitment structures—focus specifically on attracting skilled candidates that will address attrition projections for hard to fill positions nationwide (i.e. bargaining: electronic technicians, automotive mechanics and truck drivers; nonbargaining: accountants, economists, psychologists) (2003).
- Continue to use Web technology to enhance the recruitment and hiring processes for attracting candidates for vacancies throughout the organization (2004).

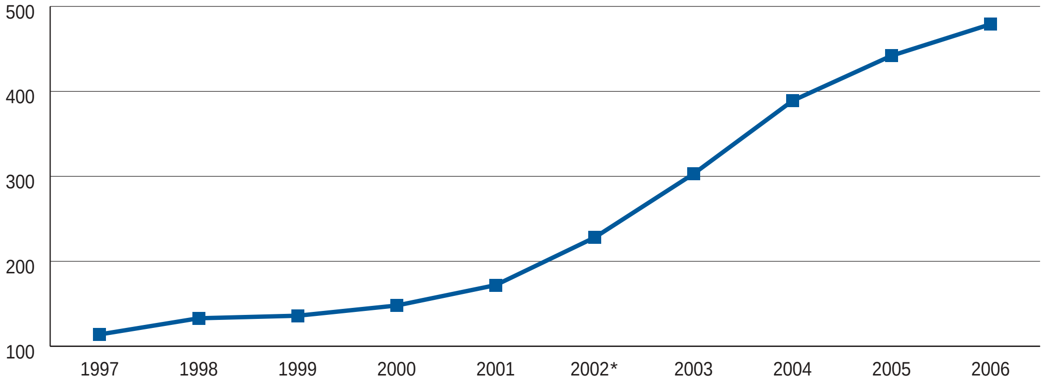
Metrics

- Retention data on candidates hired from new recruitment initiatives
- Time to fill
- Cost to hire
- Satisfaction of client with candidate hired
- Applicant pass-through rates

IMPACT OF STATUTORY SALARY CAP ON POSTAL POSITIONS

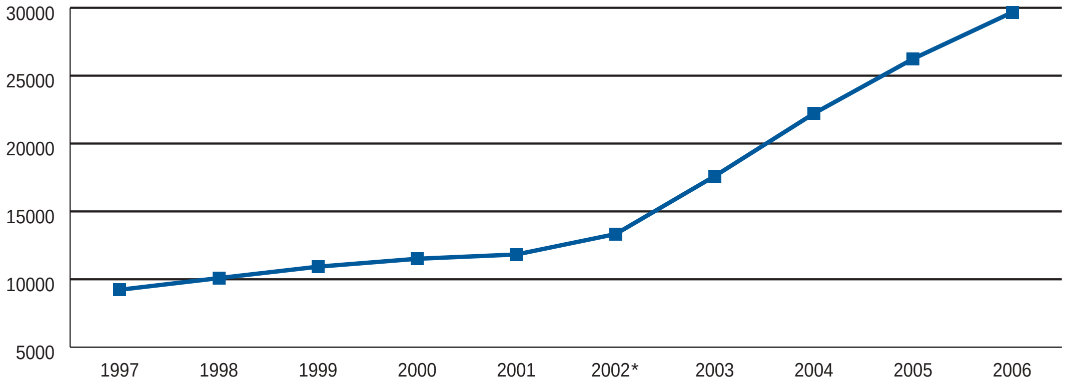


OFFICER AND EXECUTIVE RETIREMENT ELIGIBLES



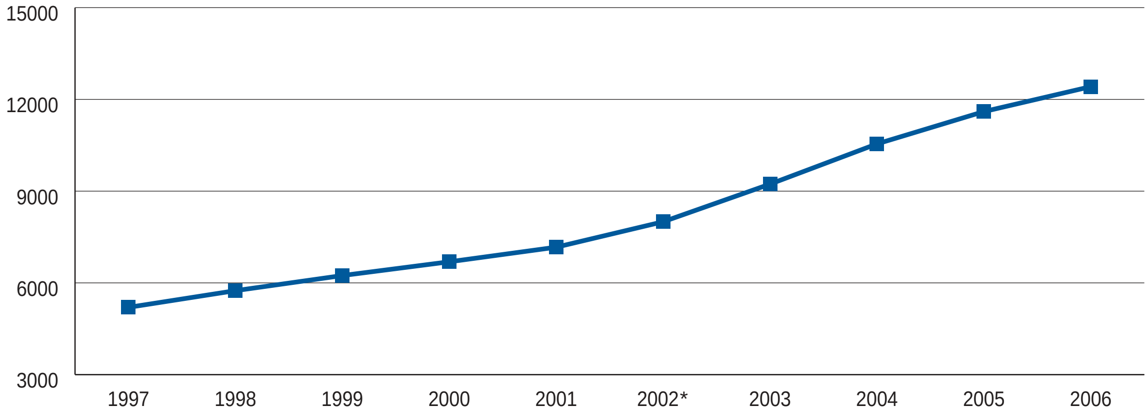
Eligible	114	133	136	148	172	228	303	389	442	479
Percent Eligible	18.9%	20.2%	18.1%	18.3%	20.2%	26.3%	34.9%	44.9%	51%	55.2%

MANAGER, SUPERVISOR, AND POSTMASTER RETIREMENT ELIGIBLES



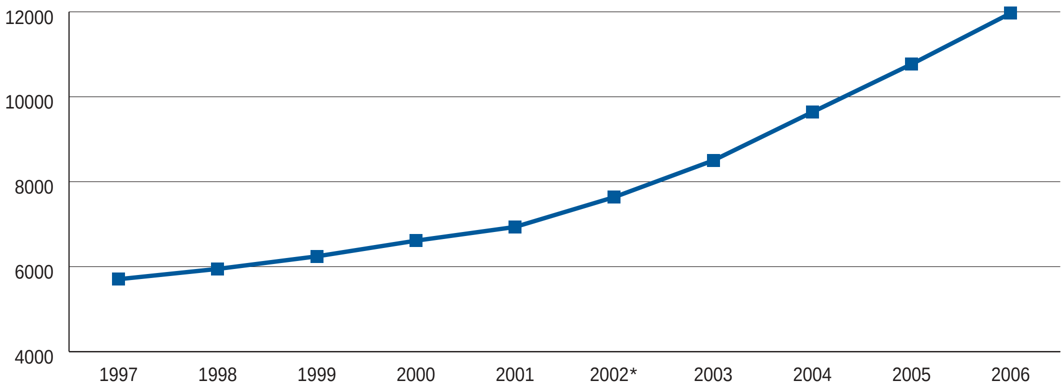
Eligible	9,228	10,087	10,928	11,511	11,827	13,330	17,601	22,214	26,241	29,665
Percent Eligible	11.6%	12.6%	13.4%	13.8%	14.2%	16.2%	21.4%	27.1%	32%	36.1%

NATIONAL POSTAL MAIL HANDLERS UNION RETIREMENT ELIGIBLES



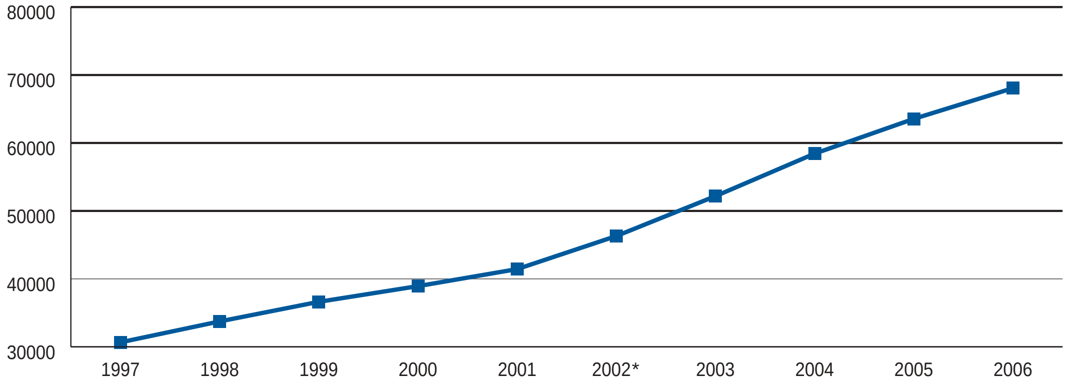
	1997	1998	1999	2000	2001	2002*	2003	2004	2005	2006
Eligible	5,200	5,746	6,240	6,690	7,167	7,999	9,230	10,545	11,602	12,417
Percent Eligible	8.9%	9.7%	10%	10.8%	11.8%	13.3%	15.4%	17.6%	19.3%	20.7%

NATIONAL RURAL LETTER CARRIERS ASSOCIATION RETIREMENT ELIGIBLES



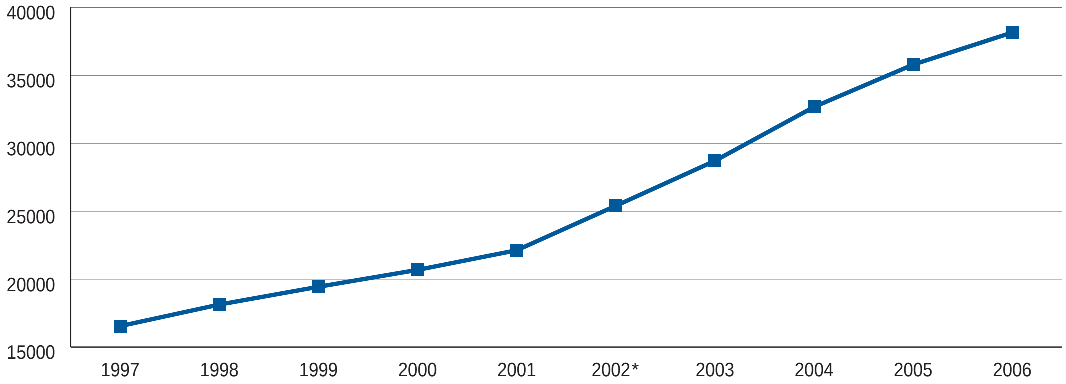
	1997	1998	1999	2000	2001	2002*	2003	2004	2005	2006
Eligible	5,705	5,947	6,243	6,612	6,935	7,637	8,501	9,640	10,768	11,968
Percent Eligible	11.8%	11.9%	12%	12.1%	12.2%	12.8%	14.2%	16.1%	18%	20%

AMERICAN POSTAL WORKERS UNION RETIREMENT ELIGIBLES



	1997	1998	1999	2000	2001	2002*	2003	2004	2005	2006
Eligible	30,665	33,742	36,626	38,933	41,439	46,304	52,179	58,434	63,548	68,063
Percent Eligible	9.3%	10%	10.5%	11.2%	12.2%	14.2%	16%	17.9%	19.4%	20.8%

NATIONAL ASSOCIATION OF LETTER CARRIERS RETIREMENT ELIGIBLES



	1997	1998	1999	2000	2001	2002*	2003	2004	2005	2006
Eligible	16,543	18,126	19,435	20,677	22,121	25,394	28,704	32,669	35,782	38,146
Percent Eligible	6.9%	7.7%	8.1%	8.5%	9.2%	10.6%	12%	13.6%	14.9%	15.9%

Strategy 2: Utilize succession planning to identify, develop and select current and future leaders

Background

While executive succession planning has been a key leadership initiative, the organization’s ability to address a potential leadership drain has never been more critical. Approximately 55 percent of key officers and executives and 36 percent of managers and supervisors will become eligible to retire over the next five years, and the organization is faced with not only retaining and developing key talent, but infusing the organization with new talent and skills. To meet this challenge, the Postal Service will undertake activities that allow it to continue to develop those identified as high potential leaders today, as well as seek talent from the current labor market. The succession-planning program has been the backbone of the Postal Service‘s leadership strategy since 1994. This program incorporates the major components of identifying, developing, preparing, and selecting individuals for executive positions in the Postal Service. Employees are identified by their respective officers as a “successor” for a specific executive position through a process that defines an employee’s management, functional, and human relations skills.

Throughout the organization, leaders assume a key role in working with high-potential individuals, helping to develop the leadership and functional competencies necessary to fill executive positions. The officers of the organization, along with the Postmaster General, are active participants in the process.

Vacant executive positions are usually filled by either selecting an individual who has been identified as a potential successor, or through outside recruitment. Trends reflect that on average, 96 percent of the vacant PCES positions are filled with individuals who have been identified as successors and who have demonstrated the potential for future success.

Having a strong succession-planning program has enabled the Postal Service to meet its current demand in filling executive positions. However, as it experiences an increase of executives leaving for other federal agencies and private sector firms, and as retirements begin to increase, more will have to be done to identify and prepare talent for executive positions. Postal Service strategies include reinforcing leadership accountability in the entire planning process with particular emphasis on developing high potential individuals. Additionally, the Postal Service continues its commitment to providing educationally enriching opportunities as well as challenging leadership assignments for key executives. Finally, as both a recruitment initiative, and a training initiative, the Postal Service will implement a Management Intern program, to attract candidates to fill middle management positions thus establishing a baseline pool for future leadership. Additionally, a similar program will be deployed to address the need to build a bench-strength of technical and professional skills for critical positions at headquarters.

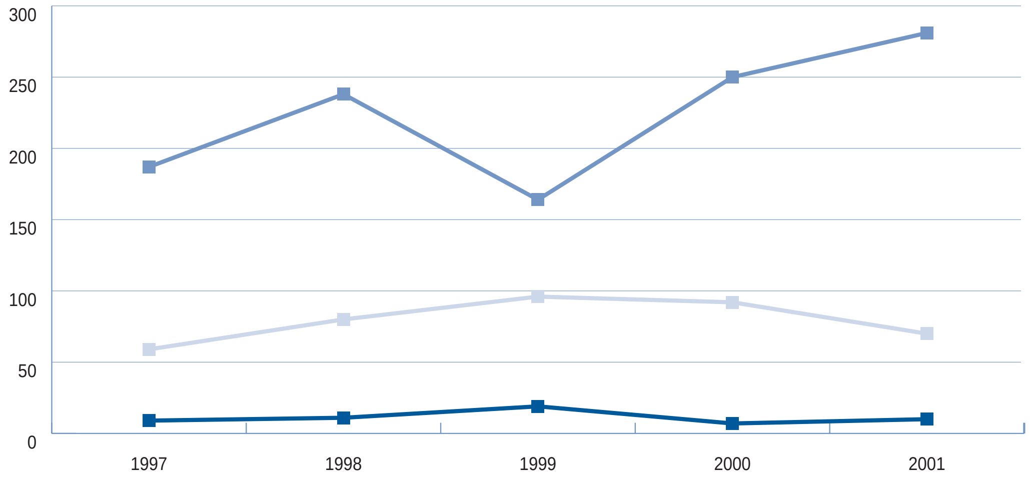
Milestones

- Continue offering executive development programs (MIT and Stanford / Sloan Fellowships and the Harvard Advance Management Programs) for high-potential executives (2002).
- Establish accountability for individual development plans. Officers and executives will be held responsible not only for having IDP's for successors, but ensuring that planned activities are accomplished (2003).
- Establish metrics to evaluate the effectiveness of succession planning (2003).

Metrics

Each executive position has a cadre of ready-now successors identified to assume full responsibility for an executive position.

POSTAL CAREER EXECUTIVE SERVICE REASSIGNMENT TRENDS



■ PCES to PCES	187	238	164	250	281
■ EAS to PCES	59	80	96	92	70
■ New Hires	9	11	19	7	10
Successors	96.5%	96.6%	93.2%	97.9%	97.2%

Strategy 3 — Ensure that a dynamic training continuum is available to develop a pool of talent to fill leadership positions

Substrategy 1: Maximize available training and development programs in order to have a pool of potential successors at all levels of the organization

Background

All employees are trained for their specific positions and development programs are available to support employee career paths from the craft through supervisory, into management, and finally, into executive positions. Training is competency-based and developed to leverage learning, skills, and knowledge throughout career progression. Building bench strength for all levels of management is a critical assignment for Human Resources. The Postal Service will establish a defined career path for supervisors and managers, thus facilitating succession at the low to mid-level positions within the organization. This process would then feed into the existing succession plan for executives and officers.

Milestone

Establish pools of qualified employees for all major job families (2004)

Substrategy 2: Implement more technology based training solutions

Examples are e-learning curriculum, job aids, just-in-time training, blended learning, use of authoring and simulation tools to maintain and build an interactive training continuum.

Background

The Postal Service currently faces challenges in communicating information and training due to varying levels of available technology in the organization. Technology provides a broad opportunity to train and develop employees locally, at low cost and precisely when information or training is needed. The Postal Service currently delivers a continuum of training and development for employees using a variety of delivery methods which includes classroom, distance learning through the Postal Satellite Training Network and the Postal Audio Tele-training Network, video, compact disc, postal intranet, and the Web.

Milestones

- Add technology delivered components to managerial foundation programs: Associate Supervisor Program, Career Management Program, Processing and Distribution Management Program, Advanced Leadership Program (2004). Initiatives such as the computer-based Leadership Excellence at the Desktop (LEAD) which will be used as a component for coaches and mentors.
- Offer just-in-time technical training at the job site through e-learning, which is Web-based for 10 percent of all existing courses each year beginning in 2003.

Substrategy 3: Secure / develop a learning management system utilizing current legacy systems to coordinate administration, scheduling, tracking, assessment, and testing of learners in both classroom and e-learning settings

Background

In the current learning environment there are multiple data sources which house training related information for managing day-to-day training activities. These data sources are not tightly integrated with each other. The organization does not have a central entry point for learning which is connected to individual performance results or business indicators, and therefore, the current state is neither an adequate nor an efficient process to meet organizational business goals. By integrating the multiple data sources that house training related information, the Postal Service can replace redundant, manual processes with organization-wide standardization, and give operational managers information to make cost effective and targeted decisions about training.

Learning Management Systems provide the following;

- **Customer Support –** provide a unified online customer interface;
- **Performance Management –** Online job support / job aids;
- **Data Management –** automate field data entry, connect legacy databases, and support local training administration;
- **Content Management –** allow modular, reusable training content that can be easily customized and adapted, connect content from different functional stakeholders, and connect vendor provided content; and
- **Competency Management –** connect individual development plans to competency assessments and training information, provide competency to curriculum mapping, connect career paths to jobs to curriculum to competencies.

Milestones

- Review existing off-the-shelf resources for purchase (2002).
- Continue to enhance current system (i.e., automated enrollment system) (2006).

Interdependencies

On the following page is a chart that describes the Postal Service training and development action plan by employee pool level.

ACTION PLAN FOR TRAINING AND DEVELOPMENT

			RECRUITMENT	
POOL LEVEL	PROGRAM NAME	PURPOSE DESCRIPTION	INTERNAL EXTERNAL	MILESTONE
PS	Craft Skills	Required craft training for craft specific training, e.g., orientation, regulated and mandatory training.	Both	Ongoing
PS	Craft Skills	Training for skilled positions, and developmental / promotional opportunities, e.g., maintenance.	Both	Ongoing
PS and thru EAS 15	Associate Supervisor Program	The purpose of the Associate Supervisor Program is to attract, select, and train the best possible candidates for first-line supervisory positions. The structured selection process is designed to screen applicants based upon the specific knowledge, skills and abilities required for the success of Postal supervisors. The goal of the selection is to select the applicants who best meet the requirements of the position.	Both	Ongoing
EAS 15 – 23	Career Management Program	Career Management Program course curricula cover skills and knowledge identified by the field as critical for effective supervision and management. Provides skills and knowledge to guide increased efficiency, continuous improvement and outstanding customer service.	Internal	Ongoing
EAS 18 – 25	EAS Leadership Development	EAS Leadership Development is a process approach designed to create an environment that provides early identification of leadership talent. Focus is to identify positions most critical to operational needs and develop a pool of talent to fill positions. (IDP needed)	Internal	2004
EAS 22 – 25	Processing and Distribution Management	The Processing and Distribution Management Program was built to develop bench strength for plant manager positions. Focuses on core operational aspects of plant management position. (IDP needed)	Internal	Ongoing
EAS 22 - PCES	Advanced Leadership Program	The Advanced Leadership Program provides the knowledge, skills and experience necessary for participants to positively impact and support future postal management decisions and direction. The program seeks to develop a highly competent managerial base from which future organizational leaders will emerge. (IDP needed)	Internal	Ongoing
EAS 19 – 21	Management Intern	The Management Intern program prepares internal and external candidates to assume critical operational positions.	Both	2002
	Professional Specialist Intern	The Professional Specialist Intern program prepares internal and external candidates to assume technical or professional responsibilities at postal headquarters.	Both	2003
EAS 15 – PCES	Leadership Excellence at the Desktop	Leadership Excellence at the Desktop is a performance support tool to provide just-in-time information and coaching at the desktop.	Internal	Ongoing
PCES and Officers	Executive Training	Develop to increase leadership performance based on executive competencies and assumption of the need for continuous learning. (IDP needed)	Internal	2003
PCES and Officers	Ongoing PCES Development	Refresh and develop executives based on current and emerging business trends. (IDPneeded)	Internal	2003
PCES and Officers	Sloan	Select developmental programs for “star” executives in the succession planning process as well as our officers. (IDP needed)	Internal	Ongoing

IDP – Individual Development Plan; PS – Postal Service; EAS – Executive and Administrative Schedule; PCES – Postal Career Executive Service

Strategy 4: Create a Performance-Based Pay System

The Postal Service will redesign the performance-based pay systems to improve accountability for individual contributions to organizational success; provide clear expectations and feedback on progress towards goals; and reward and recognize exceptional individual performance for achieving challenging objectives.

Putting more pay-at-risk in the total compensation mix helps achieve these objectives and moves the Postal Service closer to a private sector model of total compensation.

Background

The Postal Service has led the federal government in building market-based, performance-driven compensation systems. While considerable organizational success has resulted from these changes in the past, there is still room for improvement in the total compensation strategy to help drive transformation of the Postal Service. This new pay system will place a greater focus in rewarding individual, rather than group achievement. Operations is taking the lead on developing objective performance measures through the use of metrics at all operational levels of the organization. Human Resources is responsible for redesigning performance-based compensation systems and consulting with the management associations on changes.

Milestones

- Consult with the Management Associations in 2002
- Complete the redesign of the performance-based pay programs by 2003 / 2004
- Evaluate operations executives under new assessment / pay system for 2002
- Evaluate Headquarters / field support executives and key operations managers down through EAS grade 18 under new assessment / pay system for 2003
- Evaluate front line supervisors down through EAS grade 15 under new assessment / pay system for 2004

New Performance Management System

Management Cycle

The Management Cycle of planning, implementation, and review consists of four distinct phases of activities intended to give direction to the organization and to build and sustain improved performance against the goals that are set:

Establish:	Establish overarching goals, subgoals, indicators, and targets at the national level.
Deploy:	Deploy resources to achieve goals, subgoals, indicators, and targets.
Implement:	Implement improvement actions.
Review:	Review performance and adjust actions accordingly.

The Management Cycle phases overlap, so that at any given point in a year, the Implement phase for the current year is ongoing; the Establish and Deploy phases for the coming year may be in progress; and simultaneously performance for the previous year and the quarter may be under review. The phases are timed to ensure that overarching goals, performance subgoals, indicators and targets have been set and resources deployed throughout the organization before the beginning of the fiscal year. This approach will focus the Postal Service management cycle on new line-of-sight performance measures—the systematic measurement and assessment through the National Performance Assessment System.

Phased Implementation of National Performance Assessment System

The new Performance Assessment System will be phased in. The annual management cycle for establishing national goals, indicators and targets already exists. The first step in implementing the National Performance Assessment System is to consult with the management associations as required by law. The consultation process should be completed by 2002. In 2002, operations executives are being evaluated under this system; in 2003, Headquarters / field support executives, field key operations managers and EAS grade 18 and above will be included. By 2004, the Postal Service intends to have the National Performance Assessment System in place for front line supervisors down to EAS grade level 16.

SAMPLE INDICATOR LISTING UNDER NATIONAL PERFORMANCE ASSESSMENT SYSTEM

Group	Weight	Indicator
Budget	35%	Total Adjusted Operating Expense Total Adjusted Work hours
Overtime	5%	Carrier Overtime Customer Service Clerk/Mail Handler Overtime Mail Processing Clerk/Mail Handler Overtime Penalty Overtime
Attendance	5%	Total Sick Leave Total Sick Leave %SPLY
Service	35%	Advance Customer Service Measurement Delivery Confirmation Priority Mail Scanning Performance Delivery Confirmation Priority Mail Service Performance Effectiveness First-Class Mail - 2/3 Day Orig/Dest Composite First-Class Mail - 2/3 Day Orig/Dest Composite Points to SPLY First-Class Mail - 2 Day Orig/Dest Composite First-Class Mail - OND Destinating Express Mail - Intra District Bulk Mail Center - Intra District Priority Mail - Overnight Delivery Priority Mail - Surface Within 2 Days Priority Mail - Total Within 2 Days
Safety	20%	Motor Vehicle Accidents Motor Vehicle Accidents %SPLY OSHA Injury & Illness OSHA Injury & Illness %SPLY

Strategy 5 —Build a Highly Effective and Motivated Workforce

The Postal Service will reinforce individual accountability and management responsibility for a safe, secure, satisfying, and diverse work place.

Substrategy 1: Use existing programs and measures to create managerial accountability

Background

In addition to the Voice of the Employee (VOE) survey, there are other measures that can be used to create accountability for a better workplace. The VOE survey has traditionally been included in organizational performance targets. Improvement in troubled worksites, support of district involvement in promoting the Employee Assistance Program (EAP), maintenance of trained threat assessment and crisis management teams, and support for training for such topics as sexual harassment prevention and violence awareness prevention currently exist but are not uniformly enforced.

Milestones

The Postal Service will pursue this strategy by holding district, area, and headquarters leadership respectively accountable for the following activities:

- Maintaining a focus on improving the percentage of favorable responses to questions on the results of the VOE survey (2002).
- Identifying troubled worksites and developing effective plans for correcting problems (2002).
- Supporting the work of the District Joint EAP Advisory Committee (2002).
- Supporting Diversity’s continuous education initiatives.
- Maintaining trained Threat Assessment Team and properly prepared Crisis Management Team (2002).
- Providing violence awareness and sexual harassment training according to policy (2002).

Metrics

VOE Survey. The 2002 target is to achieve an index score equal to or greater than the end-of-year 2001 baseline.

Troubled Worksites. In 2002, the National WEI Advisory Committee will establish new objective criteria for identifying troubled worksites and for tracking the progress of the action plans for remediation. The criteria will be completed by early 2003. Following completion, the criteria will be used by Headquarters and the field to assess and remediate troubled sites.

District EAP Advisory Committee. Beginning in 2002, all Committees will meet quarterly to include teleconferences, if necessary, to conduct business. At least one meeting during the year will be conducted with all members present in the same location. Minutes will be submitted to the National EAP Committee.

Threat Assessment Teams (TAT). By the end of 2002, all districts must ensure that all TAT team members have received the requisite training by providing a roster and training dates to the national WEI office. Rosters and proof of training will be submitted each year.

Crisis Management Teams (CMT). By the end of 2002, all districts must ensure that all CMT team members have received the requisite training by providing a roster and training dates to the national WEI office. In addition, all districts will have reviewed their Crisis Management Plans and conducted a full CMP simulation. Rosters and proof of training will be submitted each year.

Training. After initial training, all employees are expected to have sexual harassment prevention training at least every other year. Beginning in 2000, all employees have received at least four hours of workplace environment training each fiscal year.

Substrategy 2: Organize the most predictive workplace data into proactive information for use by the districts and areas to create proactive interventions

Background

The organization is rich with data but more reactive than proactive in responding to workplace environment issues. The goal is to organize the data that currently exists into a more cohesive whole and to form predictive profiles that will allow the Postal Service to become more proactive in dealing with potential workplace environment issues. It will pursue this strategy by collecting data from the programs and activities in Substrategy 1 during 2002 and early 2003. The Postal Service will use that information to develop and test a Workplace Environment Profile.

Milestones

- Develop and test the Workplace Environment Profile (2003).
- Incorporate metrics from the Profile in the performance assessment system (2004).

Voice of the Employee Survey Targets for 2002

There are 35 total index questions on the Voice of the Employee Survey. Surveys are sent to one-quarter of the population of any facility or office each quarter. Results of the survey are reported by performance cluster each quarter. The response rate for the organization was 54 percent in 2001.

Six of the index questions were selected in 2000 as baseline data and the focus for improvement in the workplace in 2001 and 2002. The six index questions are:

- Question 13. I am satisfied with the recognition I receive for doing a good job.
- Question 16. People in my work unit are held accountable for doing their job well.
- Question 23. I feel excluded from my work unit because of my race, ethnicity, gender, disability, etc.
- Question 24c. In the past 12 months, I have personally been sexually harassed by a postal employee.
- Question 29c. Rate your supervisor on treating you with dignity and respect.
- Question 29d. Rate your immediate supervisor on ability to communicate with employees.

An index score is computed from the six survey questions listed above for each district, area office, and functional group at headquarters including headquarters-related functional units. The index score is computed and reported each quarter.

AVERAGE POSTAL SERVICE VOICE OF THE EMPLOYEE SCORES BY QUARTER

	2000	2001	2002
Qtr 1	56.7	56.3	58.3
Qtr 2	57.2	58.0	-
Qtr 3	57.6	59.0	-
Qtr 4	58.4	59.3	-
EOY	57.5	58.1	-

Strategy 6: Build the Labor-Management Relationship

Substrategy 1: Expand various joint employee involvement and quality of work-life initiatives with labor unions. Develop and provide contract administration and labor / management training to both management and bargaining unit employees.

Background

Joint involvement by the parties has proven to be an effective ingredient in building trust and a willingness to cooperatively solve and address mutual challenges. The various employee involvement and quality of work life (EI / QWL) processes have tackled such disparate topics as self-managed work units and productivity improvement initiatives. These joint efforts utilize the creativity of employees focused on topics that improve and have relevance to the work unit. A sense of ownership for the improved work processes by the employees is an additional benefit resulting from employee involvement initiatives. Joint training benefits both management and bargaining unit employees by not placing an emphasis on either group, but rather focusing on joint strengths that can be obtained through understanding and knowledge.

Metrics

The reduction of grievance disputes will be a primary metric in measuring success in efforts to improve contract interpretation.

Substrategy 2: Postal Service and employee and management leadership participation in joint initiatives.

Background

The willingness of employee and management leadership to convene in order to deal with broad, long-term, strategic solutions to problems facing the Postal Service and its employees creates trust. Strategic alliances are created that promote productive changes and provide the advocacy to do so. The anthrax incidents exemplified how the Postal Service's employee and management groups can pull together to address a shared problem. The Mail Security Task Force was created and was composed of the top leadership officials of the Postal Service, the management organizations, and the labor unions. The presidents and officers of these organizations met on a daily basis to share concerns and to map strategy to deal with this unprecedented assault on the mail system, on postal service employees, and on the American public. This task force was mobilized within hours of the anthrax incidents and became the information and strategy focal point in the weeks that followed.

Communication and cooperation among all Postal Service employee groups have never been more productive, and the Postal Service intends to build on these successful efforts by continuing to participate in joint initiatives.

Metrics

Although the participants will develop their own benchmarks for success, reoccurrence of the behavior demonstrated by employee and management leadership during the anthrax crisis will reaffirm the value and success of participation in Joint Initiatives.

Substrategy 3: Development and expansion of *Joint Contract Administration Handbooks and Manuals*

Background

In order for any level of trust to exist in the labor-management relationship, both parties must have a mutual understanding of the tenets of the national labor agreements. The development of joint handbooks and manuals also leads to an improved ability to resolve issues and disputes since both parties identify their jointly shared interpretations of contract provisions and then ensure that the same interpretation is understood by their field counterparts.

Metrics

Decreased grievance activity generated by proper application of national contract agreements.

Substrategy 4: Development and expansion of alternatives to traditional discipline and dispute resolution methods

Background

A set of behaviors believed by the national parties to be essential to the effectiveness of any dispute resolution process as well as effective working relationships between the union and management at all levels has been developed and will continue to be refined. As a result, some of the alternative discipline methods now being considered include providing a paid day of reflection for the employee to think about his / her job behavior, “no time off” disciplinary suspension letters, and joint labor / management corrective action plans.

In addition, further development and refinement of the REDRESS® program continues in an effort to resolve and/or reduce the number of EEO disputes. The REDRESS program is voluntary and utilizes a mediated approach to resolving workplace EEO disputes. Its use is being expanded in later stages of the administrative processes. The use of labor and management Dispute Resolution Teams (DRT) has also been highly successful.

Metrics

The national parties agree to establish a procedure for monitoring and intervention to ensure the effectiveness of the dispute resolution process.

Strategy 7: Improve Workforce Planning

The Postal Service will build and maintain a flexible workforce that can readily adjust to changes in customer demand and improvements in operational efficiency through standardization and performance measurement.

Background

Repositioning the workforce involves determining the specific skills and talents necessary to meet customer requirements while minimizing operational costs. The strategies under “Improve Operational Efficiencies” will require reductions and adjustments in the workforce and specific operational activities. Consideration must be given to redeploying talent, to attracting skills that do not currently exist, and as necessary, to eliminating labor costs associated with redundancies and the performance of tasks that are no longer necessary. While operational changes will require fewer employees, attrition trends may still leave the business lacking in certain skill sets. This mismatch will strain the continuity of the core business.

These factors will demand that the Postal Service change its approach to workforce planning. We will move to an integrated workforce planning process, rather than gathering and reporting data by multiple functional organizations. A single function will be responsible for reporting trends and issues. This approach will demand assimilating data from business and operational plans and comparing this data to attrition trends and projections. Data from the workforce planning trends will be used to align human resources with operational requirements, and modify programs that affect the Postal Service’s ability to swiftly redeploy or adjust the workforce. Additionally, predicting the skills and abilities necessary to successfully compete in business will be as critical for entry-level positions as it is for senior leadership positions. This will demand the introduction of new tools that will assist in determining skill needs and staff availability by location.

Finally, as the labor market tightens, the Postal Service needs to maximize the potential of its current workforce and to pursue strategies and programs that allow for repositioning and rightsizing the workforce.

Milestones

- Ongoing monitoring of the workforce allocations as well as the business and operational changes that will drive shifts in the workforce plan (2002).
- Understand the impacts that will result from business and operational changes.
- Fully utilize the provisions of the collective bargaining agreements to reposition the workforce as needed to meet customer demands and operational requirements, recognizing that the majority of employees currently have layoff protection (2002).
- Execute reduction in force (RIF) avoidance strategies to include voluntary early retirement offerings and the internal movement of employees qualified to fulfill the needs that remain (2002).

- Establish accountability within a single function for workforce planning analysis in order to standardize complement management activities (2003).
- Consider alternative to current RIF processes to include voluntary reduced hours, retirement incentives, layoffs, and voluntary sabbaticals (2005).
- Seek cost efficient ways to move people from positions that are no longer necessary to those that remain critical (2004).
- Assess the challenges that the organization faces and the need to move employees throughout the organization. Modify the applicable placement, training, and rightsizing processes (2005).

Metrics

- Workforce trends: attrition, accessions
- Cost per workhour
- Cost per turnover

Strategy 8: Expand Shared Services / Explore Outsourcing

Substrategy 1: Expand use of shared services

Background

Shared services is a model for delivering administrative services better, faster and cheaper and has been used successfully in a growing number of companies. Shared services refers to sharing technology, people, and any other resources within and across administrative functions in order to reduce costs and improve the quality of administrative services. Effective shared services efforts include three key components: 1) reengineered, standardized processes; 2) technology integration (standards, shared tools, pieces that fit together); and 3) effective planning and implementation of staffing changes.

Milestones

- Finance will begin national rollout of shared services in accounting (moving work of 85 districts to 3 shared service centers) (end of 2002).
- Begin pilots of shared services in human resources for hiring and benefits transactions (end of 2002).
- Complete accounting shared services rollout (end of 2003).
- Complete pilots in Human Resources for hiring, benefits; begin national rollouts; begin pilots of more human resources processes (end of 2003).
- Complete national rollout of human resources shared services (end of 2004).

Metrics

Reduction of personnel and nonpersonnel costs for transactional administrative processes. Improved performance metrics for each process.

Substrategy 2: Implement those outsourcing initiatives which have the potential to: a) increase service and quality levels; b) better utilize resources; c) reduce costs; d) allow greater emphasis on the Postal Service's core business.

Background

The Postal Service has historically utilized a great deal of outsourcing. Many of the Postal Service's noncore activities have been outsourced for decades. Examples of these activities include contracting for transportation services, and the use of contract stations to provide retail services. Similarly, many of the Postal Service's equipment and vehicle maintenance activities have been sourced from the private sector. The Postal Service has traditionally looked to obtain services from the best source in order to better utilize internal resources, reduce costs, and increase quality.

Labor Relations is pursuing the establishment of an Employee Stock Ownership Plan for EEO investigative work. Through an ESOP the Postal Service can maintain the continuity of needed expertise and knowledge while allowing for a more efficient and cost effective means of providing this service. Overall, overhead postal costs can be reduced through an employee owned company, which can provide employees with incentives for increased productivity and profitability.

Metrics

The Postal Service will evaluate cost savings derived from outsourcing and ESOP initiatives. It will use existing quality and performance measures to determine if these are improved by the initiatives.

Interdependencies

The postal–contractor relationship is a key interdependency.

Strategy 9: Improve the Collective Bargaining Interest Arbitration Process

The Postal Service will seek to modify the process currently used to determine final collective bargaining agreements when the parties cannot reach agreement during the negotiation process.

Background

The Postal Service engages in collective bargaining around hours, wages, and working conditions with the unions representing its bargaining unit employees. When the parties are unable to reach agreement during the time period established for those negotiations, the process provides for a period of fact-finding prior to binding arbitration. That process is led by a three-person panel selected by the Federal Mediation and Conciliation Service, and has generally proven unsuccessful. This unnecessarily delays decisions on labor agreements which could affect nearly 770,000 employees.

Milestones

- Continue discussions with labor organizations (2002).
- Meet with craft union leaders to seek agreement on modifications to the current interest arbitration process (2003).

Metrics

Agree upon a modification of the process to include mediation by the next cycle of negotiations.

Strategy 10: Reduce Injury Compensation Costs

Substrategy 1: Expand the Preferred Provider Organization Program with First Health and Office of Workers' Compensation Programs

Background

Expand the preferred provider organization (PPO) program with First Health throughout the Postal Service. First Health, through their hospital and physician network, is able to reduce medical fees below what Office of Workers' Compensation Program (OWCP) allows through their fee schedule. The Postal Service is presently operational in four of ten OWCP district offices and needs to expand systemwide. First Health is also able to identify duplicate medical payments that get through OWCP's medical bill payment system.

First Health is the nation's largest PPO network and is presently reaching 50 percent of the Postal Service's injured employees. Network provider bills are paid at agreed contract rates that are usually substantially lower than what OWCP allows. The Postal Service needs to expand this program as quickly as possible to maximize savings.

Milestones

- Continued expansion of program to additional Department of Labor regions (2002).
- Expansion of the program throughout the Postal Service (2003).

Metrics

The actual provider network savings to the Postal Service in dollars and the additional savings in dollars to the Postal Service by preventing duplicate payments that OWCP would have missed.

Interdependencies

U. S. Department of Labor – Office of Workers Compensation Programs

Substrategy 2: Move all Federal Employees' Compensation Act recipients to FECA annuity at age 65

Background

Employees who receive benefits through the Federal Employees' Compensation Act (FECA) program will receive 66 2/3 percent or 75 percent of their basic salary, the latter for employees with a dependent. This tax free salary is extremely generous and in many instances equates to as much as 25 percent more than what the employee would receive for a comparable Office of Personnel Management (OPM) retirement through one of the government programs. The annual compensation cost of living adjustments that are added each year to an employee on total injury disability rewards someone who stays out on compensation versus returning to work.

Using a level EAS-13 as an example, if placed on compensation starting in 1993, that person would make more money staying on compensation than by returning to work. The conservative model that compares a person on FECA workers' compensation with a post-tax working employee reveals that a person on compensation starting in 1993 would start to make more money than a working employee by 1997. Carried out a full ten years, the employee on compensation earns $1,300 more a year by staying on compensation than a working employee. Of equal concern is the second model that compares a person on compensation and that same level EAS-13 who retires. In that model, the person on compensation will make over $185,000 more than the retired employee in a ten-year period. This difference in paid income actually becomes a disincentive to retire and drives up the injury compensation costs for the Postal Service. The Postal Service cannot afford to have employees paid at a higher rate than a normal retirement, especially given that the Postal Service is charged an administrative fee on top of the actual benefits charge. Employees commonly file for disability retirement then waive the retirement benefits to continue receiving compensation. This provides them with the highest possible income while ensuring a survivor annuity for their spouse. The Postal Service needs relief in the form of a FECA managed retirement program that equates to the same costs as a normal retirement for all present and former Postal employees over age 65 on the compensation rolls of OWCP.

Milestones

- Analyze administration proposal and develop government relations strategies (2002).
- Modify the law to be retroactive to all employees (2003).

Metrics

Substantial savings in cash payments to U. S. Department of Labor and a reduction in the Postal Service's accrued liability

Interdependencies

Office of Management and Budget and the U. S. Department of Labor – Office of Workers Compensation Programs

Substrategy 3: Encourage the Office of Workers' Compensation Programs to revise current regulations to allow for direct contact with the treating physician by the employing agency

Background

Prior to January 1999, postal managers had the ability to contact an injured employee's treating physician directly (by phone and/or in person). That immediate contact gave the postal managers the opportunity to explain limited duty assignments and offer options to accommodate employees. This type of personal and immediate contact with the medical community assisted in reducing paperwork and associated medical costs. Changing this current regulation would ensure that postal managers initiated close monitoring of employees' physical condition and it would allow early workers' compensation program specialists' intervention to assist the employee in a speedy return to the work environment.

Milestones

- Presentation of proposed revision to Secretary of Labor (2002).
- Series of subsequent meetings to effect the revision (2003).
- Monitor regulatory change process (2002/2003).

Metrics

OWCP agreement for implementation of regulatory change process.

Interdependencies

Department of Labor - Office of Workers Compensation Programs.

Substrategy 4: Private sector outplacement of injured Postal Service employees and the creation of new internal positions to accommodate injured workers

Background

Federal Employees' Compensation Act regulations direct the private sector outplacement of injured employees for federal agencies. The Department of Labor, Office of Workers' Compensation Programs (OWCP), oversees this activity through its Vocational Rehabilitation Program. At this time, the Postal Service identifies injured employees who cannot work within their medical limitations and initiates action with the OWCP to start their rehabilitation process. However, with the continual deployment of automation equipment, the available number of employee assignments for injured and noninjured employees is being reduced as well. The OWCP rehabilitation process is based on conducting vocational testing to establish a wage earning capacity, and the training program can last from 90 days to two years. The Postal Service is quickly approaching a situation where they will no longer have positions available to internally accommodate their injured employees and is in need of an accelerated rehabilitation process that will expeditiously outplace injured employees in private sector employment positions.

Milestones

- National implementation of the Reassessment Initiative for identification of productive work assignments for rehabilitation, limited duty, and periodic roll category employees (2002).
- Identification of employees for private sector placement through an accelerated rehabilitation process with OWCP (2003).

Metrics

- Successfully implement, with the OWCP, an accelerated private sector placement program that reduces the amount of time necessary for an outplacement from up to two years to less than one year.
- Reduce the number of postal employees in nonproductive rehabilitation assignments by initiating action with the OWCP for private sector placement.

Interdependencies

Department of Labor – Office of Workers' Compensation Programs

Substrategy 5: Interagency work cooperation to attain organizational objectives

Background

Often organizations have goals that conflict with each other. An example of such a conflict is the FECA program objective for speed in processing compensation claims and medical bills. The Postal Service noted that in 1999, the OWCP changed the processing of compensation claims to meet new internal goals. The Postal Service needs to work with the OWCP to develop joint strategies to achieve both organization's objectives, and not at each other's expense.

Milestones

- Joint meetings to develop action plans that will not adversely impact each other's organizational goals (2003).
- Attendance at national meetings to review strategies (2002).

Metrics

Claims are paid in a timely manner and quality checks are performed to prevent duplicate payments and unbundling of medical costs.

Interdependencies

Department of Labor – Office of Workers' Compensation Programs.

COMPARISON OF FECA WORKERS' COMPENSATION BENEFITS AND EAS-13 POST-TAX "TAKE-HOME" PAY

Calendar Year	Net Pay	Workers' Compensation (75% of Base Salary)
1993	$ 30,799	$ 29,775
1994	31,851	30,395
1995	32,303	31,206
1996	32,464	31,996
1997	32,627	33,010
1998	32,790	33,602
1999	33,101	34,134
2000	33,453	35,022
2001	34,483	36,091
2002	35,362	36,666
Total	**$ 329,233**	**$ 331,899**

Assumptions:

EAS-13 Salary $30,799 (effective January, 1993)
Employee receives normal salary increases
Married for all tax calculations and workers' compensation
No impact for life insurance and health benefit premiums

PROJECTED: COMPARISON OF FECA WORKERS' COMPENSATION BENEFITS AND EAS-13 POST-TAX "TAKE-HOME" PAY

Calendar Year	CSRS Retirement Net Pay (56% of High 3+ taxable)	Workers' Compensation (75% of pre-injury salary plus COLAs – non-taxable)
2003	$ 21,949	$ 37,847
2004	22,547	38,982
2005	23,162	40,152
2006	23,796	41,356
2007	24,449	42,597
2008	25,122	43,875
2009	25,814	45,191
2010	26,528	46,547
2011	27,263	47,943
2012	28,020	49,381
Total	**$ 248,651**	**$ 433,870**

Assumptions:

Married for all tax calculations and workers' compensation
No impact for life insurance and health benefit premiums
Includes $648 per annum Medicare B charges for CSRS retirement
No adjustment for non-taxable portion of CSRS
Assumes 3% per annum COLAs

Appendix P

APPENDIX P — Federal Emloyees' Compensation Act (FECA) Overview

Background

The Federal Employees' Compensation Act (FECA) was first enacted in 1916 to provide disability benefits to civilian federal employees who became injured in the course of their federal employment. FECA has been the subject of numerous amendments, most of which have resulted in increased benefits for injured employees and their dependents. The most recent major amendments to FECA occurred in 1974. The major provisions were the establishment of Continuation of Pay (COP) for traumatic injuries, and allowing injured employees the initial free choice of physician. The COP provisions provide for up to 45 calendar days of regular pay without a waiting period. COP is paid by the employing agency and starts the day after the injury. It was anticipated that inserting the 45-day COP period in front of wage loss compensation would allow Office of Workers' Compensation (OWCP) to clear up backlogged cases by allowing a majority of cases to be resolved before the end of the COP period. Unfortunately, by allowing injured employees to immediately receive COP, the floodgates were opened for a dramatic increase in claims.

There are five basic types of benefits:

- Disability Compensation. Wage loss benefits of 66 2/3 percent of pay with no dependents or 75 percent with dependents. Night differential, premium pay, Sunday pay, and cost of living adjustments (COLA) are included in the pay rate. Overtime is excluded. The minimum pay is a GS-2 Step 1, and the maximum is a GS-15, top step. COLA increases are given each March 1.
- Medical Benefits. OWCP will pay for any medical services, appliances or supplies which will cure, give relief, reduce the period or degree of disability, or aid in lessening the amount of monthly compensation. This is a lifetime benefit with no dollar limit.
- Schedule Awards. This is the amount given to an injured employee for the loss of function of specific body members.
- Vocational Rehabilitation.
- Death Compensation.

FECA covers all federal employees. The Postal Service and other nonappropriated agencies are treated differently in the following ways:

- The Postal Service is charged an administrative fee by OWCP. The charge for FY 2001 was $30 million.
- All payments made by OWCP to and on behalf of injured employees are charged back to the Postal Service. Other federal agencies include these charges in their budget requests.

State workers' compensation programs differ significantly from FECA in the following ways:

State programs have waiting periods before receipt of compensation. FECA has no waiting period before COP. There is a 3-day waiting period after COP before compensation is paid. However, if the disability exceeds 14 days, the waiting period is waived.

Most state programs only have one rate of compensation – 66 2/3 percent with a weekly maximum amount. FECA has two rates: 66 2/3 without dependents and 75 percent with dependents.

Most state programs allow for a formal challenge to a claim. FECA is nonadversarial, with only an informal challenge procedure.

Under most state programs, workers' compensation can be self-administered or contracted through a third party administrator.

Specific issues under FECA that are contributing to escalating compensation costs:

- Inability to contact medical provider by phone.
- No waiting period before wage-loss compensation is paid.
- Compensation rates too generous. Should be only one rate—66 2/3 percent.
- Compensation should not be a lifetime benefit. At retirement age, compensation should be adjusted to a tax-free amount equal to what a retiree would receive.
- Medical costs are not adequately controlled by fee schedule.

Appendix Q

APPENDIX Q — Enabling Strategies

The transformation of the Postal Service now underway necessarily involves a restructuring of functional activities that facilitate and enable the work of the organization. Financial management must be enhanced to improve financial reporting transparency and the ability of the Postal Service to finance capital improvements. Further development of the Information Platform and better use of technology are essential to support modernization in all areas. Securing the mail, the mission of the Postal Inspection Service, has never been more important. Regulatory reforms, likewise, must be pursued to support the Postal Service to respond to transformational imperatives.

This Appendix to the *Transformation Plan* contains additional explanation, detail, and examples of near-term strategies that enable the organization. This is not meant to be a comprehensive list of postal projects, but meant to outline those that will contribute to the success of postal transformation.

Strategies in this Appendix include:

- Enhance Financial Management;
  - Debt Management
  - Monthly Reporting
- Expand Usage of Supply Chain Management;
- Strategically Apply Technology; and
  - Enhanced Security
  - Upgraded Infrastructure
  - Universal Computing Connectivity
- Ensure Safety and Security of the Mail, Customers, and Employees.

Debt Management

Overarching Objective

Reduce outstanding debt

Strategy: Reduce debt and remain within the current statutory debt limits

By recovering prior year losses and maintaining a disciplined capital investment program, the Postal Service will endeavor to limit financial risks by reducing debt and remaining within the $15 billion debt limit.

Substrategy: Preserve liquidity while managing interest expense

The plan to remain within the $15 billion debt limit will be modified as necessary to ensure that the Postal Service preserves its ability to meet all of its cash obligations. The Postal Service will continue to adjust the amount of floating-rate and fixed-rate debt to manage interest expense and mitigate the risks posed by higher interest rates.

Background

Under current law the Postal Service may increase its outstanding borrowing by up to $3 billion annually, which includes a $2 billion increase for capital investments and a $1 billion increase for operating expenses. The Postal Service is subject, however, to a total debt limit of $15 billion, which has been in place since 1992, when it was raised from $12.5 billion. Prior to 1991, the debt limit had remained at $10 billion since postal reorganization. The law also requires the Postal Service to notify the Secretary of the Treasury at least fifteen days prior to offering debt obligations. The Secretary has a right of first refusal to purchase the Postal Service debt within the fifteen-day period or a commercially reasonable time period thereafter. Since 1974, the Postal Service has borrowed exclusively through the Treasury's Federal Financing Bank. In the past several years, the Postal Service and the Treasury have reached agreement on important issues related to borrowing. As a result, the Postal Service currently has the flexibility required to manage its debt.

Debt is a reflection of capital spending and overall financial performance. Over time, changes in debt are largely determined by the difference between cash flow from operations and capital cash outlays. Cash flow from operations is influenced by net income (or losses), and noncash expenses such as depreciation. Capital cash outlays are the funds invested in capital improvements such as facilities, automation equipment, and information technology. From 1997 through 2001, Postal Service capital cash outlays exceeded cash flow from operations by $5.2 billion. Consequently, debt increased by $5.4 billion—from $5.9 billion to $11.3 billion—during that time. Cash on hand at the end of fiscal year 2001 totaled approximately $1 billion, or less than one payroll.

The Postal Service has managed its mix of short- and long-term debt to lower its interest expense over time. As a result of this strategy and lower interest rates, annual interest expense on Postal Service debt remains lower than it was during much of the 1990s. Current interest expense is but one of the potential costs associated with debt. However, the fact is that Postal Service debt—the obligations that are subject to interest and principal payments—almost doubled between the ends of fiscal years 1997 and 2001, from $5.9 billion to $11.3 billion. While interest rates may or may not remain relatively low, a more important consideration is that the increase in debt, however necessary to preserve liquidity, has also increased financial risk by adding to the obligations of the Postal Service. In light of risks to mail volume growth, which create risks to cash flow, the Postal Service's capacity to service growing debt is limited.

The Postal Service has attempted to determine an appropriate debt level. The Postal Service has considered various means of evaluating its debt ceiling, including post-1992 revenue growth, asset growth, and inflation. Such analysis has major drawbacks, however, because it assumes that the debt ceiling of $15 billion was optimal when instituted in 1992; and the analysis does not assess the future risks facing the Postal Service. By remaining within its $15 billion debt limit, the Postal Service can limit the risks it carries into administrative and legislative transformation.

As mentioned earlier, the change in debt is largely determined by the difference between cash flow from operations and capital cash outlays. Since cash flow from operations is linked to net incomes (losses), stabilizing and reducing debt will require that the Postal Service recover its prior year losses and carefully plan its capital cash outlays so they do not exceed cash flow. As the past two fiscal years have demonstrated, the Postal Service cannot simultaneously generate net losses and reduce its borrowings.

As a final point, the consequences of running out of cash far exceed the costs of increasing debt. Therefore, the Postal Service will do what is necessary to keep from running out of cash, even if doing so means accepting a temporary increase in its statutory debt limit. Under such an outcome, the Postal Service would seek to reverse the temporary increase in debt, and resume its strategy of keeping its debt below $15 billion, while reducing outstanding debt.

By reducing outstanding debt, by remaining within its $15 billion debt limit, and by managing its interest expense, the Postal Service can limit the risks it carries into administrative and legislative transformation.

Metrics

Amount of debt and interest expense

Interdependencies

The Postal Service's ability to apply cash flow toward debt reduction requires both recovery of prior year losses and some limits on capital investments.

Monthly Reporting

Strategy: Convert Postal Service reporting (financial and all other) from the existing accounting period format to a calendar month format

Background

The Postal Service, for financial reporting purposes, uses both a postal fiscal year (PFY) and a government fiscal year (GFY). The Postal Fiscal Year is used for internal reporting and the Government Fiscal Year is used for rate cases and reporting annual audited financial statements.

The Postal Fiscal Year consists of thirteen, four-week accounting periods. Each accounting period consists of two biweekly payroll cycles. The Postal Service assumes that the construction of the thirteen accounting period fiscal year was mandated by the need for accurate reporting of salaries and benefits that constitute approximately 75 percent of Postal Service total costs. This could only be accomplished by including complete payroll cycles. Up until the implementation of the new Time and Attendance Control System (TACS) no daily information was available as part of Postal Service timekeeping systems.

A postal quarter (PQ) consists of three consecutive accounting periods except for PQ 4, which consists of the last four accounting periods of the fiscal year.

Trends / Supporting Data

One of the major disadvantages inherent in the present structure is that the Postal Fiscal Year is only 364 days long. The Postal Service does not add the extra day (or two) to align the PFY to the calendar year because of the necessary tie to the payroll cycle. That means that every five or six years, the PFY slips by one week, making the PFY more and more out of line with the GFY. For example, the end of PFY 2001 was September 7, 2001. The end of the GFY was September 30, 2001. The start of PFY 2001 was September 9, 2000. The start of GFY 2001 was October 1, 2000. Normally this difference does not result in major changes because the two periods (at the start of the PFY and at the end of the GFY) are similar. However, this year, the period at the end of the GFY (September 8-30, 2001) was eventful.

The Postal Service reports year-to-date performance as if the fiscal year started with the PFY, starting with accounting period (AP) 1 reports, AP 2 reports, etc. It is not until the end of the GFY that the year to date reporting is realigned with the GFY. This is somewhat problematic for FY 2002, because of the events of September 11, 2001. The Postal Service reported much of the lost revenue, as a result of the terrorist attacks, in GFY 2001. However, the Postal Service continues to report the lost revenue in FY 2002 as AP 1 began September 8, 2001, before the attacks took place. This is somewhat confusing within the Postal Service and certainly more confusing outside the Postal Service.

Accounting period reporting is not unknown in private industry, but monthly reporting is far more common. Much of the data about the economy from state and federal government agencies and forecasts from governmental, commercial, and educational sources are reported in a monthly format. In addition most of private industry invoices, pays and mails on a monthly cycle. Most Postal Service customers and also Postal Service competitors report in a monthly format.

Monthly reporting offers the following advantages:

- Eliminates the need for the AP 14 reconciliation that occurs at the end of each GFY. This should facilitate the year-end close.
- Eliminates the Postal Fiscal Year. The Government Fiscal Year will be used for both internal and external reporting, for both Headquarters and Field reporting.
- Aligns the Postal Service with the vast majority of corporate reporting, with external databases and with governmental reports on economic data and with standard forecasts of economic activities. Therefore, it will provide the Postal Service financial data on a basis that enables comparative analysis with competitors, as well as consistency in current external reporting of financial results.
- Generates a small saving as the books will have to close only twelve times per year instead of fourteen. It should speed finalization of the audited end of year results.
- Should simplify the estimation of accruals at the end of the fiscal year.
- Should make certain expense and revenue data more stable when reported on a monthly basis. Most private sector companies invoice and pay on a monthly basis. The end of the month burst in transactional activities will occur consistently every reporting period.
- Elliminates confusion that is created by the use of two reporting systems.
- Facilitates conversion to any alternate fiscal year.

Substrategy: Monthly Reporting — Converting from accounting period reporting to monthly and calendar quarter reporting

There are many different ways in which the Postal Service can convert to monthly reporting. At this stage, things are still flexible. Generally, the Postal Service sees no reason to change its bi-weekly payroll cycle. Payroll expenses will be mapped into months based on the percentage of hours used in each month for any pay period that overlaps two months.

Weekly reporting (from a Saturday to Friday format) will continue for many systems. The AP-to-date reporting will be replaced with month-to-date reporting.

The Postal Service's general strategy will be to put interim systems in place by the start of FY 2003 to allow us to crosswalk accounting period reporting into monthly reporting. Starting with FY 2004 Postal Service systems should be fully converted.

Metrics

Frequency of reporting

Timeline

- Identify systems that need to be modified for monthly reporting (Corporate wide) (Jan 2002 – Mar 2002).
- Create strategies for interim reporting in FY 2003 (April 2002 – May 2002).
- Implement those strategies (June 2002 – Aug 2002).
- Create permanent solutions for monthly reporting (Sept 2002 – March 2003).
- Test the permanent solutions by preparing pro forma monthly reports for June, July and August (April 2003 – June 2003).
- Fully implement monthly reporting (Sept 2003).

Interdependencies

This strategy lies entirely within the control of the Postal Service. Currently, there are no conflicts with required government reporting.

Supply Chain Management

Overarching Objective

Continue to implement and institutionalize supply chain management. Supply chain management is the analysis of the purchase process and the supply stream, from the supplier's supplier to the customer's use and disposal, in order to increase customer satisfaction and decrease overall cost. Effective supply chain management involves a number of business practices, including close interaction among end users, buyers and suppliers, long-term contracts, and ongoing analysis and improvement of operating and administrative processes. Its institutionalization, in terms of business practices, organizational design and deployment, and supplier relations, will lower overall costs and improve customer service.

Strategy: Focus Postal Service resources on lowering overall cost and furthering competitive and business objectives

Substrategy: Consolidate purchases for better quality and lower cost

Redesign purchasing organization into interdisciplinary commodity teams. Reduce low-dollar value transactions and forge stronger and more effective relations with key, strategic suppliers.

Background

The Postal Service awards contracts worth billions of dollars every year. Supply chain management maximizes these expenditures, and brings them to bear on the marketplace. Over the past several years, supply chain management has become one of the most successful aspects of contemporary businesses, and it is becoming increasingly so for the Postal Service. Process and demand management, data analysis, and other business practices provide cross-functional purchase teams with the tools to focus on strategic sourcing, while low—dollar value—but administratively expensive—transactions are minimized. Innovative business practices, such as reverse auctioning and Internet technologies like Web-based ordering are also being used to good effect. The purchasing and material management functions are being redesigned and redeployed to take advantage of varied business expertise through the use of multidisciplinary teams. Results to date have been impressive: in FY 2001, cost reductions had been predicted to be $100 million, but actually reached $157 million. Greater cost reductions will be achieved in FY 2002.

Interdependencies

Communication and cooperation between and among internal Postal Service customers, buyers, and suppliers is essential to long-term success. In addition, supply chain management is a cross-disciplinary business philosophy, and requires expertise in logistics, purchasing, contract pricing, commodities and other areas in order to be truly effective. Purchasing and Materials is redesigning its organization to best deploy these skills.

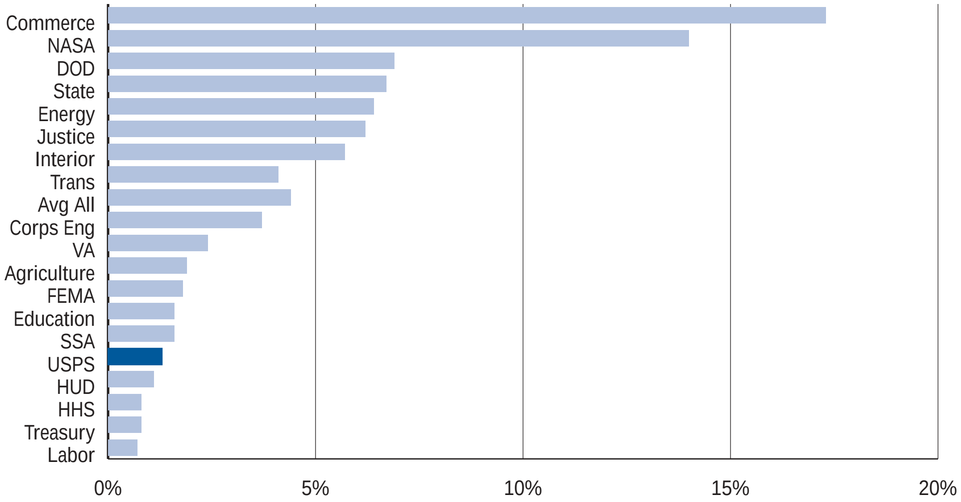
Obstacles

As supply chain management becomes more and more prevalent in Postal Service purchasing and supplying activities, resistance can be expected from some segments of the supplier community, especially as the supplier base shrinks. Certain statutory requirements, such as the Service Contract Act and the Davis-Bacon Act, also add cost and administrative efforts with which commercial businesses are not burdened. Overcoming such obstacles would require the revision of a number of federal statutes, or alternatively, the postal enterprise should be summarily exempted from such statutes.

Strategic Application of Technology

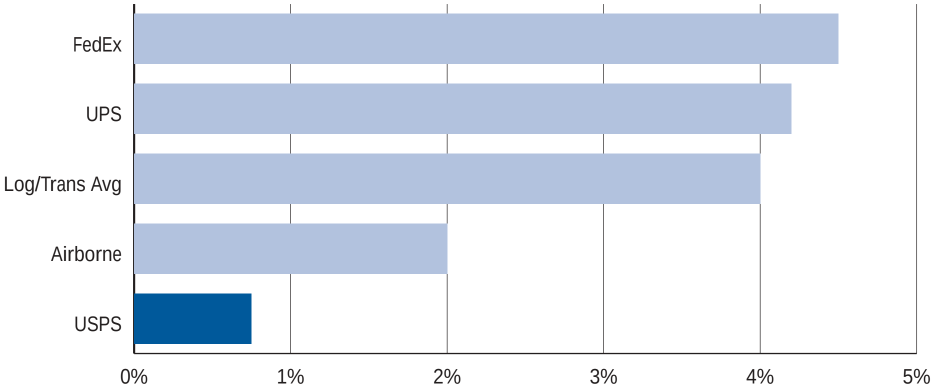
The Postal Service invests a significantly smaller percentage of its total budget in information technology than any other federal agency (see Figure 1) and private sector competitor (see Figure 2).

FIGURE 1: FEDERAL AGENCY COMPARISON — INFORMATION TECHNOLOGY BUDGET AS A PERCENT OF THE TOTAL BUDGET



Source: Office of Management and Budget, Clinger Cohen Act Report on Fiscal Year 2002 Federal Information Technology (IT) Investments, April 19, 2001; Postal Service forecast data for Fiscal Year 2003.

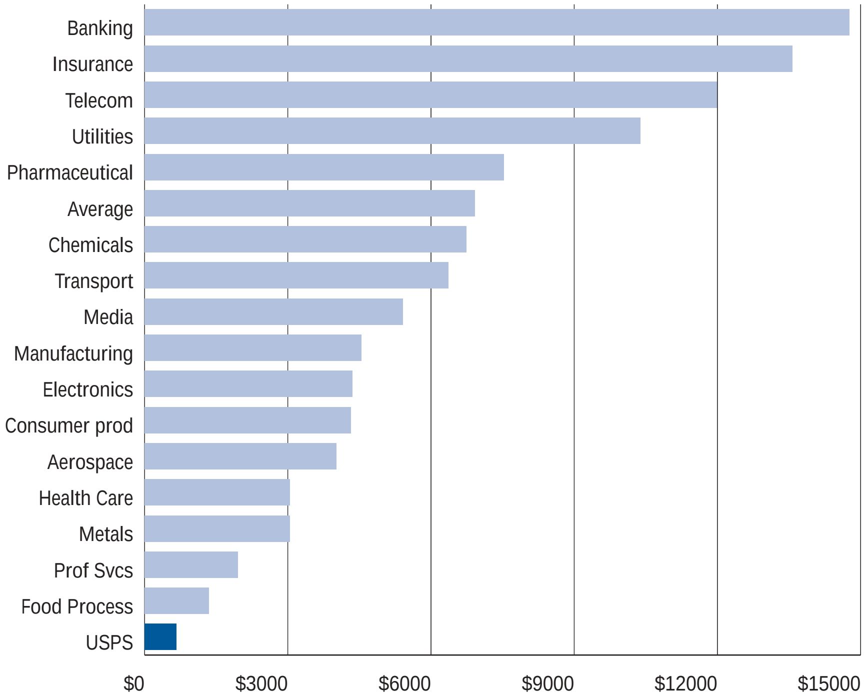
FIGURE 2: PRIVATE INDUSTRY COMPARISON — INFORMATION TECHNOLOGY BUDGET EXPRESSED AS A PERCENTAGE OF REVENUE



Source: 10-K filings, InfoWeek 500 analysis, Postal Service data.

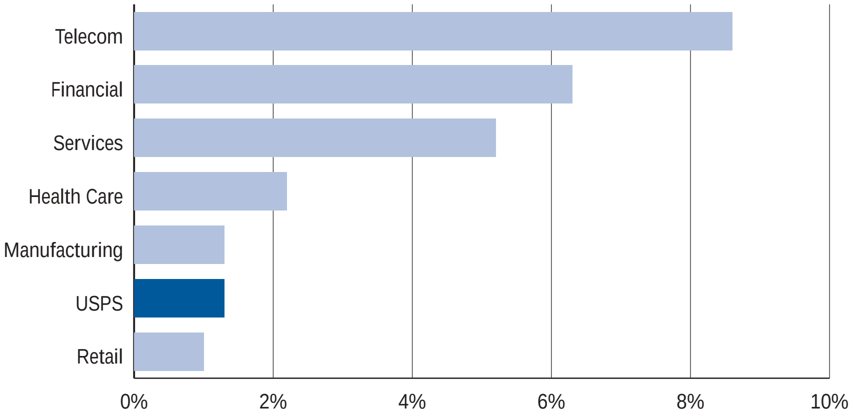
In comparison with other industries, the Postal Service's investment in information technology per employee (see Figure 3) is the lowest of all. Expressed as a percent of an organization's total budget, the Postal Service's investment in information technology is also the lowest (see Figure 4).

FIGURE 3: PRIVATE INDUSTRY COMPARISON — INFORMATION TECHNOLOGY BUDGET EXPRESSED AS AN AVERAGE INVESTMENT PER EMPLOYEE PER INDUSTRY



Industry Average Source: Information Week survey data (1997). Postal Service data: Total CTO Budget (including customer IT budgets) divided by the number of employees.

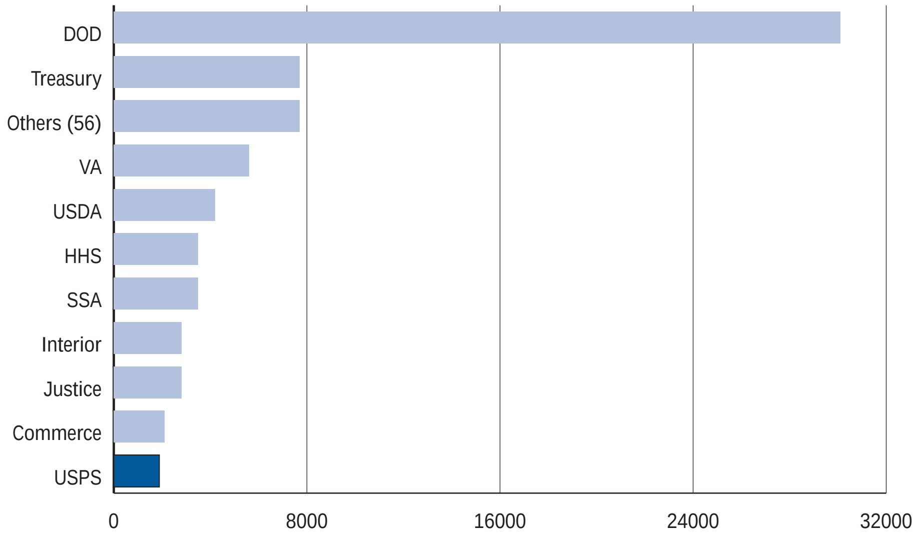
FIGURE 4: PRIVATE INDUSTRY COMPARISON — PERCENT OF BUDGET ALLOCATED TO INFORMATION TECHNOLOGY BY INDUSTRY AVERAGE



Industry Average Source: Information Week survey data (1997). Postal Service data: Total CTO Budget (including customer IT budgets) divided by $65 billion.

The number of information technology resources in comparison with federal agencies (see Figure 5) is the lowest of all.

FIGURE 5: FEDERAL AGENCY COMPARISON — THE NUMBER OF FEDERAL EMPLOYEES BY DEPARTMENT



Source: Office of Personnel Management, Federal Workforce Statistics. Total Number of GS 332, 334, 335, and 340, (approx. 70,000) verified by IT Workforce presentation, divided by the percent of GS 334s identified by agency. GS 334s represent 80 percent of Federal IT workforce.

The clear message in these comparisons of investment and resources is that the Postal Service manages its information technology functions efficiently and effectively with limited resources. This is accomplished via prudent spending, excellent management practices, and a dedicated workforce committed to the Postal Service’s success.

Enhance Security Across All Technology

Overarching Objective

Managed by the Information Security Executive Council, which is composed of the Postal Service executive leadership and chaired by the Deputy Postmaster General, the Corporate Information Security Office implements prudent enterprise wide security strategies across the enterprise. The strategy aims to protect data entrusted to the Postal Service by contractors, business partners, and customers; to ensure the continuity of its business infrastructure; and to preserve its vast investment in technologies and information. The approach to implementing this strategy is outlined in the Postal Service's *Information Security Five-Year Strategic Plan*.

Strategy: Enhance security across postal technologies to avoid disruptions in critical operations and protect sensitive information from unauthorized disclosure or modification

Substrategy 1: Education and training

Background

In November 2000, the Postal Service Board of Governors approved a three-year, multimillion dollar, enterprise wide enhanced security program. Managing the security program is primarily the responsibility of the Corporate Information Security Office, while managing the system certification and accreditation process and business continuity and contingency planning are the responsibility of the various business organizations and their respective portfolio managers. Key to the success of the information security strategy are the assurances that security policies and practices are enhanced, implemented, enforced and that the vision and mission of the Postal Service are supported.

Both government and industry experts agree that communication is an integral part of a successful implementation of an information security strategy. The Postal Service recognizes this and considers awareness and training to be one of the most cost-effective information security investments. This substrategy includes activities to effectively educate, train, and create awareness of information security requirements; to define roles and responsibilities; and to enhance understanding of security risk management.

Milestones

- Establish information security internal Web site and reading room (2002)
- Conduct annual Computer Security Day activities (Annually)
- Develop awareness articles and outreach events (Annually)
- Publish role-specific learning plans (2003)
- Deploy distance-learning capability (2005)

Metrics

- Number of articles in Postal Service publications
- Number of visits to Information Security Web site and online reading room
- Number of executives and employees viewing awareness videos
- Number of internal and external outreach events and number of outreach contacts
- Number of staff trained in information security processes
- Number of people who use distance–learning courseware

Interdependencies

Developments of new threats, vulnerabilities, and new business and government requirements that may alter the security information, including roles and responsibilities.

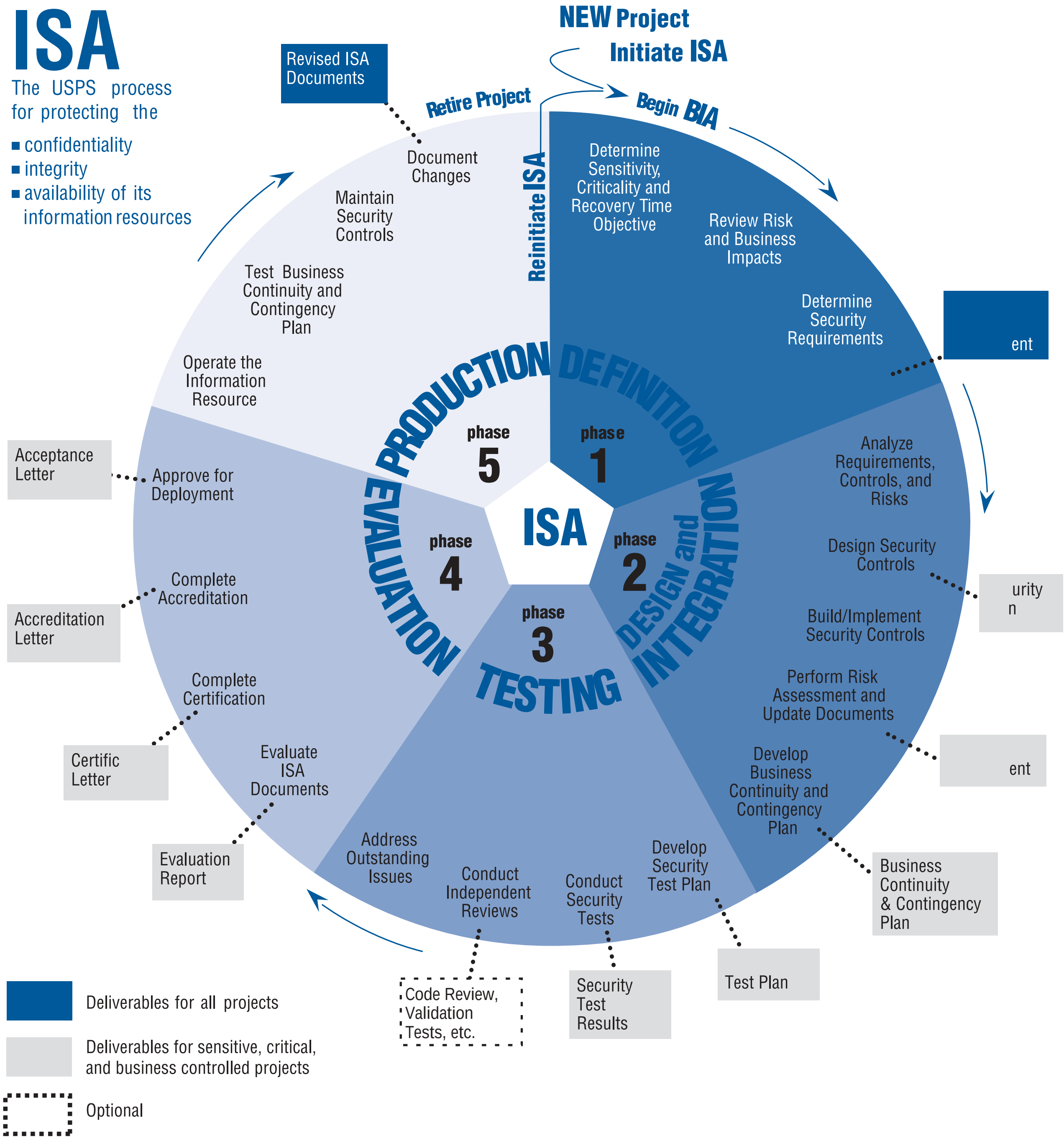
Substrategy 2: Certification process

Background

The Postal Service has over 1,500 computer applications that run the business, which are divided into ten business portfolios: Finance, Purchasing, Marketing / Sales, Human Resources, Enabling, eBusiness, International, Delivery / Retail, Network Operations, and Product Tracking. To implement a standard security certification and accreditation process will provide a level of assurance that appropriate information security controls and processes are being implemented for all information resources based on their value to the organization and their risks. This assurance is required because one uncertified, and possibly insecure, information resource could introduce vulnerabilities that could negatively affect the security of another information resource. Ensuring appropriate protections are built into technology applications and services is essential for protecting the trust and confidence of Postal Service employees and customers.

This strategic focus is comprised of all security activities needed to accomplish the objective of achieving an acceptable level of security for all new products, services, and applications, and ensuring that security is reevaluated in legacy systems. In order to accomplish this strategy, the Postal Service developed a risk-based and cost-effective Information Security Assessment (ISA) process that provides business owners with a structured methodology to classify information resources, to identify security requirements, and to make informed deployment decisions (see Figure 6).

FIGURE 6: INFORMATION SECURITY ASSURANCE PROCESS



Milestones

Each of the ten portfolios has discrete milestones to accomplish this substrategy. The dates for accomplishing the milestones below depend on the number of new applications and legacy applications in the portfolio.

- Inventory systems (2002 through 2006)
- Assess using BIA (2002 through 2006)
- Prioritize systems (2002 through 2006)
- Complete ISA (2002 through 2006)
- Approve for deployment (2002 through 2006)

Metrics

Number and percentage of all new systems and legacy systems completing the ISA process that have been certified and accredited and accepted for deployment according to plan.

Interdependencies

Development of new threats and vulnerabilities and advances in technology.

Substrategy 3: Contingency planning

Background

This substrategy encompasses all activities needed to sustain mission-critical business information resources and operations in emergencies as mandated by the Critical Infrastructure Protection Act. As a result of the terrorist attacks on September 11, 2001, the Postal Service recently focused its efforts on this substrategy and updated its recovery plans to incorporate Federal Emergency Management Administration (FEMA) guidelines for Continuity of Operations Planning (COOP) into all major policies that pertain to Information Technology facilities which support critical information resources within the Postal Service.

The objective of this substrategy is to assure the continuity of essential business functions and recovery from a wide range of potential emergencies or threats, such as the recent terrorist and anthrax attacks. To support this substrategy, the Postal Service developed templates to guide business owners in addressing requirements for system availability and to integrate individual system continuity and contingency plans into overall plans, such as Continuity of Operations Planning and Disaster Recovery Planning.

Milestones

- Identify all critical system by portfolio (2002 through 2004)
- Establish contingency plans (2003 through 2006)
- Test selected contingency plan (2003 through 2007)

Metrics

Number and percentage of all new applications and systems and legacy systems having continuity plans compliant with standards and guidelines.

Interdependencies

Development of new threats, advances in technology, and updates in business / government contingency guidelines.

Substrategy 4: Intrusion protection

Background

Protecting the Postal Service infrastructure is a key component of Postal Service security strategy. Through this substrategy, the Postal Service will implement enhanced intrusion detection software, perform periodic network vulnerability tests, and scan Postal Service networks to identify vulnerabilities. To protect sensitive and critical information from unauthorized access or use and to maintain system availability, the Postal Service is using a layered defense approach, enhancing the strength of its firewalls, and guarding the external perimeter of its network. This will enable the Postal Service to better protect its servers and applications from both external and internal threats.

Additionally, this substrategy includes activities to mitigate hardware and software vulnerabilities by implementing vendor-identified security patches, software, and hardware upgrades; and to increase access and authentication controls using sophisticated password protection and access management. The key to this substrategy is to increase its response capability by enhancing the Computer Incident Response Team (CIRT), enabling the team to identify, contain, and respond to security incidents, breaches, and penetration attempts more efficiently.

Milestones

- Deploy standard baseline hardening standards for multiple devices and operating systems (2003)
- Implement standards for new components and retrofitting legacy components (Annually)
- Develop a process to detect problems closer to origin (2003)
- Define and implement additional layers of security within the infrastructure (Annually)
- Enforce new password and access standards (Annually)
- Complete deployment and implementation of intrusion detection capability on servers (2002 through 2005)

Metrics

- Number of servers and devices compliant with security standards
- Number of users with acceptable passwords
- Number of additional sensors deployed for monitoring

- Lapsed time in identifying, containing, correcting security incidents
- Number of attacks prevented from spreading through the layered defense
- Number of external attacks, viruses, and harmful e-mails prevented

Interdependencies

Development of new threats and advances in technology.

Substrategy 5: Automated monitoring

Background

To update its policies and procedures, the Postal Service reviewed vulnerabilities identified through third-party security experts, the Office of the Inspector General (OIG), and the General Accounting Office (GAO). Compliance with security policies requires an ongoing cooperative effort among several parts of the Postal Service, including the Corporate Information Security Office, the Chief Privacy Officer, the Office of the Inspector General, and the Computer Incident Response Team (CIRT). Additionally, the Postal Service coordinates with external organizations, such as the Federal Computer Emergency Response Team (FedCERT); the National Institute of Standards and Technology (NIST); the Systems Administration, Networking and Security (SANS) Institute; and other federal and industry experts, to ensure that the Postal Service is aware of emerging threats, vulnerabilities, mitigation approaches, and vendor patches.

The information security strategy will only be effective if individuals responsible for implementing policy, process, standards, and technology controls implement and maintain up-to-date practices. This substrategy includes activities to monitor compliance with policies to ensure that the Postal Service's technology environment achieves and maintains the desired level of security. The Postal Service will monitor user activities such as the acceptable use of e-mail, the Internet, and copyrighted software; network traffic; application and data access; computer intrusions; and other common threats and vulnerabilities.

Milestones

- Draft and publish compliance operating procedures (2002 through 2003)
- Produce reports that contain metrics for monitoring, review, and audit activities (Ongoing)
- Conduct periodic network scans with automated tools (Ongoing)
- Manually spot-check policy and process compliances (Ongoing)

Metrics

- Number of initial and repeat audit findings
- Number of successful penetration attempts
- Number of policy violations identified

Interdependencies

Development of new threats and advances in technology

Upgrade the Infrastructure

Overarching Objective

The Postal Service must continually upgrade and reengineer the computing infrastructure to support current and new business requirements. Improvements in the technology infrastructure are essential if the Postal Service is to become more efficient and reduce operating costs. The postal computing environment involves three tiers of computing: distributed, mainframe, and midrange. Each of these environments must be managed as separate upgrades, but all three efforts must be tightly integrated to provide seamless computing across the enterprise.

The upgraded infrastructure supports improvements in internal computing as well as enhancements to internal service offerings. These services leverage the improved infrastructure to expand its line of standardized technology solutions and automated administrative functions. The first service-focused strategy, technical shared services, provides mechanisms to build integrated rather than stove-piped applications. The second service-focused strategy, corporate shared services, utilizes the upgraded infrastructure to reengineer back-office functions, such as finance and human resources, across the enterprise.

Strategy: Leverage technological advances and business partnerships to upgrade and leverage the infrastructure

Substrategy 1: Upgraded distributed computing infrastructure

Background

Distributing innovative technology within the organization has enabled the Postal Service to realize productivity gains and remain viable in the competitive marketplace. One of the main initiatives that supports this strategy is the Advanced Computing Environment (ACE) initiative, which encompasses the planning, design, and implementation of a suite of services that updates the distributed computing environment. This initiative includes replacing out-of-warranty hardware and software products; upgrading existing technology and processes; and enhancing the stability, reliability, and availability of the existing infrastructure.

By rejuvenating aging and obsolete components of the distributed computing infrastructure, ACE reduces operational costs, increases levels of service, provides the Postal Service with a competitive advantage, and provides a framework for rapid deployment of business systems solutions. ACE renews all aspects of the distributed computing environment: user support, help desk support, application services, architecture, and governance. It upgrades 200,000 personal computers and 18,000 servers in a consistent manner—with a standardized approach to enterprise architecture and managed services.

In addition to ACE, the Associate Office Infrastructure, the Headquarters Infrastructure, the Field Infrastructure, Plant Upgrade / Wiring, and the Mobile Data Collection Devices are initiatives that support this strategy.

Milestones

- Replacement of workstations at Headquarters (2002 through 2003)
- Replacement of Headquarters-associated workstations at facilities (2003 through 2004)
- Replacement of workstations at field sites (2003 through 2005)
- Upgrade of the messaging system across the Postal Service (2002 through 2004)
- Consolidation of help desks (2002 through 2003)
- Reduction of contractor resources that provide technology support to the field (2003 through 2005)
- Upgrade of the Associate Office Infrastructure (2003 through 2005)
- Migration of legacy applications to Web-enabled systems (2002 through 2006)
- Replace Mobile Data Collection Device (2005 through 2007)
- Refresh of all components based on technology changes (2005 through 2009)

Metrics

- Reduce total cost of ownership on desktop computers by 25-40 percent
- Reduce application development times by 50 percent
- Significantly reduce security vulnerabilities
- Reduce deployment times for new applications by as much as 90 percent

Interdependencies

The ongoing effort to consolidate data, which is outlined in the Data Access and Integration section of this plan.

Obstacles

The size and complexity of the technology infrastructure offer significant challenges in that few organizations have a similar size and scope (implementations within the Postal Service are often the largest within the industry).

Substrategy 2: Upgraded mainframe computing infrastructure

Background

The mainframe computing environment is where the majority of the Postal Service's business computer processing takes place. Today this computing environment is located in Minneapolis, Minnesota, and San Mateo, California, with backup and disaster recovery sites in Raleigh, North Carolina. These computers house and process all of the databases for the corporation, including those that support over 1,200 applications that enable Postal Service customers, business partners, and postal managers to perform their day-to-day jobs. Items that require continual upgrades or replacement as industry changes are introduced are as follows: hardware, operating system software, application software, disk storage, and data warehouse.

The three major programs that support this strategy are Corporate-wide Software, eBusiness IT Infrastructure, and Enterprise Infrastructure Utilities.

Milestones

- Upgrade disk storage for additional backup capabilities (2003 through 2008)
- Upgrade and replace operating system software (Annually)
- Implement additional data warehouse capabilities (2003 through 2007)
- Replace or upgrade vendor application software releases (Annually)
- Replace mainframe computer hardware (2004 and 2007)

Metrics

- Reduce one-time support costs by 20 percent
- Improve speed of service
- Render data and information available on-demand

Interdependencies

The following initiatives which are outlined in the *Transformation Plan*: enhanced security across all technology, value-added services, universal computing connectivity, and data access and integration.

Obstacles

The size and complexity of the technology infrastructure offer significant challenges in that few organizations have a similar size and scope (implementations within the Postal Service are often the largest within the industry).

Substrategy 3: Upgraded midrange computing infrastructure

Background

Of the three levels of the technology computing environment, the midrange computing level is the least costly applications, operations, and support services. This is the newest computing environment in the industry and not all applications can run on this technology. Most companies use this environment to support the newest technological and application changes while not jeopardizing the legacy computing on the mainframe. Over time, approximately 30 percent of the workload from the mainframe environment will migrate to this midrange computer environment, because costs can be reduced.

The two major programs that support this strategy are the Postal Field Computing Infrastructure and the Mid-Range Systems Support.

Milestones

- Provide additional UNIX computing capabilities (2002 through 2005)
- Consolidate and replace all VAX computing (2002 through 2003)
- Establish improved UNIX production support expertise (2003 through 2006)

Metrics

- Total cost of application support is reduced
- All like computing is centralized
- Better application support is provided

Interdependencies

The Shared Services strategy and the Workforce Planning initiative.

Obstacles

The size and complexity of the technology infrastructure offer significant challenges in that few organizations have a similar size and scope (implementations within the Postal Service are often the largest within the industry).

Substrategy 4: Technical shared services

Background

This initiative leverages the infrastructure upgrades by improving information technology service offerings, including products, services, and processes. It is part of a larger Shared Services business model that the Postal Service is using for all support functions. Shared Services has been proven in a number of Fortune 500 organizations to increase organizational effectiveness, improve quality of services, reduce administrative workhours, and improve customer service levels, while realizing significant cost savings. Shared Services will utilize the upgraded infrastructure to allow the internal service areas in the Postal Service to be transformed from a purely administrative provider to a strategic partner within the organization.

In a continued effort to reduce the time it takes the technology organization to deliver systems and services to the organization, the Postal Service provides mechanisms for building integrated, rather than stove-piped applications. They are more efficient because they concentrate resources and expertise. Technical Shared Services are also readily adaptable to process improvements and performance measurement. Common examples of these services are data communications, transaction processing, and access control, applications development, consulting, customer support, deployment, and training.

Milestones

- Application development, enhancement maintenance service (2004 through 2008)
- Corporate software licensing and hardware (2002 through 2007)
- Customer support services — Help Desk (2004 through 2006)
- Data acquisition and presentation service (2003 through 2006)
- Data warehouse services (2003 through 2006)
- Secure file transfer services (2004)
- Data base support services (2002 through 2008)
- Disaster recovery service (2002 through 2007)
- Distributed enterprise management services (2005)
- Distributed hardware and software deployment and support (2002 through 2007)
- Host Computing Services (2002 through 2009)

Metrics

- Reduction in development costs
- Reduction in time to build systems
- Improved reporting
- Reduction in time required to respond to changes or challenges confronting the Postal Service

Interdependencies

Infrastructure upgrades and the integration of Shared Services initiatives across the enterprise.

Substrategy 5: Corporate shared services

Background

Corporate shared services focus on those initiatives that utilize the upgraded infrastructure to reinvent the Postal Service’s back-office by reengineering human resources, finance, accounting, purchasing, and technology functions across the enterprise. Examples of corporate shared service initiatives include: the Standard Accounting Field Retail system, the Accounting Shared Services system, the Injury Compensation system, and Self Service activities, which are intranet-accessible.

Milestones

- Standard Accounting Field Retail (2002 through 2004)
- Accounting Shared Services (2002 through 2005)
- Injury Compensation (2003 through 2006)
- Self Service activities via the Postal Service Intranet (2003 through 2008)

Metrics

- Reduction in labor costs
- Reduction in time required to complete administrative activities
- Improved reporting
- Reduction in time required to respond to administrative changes or challenges

Interdependencies

Leveraging of the technology, infrastructure, and processes involved in all the various shared service initiatives from each business area.

Provide Universal Computing Connectivity

Overarching Objective

The Postal Service must continue to leverage its greatest asset by expanding the uses and the availability of the network to provide a means of reducing the Postal Service operational, training, travel, and other expenses. Expanding the use of the network will also ensure that postal employees are as productive as possible and can be “connected”—anywhere, anytime—providing significant cost savings.

Real labor cost savings will be realized as the network continues its support function for the finance and human resources areas, and becomes an integral work conduit in the operations area. An up-to-date, robust network will improve productivity and replace workhours in virtually every area of the Postal Service. To support all Postal Service, business partners, and interagency partners, the Postal Service requires a highly reliable and secure network—for voice, data, and video transmissions—available twenty four hours a day, seven days a week.

Strategy: Expand core / backbone, wide area network, and local area networks to provide universal computing connectivity

Substrategy 1: Consolidated voice, data, and video network

Background

The network continues to play an increasingly important role in all business areas of the Postal Service, from finance to human resources to mail processing to business partners. Internal, external, and interagency partners also rely on this network. With these demands on the network, upgrades are imperative if the network is to continue to meet these service requirements.

The current network infrastructure supports over 35,000 locations via 15,000 dedicated landlines and VSAT connections and over 38,000 dial-up, cable, and high-speed remote connections. While it is highly reliable and meets many of today’s postal requirements, it falls short in other areas. There are many video, voice, and other high-speed requirements that the current network infrastructure cannot meet. Not being able to meet these requirements severely limits the operational uses of the network.

The three programs that support this strategy are Telecommunications Network Operations, Telecommunications Voice Service, and Telecommunications Equipment and Wiring.

Milestones

- Evaluate all point to point existing and proposed networks (2003 through 2004)
- Consolidate mail processing networks (FRES, RBCS, PARS, and APPS) into the current MNS network (2003 through 2008)
- Develop Request for Proposal/Statement of Work for high-speed managed network services (2003 through 2006)

- Evaluate new managed network services proposals (2004 through 2006)
- Award new managed network services contract (2005 through 2006)
- Expand network services to other government agencies (2005 through 2008)

Metrics

- Track number of users, devices, and types of devices (data, voice, video, servers, desktop, laptop, and wireless devices) supported
- Provide availability and response time statistics

Interdependencies

The investigation of the use of a shared, high-speed network to support the current and proposed mail operations point-to-point networks.

Obstacles

The size and complexity of the technology infrastructure offer significant challenges in that few organizations have a similar size and scope (implementations within the Postal Service are often the largest within the industry).

Substrategy 2: Wireless technology

Background

In providing connectivity anywhere / anytime to its two thousand line managers and executives, the Postal Service has a wireless initiative underway that supports e-mail, calendar features, pager capabilities, work tasks management, address book information, and Internet access all in one device. The next generation of this technology will combine cell phone services. This wireless service will also enable Information Technology to be able to offer business continuity of operations for contingency purposes. Today, approximately two hundred users are connected via wireless technology. In addition to receiving e-mail anytime / anywhere, these wireless devices provide alerts (both visually and audibly) on the status of major applications within the postal environment. Such connectivity is exceptionally critical to the Postal Service since managers supervise the mail twenty four hours a day, seven days a week. The Postal Service is also planning to use this wireless system for disaster recovery operations. Since these devices work outside of the e-mail system, communication to key personnel can be maintained in the event of an emergency. The next logical step is access to mission critical applications via wireless technology using the same devices. This wireless access will provide a seamless view of an application regardless of whether the manager is at his or her desk or walking the floor of a plant. The future for these devices within the Postal Service is bright. As the costs of airtime and devices fall, it is becoming increasingly cost-effective to use wireless devices to conduct day-to-day business. The speed of information flow for wireless devices is also expected to increase dramatically over the next few years, allowing for more sophisticated applications.

Milestones

- Create wireless solution for daily management and contingency plans (2002 through 2003)
- Deploy wireless solution to all headquarters officers and managers (2002 through 2004)
- Deploy wireless solution to all field officers and managers (2003 through 2004)
- Provide and implement cost savings capabilities (2003 through 2007)

Metrics

- Usage of the wireless devices
- Increased productivity for management
- Savings of management time
- Efficiencies in problem resolution for operational issues

Interdependencies

Infrastructure upgrades

Obstacles

The size and complexity of the technology infrastructure offer significant challenges in that few organizations have a similar size and scope (implementations within the Postal Service are often the largest within the industry).

Postal Inspection Service — Safety

Overarching Objective

People are the greatest asset of the Postal Inpection Service. The safety of postal employees, customers and facilities is paramount for the Postal Inspection Service[1] in ensuring a safe work and business environment.

Background

Through the years, the Postal Inspection Service has established itself as uniquely qualified to provide safety and security for Postal Service employees and customers. This has been accomplished through its law enforcement and at one time, audit authority. The dedication of Inspection Service employees, their commitment to the mission, and the quality of their work has provided the Postal Service and the U.S. government with unquestioned value.

In the past, the Postal Service's greatest threats against safety came in the form of criminal acts such as robberies and assaults of employees and customers. Recent events have added terrorism to the list. The Inspection Service must continue to enhance its services, both in number and rigor, in order to protect postal employees

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[1] The Postal Inspection Service is a highly specialized, professional organization performing investigative and security functions essential to a stable and sound postal system. As fact-finding and investigative agents, Postal Inspectors are federal law enforcement officers who carry firearms, make arrests, and serve federal search warrants and subpoenas. Inspectors work closely with U.S. attorneys, other law enforcement agencies and local prosecutors to investigate postal cases and prepare them for court. There are approximately 2,000 Postal Inspectors stationed throughout the United States who enforce more than 200 federal laws covering investigations of crimes that adversely affect or fraudulently use the U.S. Mail and postal system.

and customers. Through its unique role of providing security prevention and investigative services, the Inspection Service strives to foster a safe working environment and make every effort to prevent injury or death.

Strategy: Ensure a safe, secure, and drug-free work environment

Substrategy 1: Reduce and deter employee-on-employee assaults and credible threats

- Partner with the Postal Service to establish Threat Assessment Teams (TATs) in each performance cluster, participate in orientations for newly formed TATs, train with the TAT and attend regularly scheduled TAT meetings
- Coordinate with TATs in preventive and investigative efforts to prevent employee-on-employee credible threats and assaults
- Provide immediate response and investigation for all assaults
- Seek prosecution and removal of all employees responsible for all assaults

Benefits

This program will provide a safer working environment for postal employees; increase employee morale, well being and productivity through reduced fear and stress; provide a safer business environment for customers; and enhance the Postal Service image in the eyes of the public.

Substrategy 2: Deter robberies of postal employees and facilities

- Collaborate with Security Control Officers to perform risk assessments of facilities and install countermeasures
- Develop and implement preventive, deterrent, and investigative strategies for robberies
- Conduct priority investigations when robberies occur to solve all robberies

Benefits

This program includes a safer working environment for employees and business customers, a reduction in serious injuries and deaths, and increased moral of employees through reduced fear and stress.

Substrategy 3: Reduce and deter illegal drugs in the postal environment

- Identify facilities with workplace drug problems and implement preventive, deterrent and investigative strategies
- Maintain an intelligence system to document information regarding narcotics problems in order to track problems within a specific facility

In addition to the above substrategies, the Inspection Service will emphasize programs, which address the immediate needs of the Postal Service due to terrorist and bio-terrorist attacks against the Postal Service and the American public. The programs, while continually active, are being reassessed to ensure proper service levels.

- Provide security at postal facilities where risk, vulnerability, and history demonstrate the need for an armed presence
- Ensure the security of the mail during sanitization procedures
- Develop proactive mail screening techniques to detect hazardous mailings
- Conduct and assist other agencies in the investigation of terrorist threats
- Continue to support the hazardous materials program (HazMat), by providing enforcement support for violations under the criminal code (Title 18 U.S.C.)
- Continue to provide the technical expertise in the Postal Service Aviation Security Program
- Establish and enforce a national photo identification program for Postal Service personnel
- Coordinate with personnel offices to ensure the Postal Service hiring practices include proper background investigations

Benefits

The benefits of this substrategy include a safe and healthy work environment for postal employees; an increase in morale and productivity; a reduction in crime in the postal environment, including crimes of violence; reduced accidents; and a reduction in unscheduled absences and workers’ compensation claims. Also, this program includes improved safety for postal employees through enhanced perimeter security and reduced assaults, robberies, and other criminal activity.

In addition, safer postal facilities and operations, enhanced expertise and readiness in responding to critical incidents, and less risk and exposure for postal employees and customers to hazardous situations and materials will also be realized.

Metrics

The following three charts depict the trends and results of Inspection Service investigative work in recent years. Success in these programs has helped sustain the trust the public puts in the U.S. mail system.

CHART 1: ASSAULTS AND THREATS

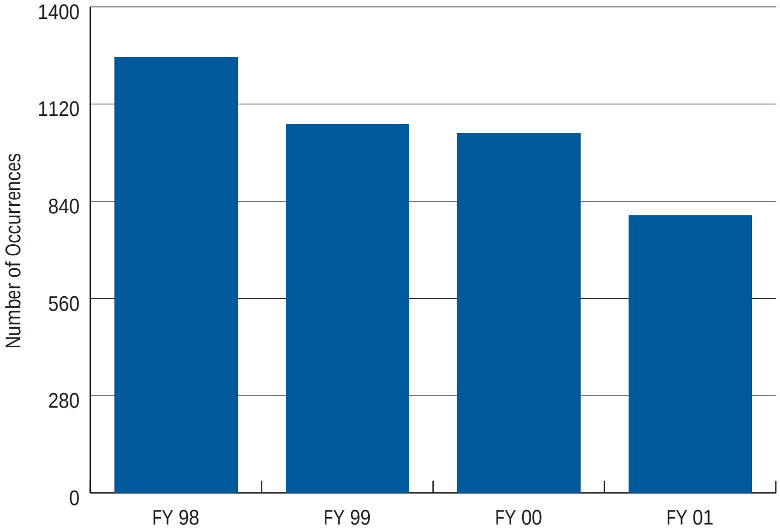


CHART 2: ROBBERIES

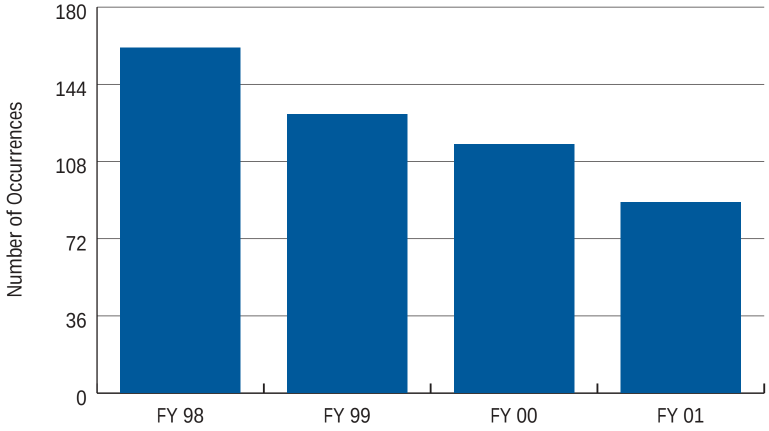
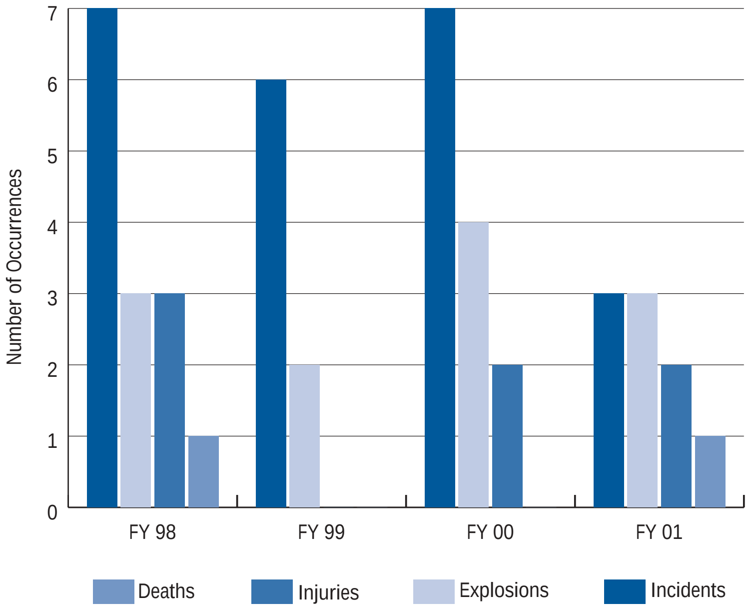


CHART 3: MAIL BOMB INCIDENTS



Interdependencies

While the Inspection Service conducts investigations and makes recommendations concerning security initiatives the implementation is the responsibility of Postal Service management. The Inspection Service also depends on the cooperation of postal managers and bargaining-unit officials and employees to participate in security initiatives.

The Inspection Service works with multiple federal, state, and local law enforcement agencies to complete successful investigations in these program areas. Support is also obtained from intra-agency groups such as the Forensic and Technology Support division, Career Development division, and Information Technology division.

Obstacles

Hazardous Mailings

- New threats posed by bioterrorism
- Early detection of biohazards in the mail stream
- Lack of industry knowledge regarding biohazards

Postal Inspection Service — Security

Overarching Objective

Providing for the security of the mail and postal products, services and assets is integral to the Inspection Service's mission to protect the Postal Service from criminal attack.

Background

Inspection Service security programs address crimes affecting the mail, postal operations, and revenue which can undermine postal operations and erode the financial stability of the Postal Service. The American people have relied on the U. S. mail to conduct the commerce of the nation and the value added by the Inspection Service must ensure this tradition continues.

Combating mail theft is essential to ensuring that the Postal Service is successful in its core function of delivery. Mail theft techniques have become more sophisticated and widely divergent in some geographic areas. Criminals no longer focus on taking the single piece of mail from the mailbox, but focus on large volumes of mail, from which they obtain information useful to perpetrate other criminal endeavors. While the Inspection Service was successful in past years in reducing the number of these volume thefts, they have resurfaced in certain geographical areas. Investigative attentions have been focused to address the areas with the most severe problems. At the same time, control of the problems in other areas must also be maintained to avoid a reoccurrence of a national problem.

Given the difficult financial position of the Postal Service, the Inspection Service must remain vigilant in investigating and preventing any crime, from both internal and external perspectives, which may negatively impact postal revenues. These crimes include embezzlements, burglaries, workers' compensation fraud and schemes to underpay postage. Now more than ever, the Inspection Service must work to ensure the security of the mail while in transit. This is not only a security issue, but overlaps into ensuring the safety of postal employees and customers.

Strategy 1: Reduce theft of mail

Substrategy 1: Reduce and deter attacks on postal vehicles, apartment panels, collection boxes, neighborhood delivery collection box units and collection box units

- Target investigative and preventive attention
- Implement effective countermeasures and strategies
- All divisions will monitor mail theft trends and aggressively address negative trends

Substrategy 2: Identify and resolve domestic and international in-transit mail theft

- Identify domestic and international airports with in-transit mail theft problems
- Implement preventive, deterrent, and investigative strategies
- Ensure only Postal Service related ground-handling employees have access to mail
- Conduct airport mail security reviews

Substrategy 3: Reduce and deter mail theft-related identity theft and identity takeover crimes

- Implement preventive, deterrent and investigative strategies
- Identify post office boxes or individual commercial mail receiving agency boxes used to commit identity theft
- Where appropriate, pursue administrative actions

Benefits

This program will reduce mail theft, identity takeover schemes and customer losses, thereby increasing customer trust and confidence in the Postal Service. Our efforts at airports will also enhance the security of international mail.

Strategy 2: Reduce and deter criminal attack of postal products, services and assets

Substrategy 1: Reduce and deter embezzlements

- Increase investigative attention to embezzlement of postal funds at retail stores and other offices under Segmented Inventory Accountability

Substrategy 2: Reduce and deter criminal misuse of the Postal Service's workers' compensation program and reduce long-term compensation cost

- Identify criminal misuse of the Postal Service's workers' compensation program

Substrategy 3: Reduce and deter postage fraud schemes

- Identify high-risk postage fraud areas and prosecute perpetrators through criminal and civil actions

The benefits of these strategies will protect postal revenue by reducing the number of employee embezzlements, increase the ability to investigate embezzlements related to new financial systems, reduce fraudulent claims by employees, assist in the maintenance of the financial health of the Postal Service and reduce the Postal Service's vulnerability to postage fraud schemes.

In addition to the above strategies the Inspection Service will emphasize programs, which address the immediate needs of the Postal Service due to terrorist and bioterrorist attacks against the Postal Service and the American public. The programs, while continually active, are being reassessed to ensure proper service levels.

Substrategy 4: Ensure sanctity and security of U.S. mail

- Evaluate compliance with security programs to ensure the sanctity of U.S. mail handled by the Postal Service and contractors
- Ensure the accuracy and reliability of the Postal Service mail condition reports used by the Postal Service and contractors
- Identify security related issues, concerns, or conditions that require corrective action by postal management
- Security escorts of high-value shipments such as registered mail and postal remittances when necessary

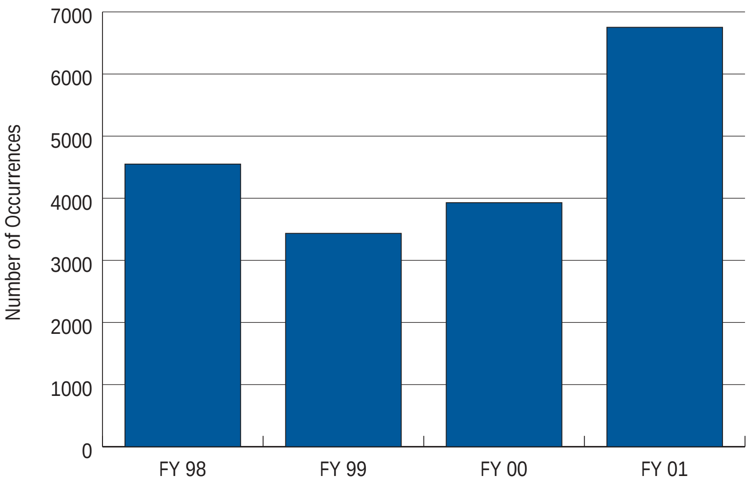
Substrategy 5: Assist postal management in the deployment and implementation of new safety and security procedures and technology

Investigative efforts in these areas will assist in promoting a secure business environment for postal customers and maximize the security of postal facilities, products and services. Additionally, the Inspection Service will work in an advisory capacity with postal management concerning new technology requirements to address the safety and security of employees and the mail.

Metrics

Charts four through seven depict the trends and results of Inspection Service investigative work in recent years. The Inspection Service has done an outstanding job in the area of burglaries, but must continue to monitor occurrences to ensure the program is maintained. In other investigative programs, the Inspection Service needs to maintain aggressive investigative and preventive attention.

CHART 4: VOLUME THEFTS



National mail thefts from receptacles or deposit points serving multiple customers.

CHART 5: BURGLARIES

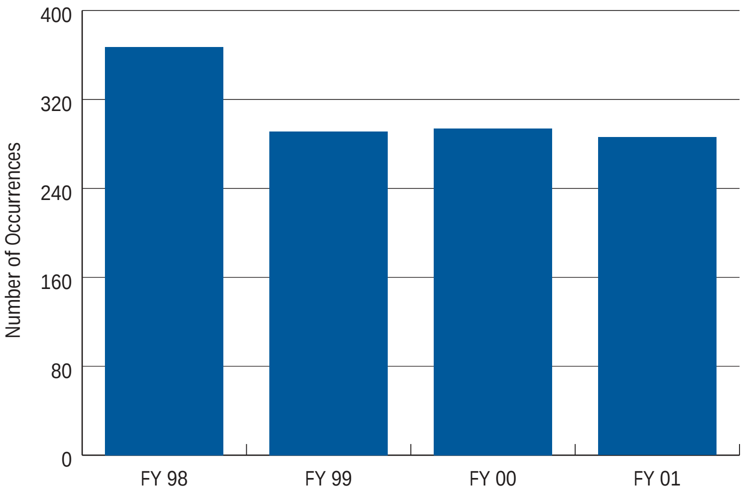


CHART 6: EMBEZZLEMENTS

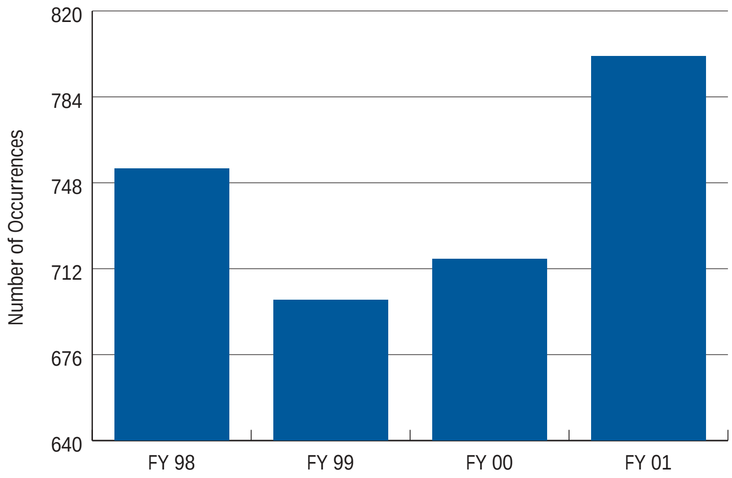
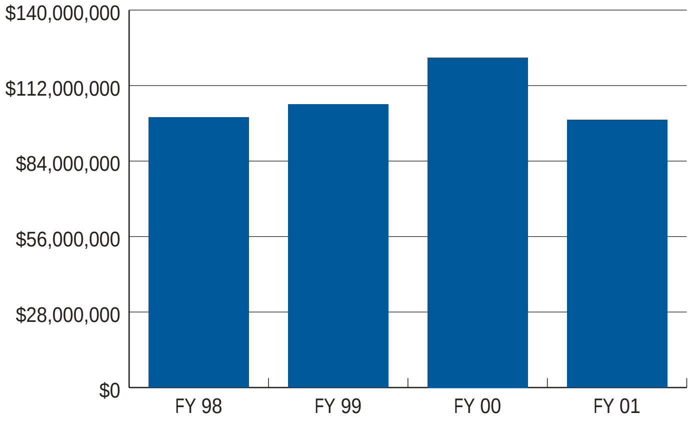


CHART 7: WORKERS' COMPENSATION FRAUD



Compensation and COP savings identified through investigations.

Interdependencies

While the Inspection Service conducts investigations and makes recommendations concerning security initiatives the implementation is the responsibility of Postal Service management. The Inspection Service also depends on the cooperation of Postal managers to implement recommendations and to apply administrative actions when necessary.

The Inspection Service works with multiple federal, state, and local law enforcement agencies to complete successful criminal investigations in these program areas. Support is also obtained from intra-agency groups such as Forensic and Technology Support division, Career Development division, and Information Technology division.

Obstacles

Mail Theft

- Implementation of all preventative initiatives
- Loss of expertise through attrition
- Under-utilization of technical tools
- Timeliness and quality of mail loss data from customers and business partners

Revenue and Asset Protection

- Investigative leads rely heavily on tips

Sanctity of the Mail

- Cooperation with business partners
- Enforcement of regulations and compliance by postal managers

Postal Inspection Service — Integrity

Overarching Objective

The Inspection Service protects the integrity of the Postal Service by combating the furtherance of crimes using the postal system.

Background

The Postal Inspection Service has investigative responsibility to protect the postal system from criminal activities. This is accomplished through criminal investigations in the areas of mail fraud, illegal drugs in the mail, money laundering and child exploitation.

The Inspection Service often takes the lead in responding to mail fraud schemes relating to telemarketing, mail orders, insurance and investments. Mail fraud is expected to increase as more promoters take advantage of the perceived anonymity of the Internet. These cases ultimately involve the use of the mail. The Inspection Service must maintain its proficiency with traditional mail fraud investigations, while improving skills related to Internet cases.

The Postal Service cannot allow its vast distribution and delivery network to be used to assist criminals in illegal activities such as the transportation of illegal substances and child pornography or to use its financial network to launder funds obtained through illegal activities. Inspection Service investigative attention in these areas fulfills the mandate to sustain America's trust in the U.S. mail.

Strategy 1: Reduce the use of the mail to defraud consumers, businesses and government agencies

Substrategy: Reduce and deter the use of the U.S. mail for the procurement or delivery of materials that promote the sexual exploitation of children

- Continue to support a nationwide child sexual exploitation initiative with the Department of Justice
- Enhance use of the Internet as an investigative tool
- Implement prevention and education strategies to protect children from sexual exploitation

Benefits

This program will ensure fewer children are at risk for sexual exploitation, identify and stop child molesters, assist in rescuing children from ongoing sexual abuse, and reduce child pornography in the mail and the Internet.

Strategy 2: Reduce and deter the use of the postal system for prohibited, illegal, and dangerous mailings

Substrategy 1: Reduce and deter multistate domestic and international telemarketing operations and direct mail operations

Identify and disrupt multistate domestic and international fraudulent telemarketing mailing operations and direct mail solicitations with call-back numbers.

Substrategy 2: Reduce and deter deceptive mailing operations

Identify and disrupt deceptive mailing operations by utilizing information from established contacts, referrals, the Fraud Complaint System (FCS), Consumer Sentinel, Publication Monitoring or those investigations referred by the national Postal headquarters Deceptive Mail Enforcement Team.

Benefits

This program will improve customer confidence in the integrity of the postal system through reduced incidents of fraudulent use of the mail and by reducing the economic losses to individuals, customers, businesses and government agencies stemming from fraudulent activities using the mail.

Substrategy 3: Reduce and deter the use of the nation's mail system by organized groups to transport illegal narcotics

- Conduct national drug interdictions coordinated by Postal Service Headquarters
- Identify and disrupt organized, illegal drug shipment groups using the mails
- Focus attention on interagency task force interdictions of mail and private carriers

Benefits

This program will include increased safety of postal employees from violence related to drugs transported through the mail and a decrease in the use of the mail to ship illegal drugs.

Substrategy 4: Reduce and deter the use of U.S. Postal Money Orders to launder money by disrupting money laundering operations

Identify and disrupt money laundering operations in high intensity financial crime areas and other geographical areas identified through intelligence and analysis of statistical data.

Benefits

This program will include reduced use of the postal system for money laundering operations, protection of the Postal Service's Money Order system from illegal activity, and disrupting the ability of criminal groups from profiting from illicit proceeds, thereby instilling trust in the Postal Service.

Metrics

The table below depicts the trends and results of Inspection Service investigative work in recent years. Success in these programs has helped sustain the trust the public puts in the U.S. Mail system.

Mail Fraud

	FY 2000	FY 2001
Arrests	1,633	1,691
Convictions	1,377	1,477

Illegal Drugs in the Mail

	FY 1999	FY 2000	FY 2001
Arrests	1,537	1,575	1,662
Drugs (lbs.)	15,436	9,335	8,000
Money ($ Million)	6.5	3.5	3.5

Money Laundering

	FY 2000	FY 2001
Arrests	96	111
Convictions	42	52

Child Exploitation

	FY 1999	FY 2000	FY 2001
Arrests	163	257	335

Interdependencies

The Inspection Service works with multiple federal, state, and local law enforcement agencies to complete successful investigations in these program areas. Support is also obtained from intra-agency groups such as Forensic and Technology Support division, Career Development division, and Information Technology division.

Obstacles

Child Pornography

Task force dependencies

Mail Fraud

- Trusting nature of the general public
- Reluctance of businesses to share proprietary information
- Mobility of criminals
- Increased use of the Internet

Illegal Drugs in the Mail

- Jurisdictional overlap

Money Laundering

- Effective inter-agency cooperation

Future Plans

With the advent of moderate postal reform, the Inspection Service’s role of providing security and conducting criminal investigations should remain relatively stable. The need for these services transcends all legislative frameworks. Should the Postal Service lose the postal monopoly on some products, it might become necessary to revisit the Inspection Service’s statutory authority, especially for deregulated product lines.

The Inspection Service must also consider the financial situation of the Postal Service, particularly the impact of declining revenue. Loss of revenue impacts funding for all postal operations including the Inspection Service. In light of new challenges due to terrorism and possible jurisdictional changes brought on by structural changes in other law enforcement agencies, such as the FBI’s focus on counterterrorism, adequate funding must be available to meet the investigative demands.

Some possible strategies to meet this situation include:

- Evaluate the impact of proposed legislative changes on the Inspection Service’s operations
- Strengthen liaisons with the Postal Service management to ensure the Inspection Service is meeting their needs
- Strengthen relations with Congress to ensure legislative adjustments allow the Inspection Service to operate in a manner conducive to the needs of the Postal Service
- Maintain liaison with the Department of Justice to be responsive to jurisdictional needs

- Prepare draft legislation to enable the Inspection Service to fulfill its mission
- Continued development of an intelligence analyst support function
- Enhance human resource capacity to ensure the appropriate placement and skill level of personnel
- Consider alternate sources of funding and appropriations

Inspection Service personnel are trained to address law enforcement and security issues and also possess an extensive knowledge of postal operations. This combined knowledge has added value to the Postal Service in providing service to its customers.

If the Postal Service were totally deregulated, the role of the Inspection Service would be in question. The need for an internal security program would still exist, much like any private industry needs corporate security. However, jurisdictional questions would arise and investigative programs would have to be reevaluated. Activities mandated by statute would have to be reviewed.

Some possible strategies in addition to those under moderate reform include:

- Consider expansion of jurisdiction to encompass private sector
- Adjust focus to corporate security
- Focus on meeting the needs of customers and consumers by being service driven and developing marketing strategies

Privacy

Overarching Objective

Ensure that the Postal Service maintains its trusted brand and provides top-rate privacy protection.

Background

The Privacy Office, established in November 2000, is responsible for ensuring that the Postal Service maintains its trusted brand, developed over its 225-year history, regarding safeguarding privacy. The privacy landscape is evolving. To ensure the Postal Service provides top-rate privacy protections in today’s world, the Privacy Office keeps up with developing legal and policy frameworks, new technologies, and business models and practices. The Privacy Office is also responsible for managing Privacy Act and Freedom of Information Act (FOIA) compliance.

To tackle these issues, the Postal Service employs a three-part program—people, policies, and processes. The Postal Service was among the first federal agencies to appoint a Chief Privacy Officer (CPO), who ensures that appropriate cross-functional groups are involved with setting policies and processes. The Privacy Office seeks to establish and implement privacy policies that reflect best practices of both government and industry. The office also continues to develop processes to ensure compliance with statutes and policies.

The Postal Service complies with both federal requirements and commercial guidelines. Adherence to federal privacy laws strengthens the Postal Service trusted brand, and allows the Postal Service to offer privacy assurances, backed by federal law, which private sector competitors do not. However, federal laws limit the ability of the Postal Service to collect, use, and sell customer data like other businesses. Federal privacy and FOIA laws also impose certain compliance requirements on the Postal Service that do not apply to private sector competitors.

Strategy 1: Standardize privacy policies and processes

- Establish enterprise-wide privacy policies across channels and customer segments
- Create uniform privacy clauses for contracts and alliances
- Establish a uniform privacy and FOIA handbook and training

Strategy 2: Streamline compliance procedures to reduce costs and increase productivity by saving time

- Rewrite all customer Privacy Act Systems of Records
- Simplify Privacy Act clearances and improve FOIA tracking

Strategy 3: Work with internal and external groups to ensure that privacy is built into data-oriented initiatives

- Establish and communicate standard processes for business drivers
- Work with drivers of personalization initiatives (marketing efforts based on customer data) and intelligent mail service (knowledge of mailer and its mail throughout the postal system).

Metrics

- Reduction in labor costs through streamlined procedures
- Increased compliance through standard processes
- Increased value in Postal product and service offerings to customers through proper use of customer data
- Recognition of the Postal Service as developer of best-in-class privacy policies and practices

Interdependencies

While the Privacy Office is responsible for developing privacy policies and processes, the office coordinates heavily with other functions in this development and to ensure successful implementation and compliance. The standardization and streamlining activities are significant undertakings, and require extensive coordination with other departments. Standard policies must be developed carefully to promote the Postal Service trusted brand, but yet be workable for business units. Personalization and intelligent mail activities will require buy-in from stakeholders, customers, and mail recipients.

Moderate reform. The Postal Service would need to ensure the appropriate transition and sharing of information between competitive and noncompetitive business lines, within any parameters set by Congress. Competitive business units would need to embrace commercial practices, while still complying with applicable statutes and voluntary policies that the Postal Service adopts.

Structural reform. In a more commercial setting, the Postal Service would have more freedom to set policies regarding use of customer data—these issues should be examined very carefully, taking into account brand strategy and customer expectations. The Postal Service would need to balance greater flexibility, business needs, and acceptance by customers. Internally, the Privacy Office would continue to need substantial integration with key stakeholders. The focus of the privacy program would be on establishing appropriate policies and processes in this environment. Regulatory requirements that do not support the brand could be eliminated.

Obstacles

The use and transfer of data may be hampered, and, under structural reform, the Postal Service brand may be impacted. There is considerable sensitivity surrounding Postal Service customer data as well as expectations around use of that data.

Moderate reform. Under moderate reform, there may be continuing restrictions on how customer data is used, and new restrictions placed on the transfer of data between business units. Competitors and regulators may object if new business units are able to transport customer data from existing units, compromising the Postal Service’s ability to implement strategies. Moderate reform, which may create these two separate business units, could hamper successful cross-business efforts by building a firewall between them.

Structural reform. The Postal Service brand image as a trusted third party provides strong privacy and security protections. Some of that brand value is linked to being a government entity that is required to adhere to federal privacy laws. Without government backing and enforcement, the Postal Service risks losing some of its credibility as a trusted third party. Policies the Postal Service adopts may also impact the brand.

Appendix R

APPENDIX R — Postal Regulation

The Postal Rate Commission

This appendix provides a brief explanation of the Postal Rate Commission (PRC) and its statutory powers. It also compares this authority to the regulatory models of selected foreign posts and traditional U.S. regulatory agencies. When Congress approved the Postal Reorganization Act of 1970, Title 39, U.S. Code, it also created the Postal Rate Commission, Title 39, Chapter 36, as an independent establishment of the executive branch to provide independent expertise in setting postal rates. The Senate proposal envisioned an independent commission within the Postal Service itself, while the House bill created an independent agency. The House version prevailed in conference, and the Commission was directed to provide recommended decisions to the Governors of the Postal Service on rates, fees, and mail classifications; the Postal Service was directed to provide funding for the new Commission**.**

The Commission thus has jurisdiction over changes in domestic postal rates, fees and mail classifications proposed by the Postal Service**,** but not over rates and classifications for international postal services. It issues Recommended Decisions to the nine Presidentially appointed Governors of the Postal Service, who in turn have four options: 1) approve the recommended rates; 2) allow the recommended rates to go into effect but under protest; 3) reject the recommendations and request reconsideration by the Commission; or 4) after rejection and reconsideration, and upon unanimous vote of all Governors then holding office, modify the recommendations to balance revenue with costs. Twice, in rate cases filed in 1980 and in 2000, the nine-member Board of Governors has modified the rate recommendations of the Commission.

The President appoints five Commissioners, no more than three of whom may be from the same political party. The President also designates the Chairman, either from sitting members of the Commission or through a new appointment. Members are confirmed by the Senate for six-year terms, subject to an additional “hold-over” year in absence of a new confirmation. The Commission, which has about 55 full-time employees, operates with a multi-disciplined professional staff of about 25 who are trained in law, economics, statistics, and cost accounting.

The ratemaking process attempts to answer two key questions: 1) how much revenue is needed to operate the postal system in a “test” year? and 2) what rates and fees are appropriate to raise this amount? The Postal Reorganization Act establishes the guiding ratemaking principle that “Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations… will equal as nearly as practicable total estimated costs of the Postal Service,” 39 U.S.C. 3621. This provision is referred to as the *break-even* requirement.

Another ratemaking principle of the Act requires “that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type,” 39 U.S.C. 3622(b)(3). This provision requires the Commission to identify the costs caused by providing the various classes of service and to attribute those costs to the respective classes and subclasses. The remaining institutional, or overhead, costs of the Postal Service are assigned by reference to the other eight factors specified in 39 U.S.C. 3622(b). These criteria are: fairness and equity; value of service; effect of rate increases; available alternatives; degree of preparation; simplicity; the “educational, cultural, scientific, and informational value to the recipient of mail matter”; and other factors the Commission “deems appropriate.” The statutory factors that apply to classification decisions are similar.

Most rate and classification proceedings are initiated by a Postal Service request, although the Commission itself may also initiate classification proceedings. The request must contain supporting evidence demonstrating why the Service believes its proposals are consistent with the policies established by Congress.

Setting postal rates involves five major elements: 1) costing; 2) volume forecasting; 3) revenue requirement; 4) pricing; and 5) rate design. These elements are interrelated, and changes in the results of one may affect other elements. For example, a new volume forecast will affect both the costs of operating the postal system and the revenues generated by a given set of rates. Similarly, a change in the attributable cost estimate for a service may require a change in rates that will affect the volume of that service.

Prior to 1970, prices for mail services were set by law by the Congress. With enactment of the Postal Reorganization Act in 1970, Congress wanted to ensure that all interested segments of the public would have an opportunity to be heard before the Postal Service changed its rates or services. Thus, it wrote into the Act the requirement that the Commission “shall not recommend a decision until the opportunity for a hearing on the record under sections 556 and 557 of title 5 [the Administrative Procedure Act] has been accorded to the Postal Service, users of the mails, and an officer of the Commission who shall be required to represent the interests of the general public.**”** The Commission’s Office of Consumer Advocate carries out this latter function, 39 U.S.C. 3624(a).

Under the Administrative Procedure Act (APA), relevant and material evidence must be considered in Commission proceedings. The evidentiary record developed in omnibus rate cases reaches 35,000 to 40,000 pages of prepared testimony, oral and written cross-examination, and related exhibits. Another 350,000 or more pages of material, primarily data sets known as Library References**,** are also provided. These data involve myriad costing, pricing, market analysis, and public policy issues. In 1976, Congress enacted legislation responding to the Commission’s delayed decision in the second omnibus rate case, during which time the Postal Service sustained significant losses. The 1976 amendments to the Postal Reorganization Act required the Commission to issue its decision within 10 months.

This rate-setting procedure is highly technical and costly. Some active participants (known as “intervenors”) report spending $1.5 million or more per case on witnesses and attorneys to represent their interests. As a result, while 100 or more parties may intervene in an omnibus rate case, the proceedings are most closely followed by a relatively small number of companies and associations that are able to devote significant resources to the process.

How the role of the Postal Rate Commission differs from that of foreign postal regulators and traditional U.S. regulatory agencies

The regulatory role of the PRC can be contrasted to the role of postal regulators in other countries. In so doing, however, one must appreciate the fact that other countries have substantially different traditions with respect to economic regulation and political systems. In other industrialized countries, postal reform has advanced by transforming the incumbent postal operator into a business, in some cases partially owned by private parties, and by narrowing or eliminating the postal monopoly. In adopting these measures, other countries have generally concluded that some form of independent regulator is needed to help ensure that the incumbent postal operator maintains an appropriate degree of universal service and does not use remaining legal privileges or a dominant market position to compete unfairly against private companies. However, the degree of authority vested in the regulator and tools of regulation vary substantially.

In countries without a tradition of strong, independent regulation, the regulator's role is more that of an enforcer of public policies set by government than that of a definer of public policy. Thus, in Germany, for example, the government, by means of an administrative decree, establishes detailed criteria for universal service, measures for reasonableness of rates, and initiates procedures for rate review. The German regulator's role is limited to administration of these standards, a more ministerial function than that vested in the PRC. Similarly, members of the German regulatory authority do not appear to enjoy the same level of insulation from political pressure traditionally accorded American regulators. Likewise, in the Netherlands, the regulator's role is to administer directives issued by the minister. In the United Kingdom, whose regulatory tradition is closer to that of the United States, the postal regulator has been given broad discretion to regulate entry and price in the delivery services sector according to general public policy criteria set out in the statute. Indeed, the U.K. regulator acts more like a traditional U.S. regulator of private utilities than does the PRC. In Sweden, the regulator's authority falls between these two models.

Regardless of the level of discretion vested in the regulator, tools of regulation vary. The regulator may enforce price regulation either before rates go into effect (similar to the approach of the PRC) or after they have gone into effect (i.e., on complaint). Regulators may set rates according to actual costs or according to efficient costs not actually achieved by the post office. The regulator may employ price caps or set specific rates. In most countries (for example, Germany, Sweden, and the United Kingdom), the role of the regulator, unlike the role of the PRC, is to regulate the entirety of the licensed delivery services sector, not just the incumbent postal operator. Even in these countries, however, the burden of regulation falls more heavily on operators with a dominant position, a category that naturally includes the incumbent postal operator and may (for now) exclude all other operators.

Still another approach towards postal regulation is exemplified by New Zealand where the postal law has been revised, so that the delivery services sector is, in effect, just another industry, with no monopoly, no licensing, no universal service obligation, and no industry regulator. The law obliges all postal services to respect minimum public interest criteria, such as privacy of letters. These criteria are enforceable by the courts. Beyond this, the government of New Zealand ensures provision of universal service by means of a contract between itself and New Zealand Post, a corporation, all of whose shares are owned by the government.

The regulatory role of the PRC may also be contrasted with that of a more traditional independent regulatory agency in the United States. The prototypical regulatory agency in the United States is the (now abolished) Interstate Commerce Commission, created in 1887. The ICC was the model for the Federal Power Commission (1920), Federal Communications Commission (1934), and the Civil Aeronautics Board (1938), among others. The general scheme of regulation administered by such agencies may be summarized as follows.

Typically, the most basic power of the regulator is the authority to control market entry for an entire industry. The law first prohibits all private firms from providing a certain type of business without a certificate from the regulator. The regulator then grants certificates to private firms for provision of specific services or services on specific routes. The limited nature of certificates allows the regulator to maintain control over the structure of the industry. Typically, a regulator would not grant certificates to new entrants in a given area or for a given route unless it was convinced that new entry would not undermine the services of incumbent firms. The regulator is further authorized to attach conditions to a firm’s certificate to ensure that it serves the public interest. Indeed, the regulator may be authorized to compel a regulated firm to extend service to certain areas if it considers such service necessary for the public interest. Alternatively, the regulator may be authorized to issue contracts for necessary public services in areas not adequately serviced by the market.

In a traditional regulatory scheme, the regulator also has authority to regulate prices, conditions of service, and agreements among market participants. The regulator must not deny a firm a fair opportunity to earn a reasonable return on its investment, or take its property without due process. Thus, regulated firms are legally prohibited from charging rates that are unreasonably high or unreasonably discriminatory. In an investigation initiated either by complaint or by its own initiative, the regulator may suspend rates that it finds to be illegal under these standards. It may, or may not, be authorized to set new rates. In some cases, the regulator may be authorized to approve changes in rates before they could go into effect. The regulator may require regulated firms to provide certain services to meet perceived public needs or respond to customer complaints. The regulator is also typically empowered to approve agreements between regulated firms (or even between corporate units of a single firm) based on public interest criteria and to exempt such agreements from further scrutiny under the antitrust laws.

In contrast to this “standard model,” the role defined for the PRC is significantly more limited. The PRC does not regulate entry into the industry. The PRC does not regulate all firms in the delivery services sector; its responsibilities relate to only one undertaking, the Postal Service. Even for this one firm, the PRC does not have plenary authority, but rather shares oversight power with the Governors of the Postal Service, who are also Presidential appointees representing the public interest. The PRC has authority to review price changes prior to implementation, and provide a recommended decision to the Governors. Under limited circumstances, Commission recommendations can be modified by a unanimous vote of the Governors. Once rates are approved, the PRC’s ability to review and reject existing rates on investigation is limited. Nor does the PRC have general authority to regulate the services of the Postal Service or agreements between the Postal Service and other participants in the sector. The PRC also lacks powers, such as subpoena and cease-and-desist authority, that other regulators typically wield in regulating the private sector. Compared to “classic” regulatory agencies, the PRC has been established as a special purpose agency with a narrower focus and more limited functions.

Appendix S

APPENDIX S — Privatization — Process and Financing Issues[†]

Privatization is one transformation strategy that the Postal Service could pursue. However, under the umbrella of privatization—a process whereby the Postal Service reduces its ties to the government and moves toward partial or complete private stock ownership—there are multiple scenarios that could take place. As a Private Corporation, the Postal Service would need to have sufficient financing flexibility to access a broad array of sources of capital for its business activities. This is a crucial ingredient for financial success.

Privatization Methodologies

In undertaking a transfer of its ownership to the private sector, the government would likely review the routes that private sector organizations typically follow when conducting a similar transaction. Broadly speaking, these routes consist of an Initial Public Offering (IPO) and a Merger & Acquisition sale (M&A). Although variations of these two basic processes exist, the applicability of these variations to the government's ownership position with respect to the Postal Service is difficult to predict. Consequently, the following descriptions of these methodologies provide a point of departure regarding the privatization process and could be refined over time.

Initial Public Offering

An IPO is the initial sale to public investors of all or a portion of the common stock of a company through a syndicate of securities underwriters, dealers, and brokers. It is a well-established privatization method, under which the owner's equity in an enterprise is publicly sold to equity investors. In the case of the Postal Service, an IPO would represent some of the government's entire share. Investors in the IPO market generally seek financial returns from capital appreciation of the purchased stock and/or dividends paid by the company. An IPO transaction is a formal and transparent process regulated by the Securities and Exchange Commission (SEC). An IPO requires that a company prepare and file a registration statement to register the company's securities with the SEC. A syndicate of underwriters then typically sells an IPO to a geographically diverse mix of institutional and individual investors. These investors carefully review the investment merits of the company and compare its potential with that of many alternative investments. Therefore, the price in an IPO, by its nature, represents a broadly based market valuation of the business.

An IPO process would result in a value for the Postal Service that represents the judgment of a wide range of potential investors, prevailing market conditions, and the projected business outlook for the Postal Service. The process results in a market value that is tied both to the value of the company and to market conditions existing at the time of the sale. The offering price can be positively or negatively affected by investor knowledge or perception of the company, general industry and market conditions, and other external factors. Accordingly, the investor community must be well informed about the company to ensure a successful IPO.

[†] This appendix was prepared for the United States Postal Service by JP Morgan.

The company and the underwriters work together to maximize investor participation. They develop and market the investment “story” and conduct informational tours to meet with brokers, dealers, and potential investors. In addition, the underwriters work with the company to gauge the market to ensure that the offering is brought to the market at the optimal time. It would be important, therefore, that the government have some flexibility as to the timing of its offering of Postal Service common stock. Additionally, it would be critical that a firm, timely decision-making process be set up in advance for government approval of the final terms of the sale to maximize the chances of a successful offering.

Assuming that there would be a transition stage leading up to full privatization, the Postal Service would have had the opportunity to develop a partial track record for new products and services under a public-commercialized structure. In determining whether it can more completely sever its ties to the government, the Postal Service would need to demonstrate to private providers of capital two things: 1) that its business strategies are viable, and 2) its business prospects are good and will provide the financial returns these investors demand. In short, investors would need to be convinced of the value proposition put forward by the Postal Service in any particular business—i.e., that the Postal Service can add equal or greater value than other competitors seeking to tap similar sources of capital.

A compelling story for potential equity investors in a commercialized Postal Service would be exchanging aspects of the monopoly for new abilities to restructure costs, manage pricing and products, enter new markets, and limit government liabilities. The combination would increase profitability and attract investor interest; such a de-monopolization strategy follows the example of a number of European postal operators. In certain European examples, e.g. Dutch postal operator TPG, value was enhanced by the ability to enter competitive businesses before the loss of the monopoly and transitionally to finance new businesses through monopoly profits.

A total or partial Postal Service valuation in advance of any equity offering would require reviewing a broad set of issues. The most important component of a Private Corporation is that such a Postal Service would be granted powers to earn profit margins higher than today and, after transition, approach the margins of other industrial leaders.

Valuation — In General

In a typical IPO, valuation considerations are extremely important and complex. In a privatization like the Postal Service’s, where comparable companies may be harder to identify (depending on the structure and business lines of the privatized entity), proper valuation would be even more challenging. The goal in an IPO is to create a scarcity value for the company’s shares. This results in great demand for shares and a sustainable market-clearing price acceptable to both the issuer and new investors.

An underwriter and the issuer will agree on a marketing price range prior to the IPO. This price range will reflect an analysis of a number of quantitative and qualitative factors, including perceived quality of management, long-term earnings growth outlook, market conditions, comparable company trading statistics, use of proceeds and the offering structure. Sponsorship of the issuer by its commercial partners and underwriters is also critical to investor perception of the company.

An underwriter will work closely with the issuer and research analysts to develop a set of projections that reflect its earnings growth potential during the next two to three years.

The first step that investors will use to determine a benchmark for valuation is to identify comparable public companies. In the case of the Postal Service, this will depend on the business profile of the entity being privatized. If there are no publicly traded comparables, the challenge is to make the case for an alternative industry sector most resembling the issuer. Investors will compare various historical and projected financial statistics of these companies to the issuer after adjusting for incomparabilities.

To determine valuation, investors will focus on multiples including price to earnings and firm value to Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). Other metrics include long-term growth rate, market capitalization, dividend yield, and liquidity. In addition, investors will look at comparable company IPO valuations. Investors expect an immediate return compensating them for lack of track record as a public company, commonly referred to as an “IPO discount.”

Once the proper comparable group and IPO multiples have been determined, these multiples are applied to the analyst’s estimates for the issuer to come up with a target valuation. The public market will value the issuer on a pro forma basis, as if the IPO has taken place and the use of proceeds as outlined in the prospectus has been applied. The underwriter will also determine a target per share price range for the offering and recommend if a stock split of the issuer’s shares is necessary prior to the offering.

Postal Service Valuation

Valuing a commercialized Postal Service requires reviewing two broad sets of issues: 1) potential resolution of key commercialization factors including disposition of labor issues (such as current interest arbitration versus right to strike), retirement benefits liabilities, postal monopoly and privileges, pricing flexibility and competitive freedoms, universal service, ability to raise and invest capital, governance, and transition rules and time frames; and 2) translating the economic model from a break-even structure to a profit maximization one.

The most basic influences on valuation will be earnings and earnings growth rates, as well as the risks associated with the business. Decisions that enhance the ability for a commercialized Postal Service to increase profit margins and/or speed earnings growth will increase the valuation, and vice versa. The risks reflect issues such as electronic diversion and increased competition.

A successful commercialization of the Postal Service will require resolution of important economic issues that will each have a large influence on valuation. A best-case scenario for the Postal Service would include flexibility in labor management; a transition period to the loss of the legal letter monopoly in exchange for immediate competitive freedoms; control over pricing and product decisions; the ability to finance growth in the competitive businesses during the transition period; retention of certain privileges including tax and licensing fee exemptions; the ability to raise capital in financial markets as well as enter into all forms of strategic alliances, and the ability to have the U.S. government assume: 1) some liabilities, such as deferred retirement benefits and environmental problems; 2) responsibility for more narrowly defined and contractually based universal service obligations; and 3) the ability to raise capital markets as well as enter into all forms of strategic alliances:

- **Labor issues and retirement benefits.** Compensation and benefits comprise about 77 percent of total Postal Service expenses. Success in managing labor-related expenses will be necessary to improve margins. A one percent swing in expenses changes net income by close to $600 million. The disposition of deferred retirement liabilities related to the Civil Service Retirement System (CSRS) would also have a huge valuation impact. The future minimum payments to fund the CSRS benefits and retirees' cost-of-living adjustments are $30 billion. If the Postal Service had been allowed to manage its own retiree benefits, like corporations, that liability could have been dramatically lower. The Postal Service will need more flexibility in setting terms of employment to achieve cost reduction objectives. Postal Service employees now enjoy interest arbitration, which would need to be reviewed relative to the right to strike. Participation in a commercialized Postal Service stock offering, through an Employee Stock Ownership Program (ESOP) or other structures, would be a potential enhancement for employees. Conrail and transforming foreign postal operators provide examples of commercializing entities gaining labor management flexibility. The valuation would be highly sensitive to the Postal Service's ability to manage its labor issues appropriately.
- **Postal monopoly and privileges.** The Postal Service enjoys monopolies on distribution of certain letter mail, access to U.S. mailboxes, and access to its network. The value of the letter monopoly is high but falling over time as targeted competitors, particularly in the Internet arena, take market share. Retaining the mailbox monopoly and control over access to the Postal Service system would clearly help earnings and valuation. Phasing out the letter monopoly over three to five years could result in trade-offs for other benefits maintained by the Postal Service. The Postal Service's ability to bring its benefits in physical delivery to the Internet could boost the valuation.
- **Pricing flexibility and competitive freedoms.** The Postal Service is now constrained in its ability to set prices, to enter into new product markets and businesses, and to differentiate product/service offerings. It is also constrained in its flexibility in managing labor and in the number and location of post offices. Flexibility alone will not guarantee greater profitability, but it will provide the foundation to develop and execute a business plan that would keep the Postal Service competitive and in a position to provide the scope of services expected by customers. Achieving these freedoms would require a transition away from a tightly regulated environment, but it would also likely increase the valuation of this new commercialized entity.
- **Universal service.** The Postal Service provides universal service in terms of product coverage, delivery service, pricing, and retail access. Today's universal service requirement is a broad set of legal and regulatory mandates and constraints. If retained, the current universal service requirement would severely impair the Postal Service's ability to differentiate price and product/service offerings. The best alternative would be a contractual arrangement where the Postal Service would guarantee significant core elements of the universal service obligation. The economics of the alternatives would have a major influence on valuation.

- **Ability to raise and invest capital.** Currently the Postal Service has limits on raising and investing capital as well as on forming strategic alliances. Investors will apply a lower valuation to an organization that is constrained in its ability to invest and organize itself to most efficiently deliver services.
- **Governance.** The new structure and governance of the organization also will have an influence on valuation. Investors clearly want a board of directors who have the ability to act in the best interest of shareholders. Federal statutory limitations not applicable to private enterprises (such as government ethics restrictions, purchasing procedures, and lobbying) would need to be significantly modified or eliminated, depending on the structure chosen.
- **Transition rules and time frames.** The most important value issues related to transition are the timing of changes in the monopoly, the ability to start immediately with competitive freedoms, and the ability to invest earnings from the monopoly in competitive businesses. TNT Post Group (TPG) in The Netherlands and Deutsche Post World Net in Germany are operating within guidelines similar to these.

The key outcomes from an economic model will be expected profitability and growth rates. Answers to the issues raised above will be necessary to create valuation scenarios. Another way to ask the question about earnings, however, is whether the Postal Service can maintain its current margins or increase margins? If it increases margins, how far can the margins go? For the purposes of a valuation exercise, one needs to make assumptions about how much freedom a commercialized Postal Service would receive and how this newly granted regulatory freedom might allow the Postal Service to increase its margins to at least the best levels it has achieved in the past decade.

Equity Investor Questions

Potential investors will not assume the commercialized Postal Service can achieve and maintain margins without seeing a track record proving its performance. Investors, including Postal Service employees, would likely ask a number of questions in order to determine whether to invest in shares of a privatized Postal Service. There are some questions that would be asked specifically of the Postal Service, given its unique status, in addition to those that would likely be asked of any company involved in an IPO. The answers to these questions are important in that they indicate earnings potential. Investors will be most interested in the potential for earnings growth and the impact government policies would have on the company’s performance.

Questions Specific to the Postal Service

- What are the U.S. government’s intentions in selling shares in the Postal Service?
  – structure of the transaction;
  – monopoly impact; and,
  – residual government interest and impact on Postal Service activities.
- What is the Postal Service relationship to the U.S. government?
  – scope of monopoly;
  – pricing restrictions;
  – labor requirements;
  – public policy mandates;
  – employee benefit liabilities; and,
  – regulatory oversight.

Questions Investors Would Ask of Any Company

- What is the Postal Service?
  – company summary
- What will be the use of the proceeds?
- What are the company's goals and the business strategy to achieve them?
- What is the potential for earnings and free cash flow growth?
  – pricing power;
  – revenue growth;
  – expense management;
  – labor costs and labor relations; and,
  - capital expenditure requirements.
- What are the Postal Service's market characteristics?
  – by key businesses;
  – size, demographic, geographic, key customers;
  – competitors and competitive landscape; and,
  – regulation.
- What is the Postal Service position in its markets?
  – market share; and,
  – growth trends.
- What are new business initiatives?
  – within the organization; and,
  – Mergers & Acquisitions (M&A), joint venture, and other opportunities.
- What is the strength of the capital structure?
  – leverage; and,
  – dividend policy.
- What do the financials look like?
  – funds required and their use; and,
  – historical financial summary.
- What are the expected valuation parameters?
- What is the corporate governance structure and who sits on the board?
- What are the strengths of the management team?
  – incentive-based financial participation in Postal Service performance
- What are the key risk factors?

Merger & Acquisition Sale

An M&A transaction involves the sale of all or a portion of the assets or equity of a company to a single buyer or a group of buyers. Investors in the M&A market often seek financial returns through a strategic fit with their current business mix. The particular attributes of a transaction, including the size, nature of the business, transaction structure, and regulatory requirements, will influence the number of potential buyers.

The most likely M&A scenario would be the acquisition of some or all of the government's equity interest in the Postal Service by a strategic buyer. This strategic buyer could be a Postal Service competitor, (e.g., United Parcel Service), a current business partner (e.g., QuadGraphics), or a third party. An M&A transaction offers both the buyer and the seller flexibility to structure the transaction to meet their respective objectives. For example, appropriate restrictions regarding foreign ownership have precedent and could be structured to meet government concerns. The government's interest in maintaining a universal service requirement would need to be negotiated. Because an M&A buyer's objectives may be different from those of the investing public (IPO) generally, the anticipated proceeds from the two types of transactions may be different.

Again, although it is impossible to predict at this time an expected value for the government's ownership interest in the Postal Service, the process by which it would be done is fairly predictable. A potential purchaser's bid would reflect its own valuation, increased by cost savings opportunities it can take advantage of and decreased by its own perception of the industry's and the company's liabilities, risks, and ongoing government control and regulation. In developing its bid, a prospective purchaser will likely rely on a combination of three different analyses.

First, similar to the IPO process, a bidder will perform a comparable trading multiples analysis to estimate the Postal Service's value based on the public market multiples of similar investments.

Second, a bidder will perform a comparable transaction multiples analysis to estimate the Postal Service's value based on the price paid in the market for similar companies. The price paid will also be expressed as multiples of net income, revenues, and other financial measurements, both on a projected and historical basis, as in the case of a comparable trading multiples analysis. In both cases, if pure comparables do not exist (which is the case with the Postal Service) peer groups consisting of transportation and other companies would be used as a proxy.

The third analysis will be a discounted cash flow (DCF) analysis. A DCF analysis provides an estimate of the value of a company by forecasting the business's free cash flows (after-tax operating profit adjusted for noncash charges and investment requirements for fixed and working capital) and discounting those cash flows to the present at an appropriate discount rate or cost of capital. The discount rate is intended to reflect market interest rates, the time value of money, and the unique risks of the business.

In pursuing one of the above strategies, or a derivative of the IPO or M&A sale, the government can rely on a standard process. The government will likely need to hire an advisor such as an investment banker to provide an assessment of privatization alternatives and assist in executing the selected strategy. The advisor would be responsible for providing market analyses, conducting independent market valuations of the Postal Service as a private sector business, commenting on prospective investors or buyers, advising on the best strategy, and implementing that strategy. As such, a Privatization Schedule can be developed which has as its goals to best meet the objectives and criteria of the government for the privatization. Specifically, the advisor would:

- Determine what, if any, benefits accrue to the government and the Postal Service assuming implementation of a privatization strategy;
- Make several key assumptions about the Postal Service's operating performance, market conditions, and major uncertainties in performing a valuation analysis;
- Perform a net present value analysis comparing the economic return to the government from implementing the privatization with the economic return from maintaining its ownership;
- Clarify its understanding of and help define the Postal Service's future relationship with the government;
- Assist the Postal Service in developing its ultimate Privatization Plan for submission to the government;
- Assess the receptivity of potential privatization markets to various transaction structures; and/or,
- Participate in the consensus-building process with government, including executive and legislative branch entities.

Additionally, legislation would undoubtedly be required to set forth the Postal Service's transition to the private sector. This could be part of the legislation required for statutory changes. As in the case of other U.S. privatizations, like that of the United States Enrichment Corporation, discussed in Appendix T, *Overview of Selected Government Entities and Government Sponsored Enterprises,* authorizing legislation can stipulate at the outset that the government's equity interest in the company is to be privatized at an appropriate time, while also detailing the necessary legislation, to the extent necessary, in implementing the privatization.

Alternative Privatization Strategies

Most alternative privatization mechanisms are variations of the IPO or the M&A sale. The applicability of these alternatives will become evident at the time of privatization from an analysis of several factors, including the government's objectives, general statutory requirements described in the authorizing legislation, the receptiveness of prospective investors or purchasers, and the historical and projected success of the corporation. Additionally, the ownership interest and objectives of the strategic partners, if any, will be an important consideration in the evaluation of these less straightforward options. Several of these alternatives are described below.

Employee Ownership

In an employee ownership transaction, all or a portion of a company's equity is sold to its employees or managers. Many of the same issues that arise in an IPO process are relevant to an Employee Stock Ownership Program (ESOP) conversion and employees are likely to raise many of the same investor questions about earnings potential and business viability that are discussed above.

One hundred percent employee ownership requires the transaction to be structured as an M&A sale, in which the employees collectively finance the purchase of the company's stock, pledging the corporation's assets as security. Employee ownership has the benefit, in perception at least, of aligning employee interests with those of the overall success of the company. The applicability of this structure in the case of the Postal Service would be driven in part by the number of employees, the extent of their personal assets, the objectives of the government's strategic partner(s), and an analysis of acceptable leverage as part of the overall capital structure.

Although public equity investors are likely to welcome some level of employee ownership, strategic partners are less interested in purchasing or operating a corporation owned half by employees and half by the buyer, effectively limiting control by the partner. Corporations typically provide for a level of employee ownership through an ESOP, in place of a less-than-100 percent sale of the company to employees. Under an ESOP, employees are awarded equity in the company, either publicly traded or private, as part of their overall compensation package. This has the similar perceived effect of aligning interests while maintaining overall ownership in the hands of shareholders (in a publicly traded corporation) or a few senior officers (in a privately-held corporation).

An employee purchase of the government's interest would require a valuation process similar to that described in the M&A sale discussion.

ESOP Process

The ESOP structure is a product of complex federal legislation. The Postal Service would likely approach the establishment of an ESOP in a manner similar to a private company. There are, however, different rules and considerations that need to be made when dealing with the conversion of a federal government entity versus a private entity. The Postal Service has been examining many of these issues in the context of its plan to convert its Equal Employment Opportunity investigations unit to an ESOP. Many of these topics are addressed in detail in a 1995 National Performance Review discussion paper titled, "Federal Privatization Through ESOPs."

In general, a conversion to an ESOP requires three important steps first:

- A valuation of the organization must be completed by an independent party;
- The financial impact of the conversion on the existing owner's stake should be estimated. In the case of the Postal Service the existing holder would be the U.S. government and the considerations would be related to impact on the federal budget; and,
- The organization should create a plan to fund all stages of the ESOP. Since ESOP participants have a put option when they leave, the plan should project how it will meet the obligation to repurchase the stock of departing employees.

Typically, in the next stage, the firm and its advisers will prepare a formal plan document that lays down the specific terms and features of the ESOP. A valuation report will be prepared. The plan should address the ESOP's 1) use and operation, 2) eligibility requirements, 3) participation requirements, 4) company contributions, 5) account allocation formulas, 6) vesting and forfeitures, 7) voting rights and fiduciary responsibilities, 8) distribution rules and put options, 9) employee disclosures, and

10) provisions for plan amendments. The firm must also establish a trustee for the ESOP. The stock and any other assets held by the ESOP must be held in the name of the trustee.

Tax Benefits

ESOPs, both leveraged and nonleveraged, offer tax benefits. For a contribution to a nonleveraged ESOP, either stock or cash, the plan sponsor receives a tax deduction equal to its ESOP contribution expense. A leveraged ESOP allows the ESOP to borrow money from a bank or other qualified lender. Since ESOP contributions are tax deductible, a corporation that repays an ESOP loan is able to deduct both principal and interest from taxes. This can decrease the cost of financing to the firm considerably by reducing the number of pretax dollars needed to repay the principal by as much as 34 percent, depending on the company's tax bracket. Secondly, dividends paid on ESOP stock passed through to employees or used to repay the ESOP loan are tax deductible. This provision of federal tax law allows a firm to free up cash.

ESOP Precedents

There are currently about 14,000 ESOP companies operating in the United States, with approximately 18 million employees participating in ESOPs. While the federal government has created several smaller ESOPs, there has never been an ESOP conversion of a federal entity that is even close to the size, scope and importance of the Postal Service. There have been large private ESOP transactions, however.

The Office of Personnel Management

In 1996, the Office of Personnel Management (OPM) privatized its Office of Federal Investigations through the creation of an ESOP. The Office conducted background investigations on federal personnel and employed approximately 730 people at the time of privatization.

The new company, U.S. Investigations Service (USIS), became the first 100 percent employee-owned company to be created through a federal government privatization. The process grew out of an order from President Clinton in 1994 for all government agencies to look for programs and functions in the federal government that could be streamlined or eliminated. The OPM then devised a detailed conversion plan culminating in USIS's creation. All government employees who moved into the ESOP saw no reduction in pay, were granted a 401K savings plan, and received a health and life insurance package similar to that of the Federal government. To help guide the new organization through the ESOP process, OPM worked with a commercial bank, an investment bank, and a law firm with extensive ESOP experience.

United Airlines

In 1994, 54,000 of United Airline's 75,000 employees purchased 55 percent of United Airline's parent, UAL, for $4.9 billion. This ESOP, the largest in the United States, was a product of difficult negotiations between unions and United Airlines management. As a result of the ESOP, union representatives agreed to pay reductions for their members in exchange for ownership. The UAL ESOP was structured differently than most traditional ESOPs. In 1994, the ESOP borrowed money to buy United Airlines stock on behalf of the employees. During the next five years and nine months employees contributed money to the plan in order to repay the original loan. As the loan was repaid, employees were allocated shares in the ESOP.

Avis

In 1987, Avis established an ESOP for $1.75 billion, making its 11,000 employees owners. The transaction was partly financed by a $1 billion loan from a group of 30 banks led by Irving Trust Co. Avis offered its domestic fleet of 135,000 vehicles as collateral. Additional financing of $395 million was acquired from General Motors Acceptance Corp., Chrysler Credit Corp., and Pittsburgh National Bank. The Avis trust was given the responsibility of disbursing stock to employees as loans were repaid over 25 years. Employees were allocated stock according to their salary and position. Although employees were not allowed to sell stock, upon their death, retirement or departure from the company, Avis would repurchase their shares.

Customer Consortium Purchase

The purchase of the Postal Service’s stock by a consortium of its customers is another type of M&A transaction. Companies which rely heavily on the Postal Service would pool their resources to structure a joint ownership of all or part of the corporation. A consortium purchase is similar to what is typically described as a joint venture (JV), in which differing parties with differing strengths and capabilities unite to operate an entity. Under a consortium purchase or JV, the purchasing entities have significant flexibility to structure ownership, voting control, management, and other factors in the operation of the corporation.

An M&A transaction of this type is highly complex when multiple buyers are involved. It would require negotiations among a number of parties, involving much more complexity than a standard M&A transaction. This is driven by the need for review by multiple regulatory bodies regarding antitrust concerns, the need to balance many differing objectives on the part of the prospective buyers, and the need to reconcile potentially divergent valuations.

Leveraged Buyout

A leveraged buyout (LBO) typically involves the acquisition of a company or group of assets by investors seeking to maximize their returns through attractive purchase prices and the use of significant financial leverage. LBO investors raise their funds by borrowing against the assets of the company they are acquiring. When managers of a company undertake an LBO, it is typically referred to as a management-led buyout and is similar to the employee ownership structure discussed earlier. Under such a scenario, a significant portion of earnings is required to meet debt service and repayment, usually at the cost of capital investment in the long-term success of the company. Other cost reduction measures are often undertaken, as well, during the period in which the LBO investors maintain ownership. Typically, these investors have a predetermined time frame for their ownership, after which they seek to either sell the company or, more likely, effect an IPO.

Alternative IPO Strategies

A master limited partnership (MLP) is a form of an IPO that involves an owner placing a subsidiary into partnership and selling limited partnership interests to public investors. Since the original owner retains the general partner interest itself, such a structure might not be ideal for the government, unless a follow-on sale of that interest were sold to a third party through an M&A transaction.

MLP's are essentially tax-driven vehicles because they eliminate the "double taxation" of corporate earnings. Taxes are paid only at the unit-holder level, based on the share of the MLP's earnings. As a result, they are largely attractive to investors seeking substantial cash payouts, which would be amplified by the tax advantages. Since the seller is the government, privatization proceeds based on tax advantages do not increase returns to the government as they would a third party purchaser. Since the Postal Service and the federal government pay no taxes, the benefits of an MLP would be lost in a government transaction and likely make it an unsuitable strategy.

A partial IPO is another potential strategy, allowing the government to divest its ownership through a series of partial offerings over an extended period of time. Such a path is designed to meet two main objectives:

- In the event that the seller is not comfortable with the IPO valuation overall, an initial partial offering will allow for the company to develop a trading history in the public markets, possibly positioning subsequent offerings to occur at more attractive levels. Subsequent offerings will be valued based on the then-current stock price of the company.
- Along the same lines, an initial partial offering allows time for a publicly-visible performance and track record to develop. This often has the effect of increasing interest in the stock and may alleviate concerns of a one-time offering which is large compared to market capacity.

Again, these examples of variations on the IPO or M&A sale process provide insights to the flexibility of potential privatization structures. The applicability of these would only become clear over time as the Postal Service approaches profit-sustaining capability and the government seeks to divest its ownership. The IPO and M&A sale processes described earlier in this section are points of departure from which an appropriate privatization strategy can be developed.

Financing a Privatized Postal Service

Prior to privatization, the Postal Service would have had the opportunity to develop a limited range of competitive products and services. By creating a private entity with significantly fewer, if any, ties to the government, a Private Corporation would enable the Postal Service with relatively unfettered ability to expand these initiatives and enter into other businesses of its choosing.

Regardless of the entity's exact legal structure, one key determinant of whether a privately owned Postal Service could successfully compete in new businesses on a wide open playing field would be whether the entity can access the capital necessary to support and finance its legacy businesses, as well as any new ventures.

Role of Debt/Access to Credit

The goal of a Private Corporation Postal Service would be to maximize the value of its equity for its shareholders while fulfilling any public mission obligation required of it. The development of financial policies that balance appropriate levels of equity and debt in the capital structure is a complex process subject to considerable judgment or “art,” in addition to the more objective “science” of standard parameters set forth by markets or corporate finance theory. The relevant factors considered include: 1) the financial prospects for the company, 2) the expected ability to pay interest and repay debt, 3) the availability and cost of equity and debt, and 4) the risk tolerances of the shareholders and debt holders. The balance between debt and equity can be a key driver of stock market valuation.

Debt has the potential to magnify risks and returns to equity shareholders, while dividing the risks and returns of ownership between shareholders and lenders. When companies are profitable, interest expense, which is tax deductible, can provide a tax shield that enhances earnings. The availability and market cost of debt are critical components in determining appropriate debt levels. Market costs of debt rise as a company’s risk of insolvency increases, and greater levels of debt increases the risk of insolvency. Provided that returns to the company exceed the principal and interest costs of debt, the addition of debt can magnify earnings available to shareholders. Conversely, debt can magnify losses and reduce shareholder earnings if company returns do not exceed the principal and interest costs of debt.

Rating a Private Corporation Postal Service

Credit rating agencies, such as S&P and Moody’s, use basic forecasts as a tool to compare the abilities of companies to service their debt. The traditional letter ratings from each agency (i.e., AAA, BBB, etc.) imply probabilities of default and recovery. These ratings guide investors to appropriate debt pricing and availability. Companies often use credit ratings as key inputs in balancing debt levels with cost effective market access. When a company’s actual performance falls short of expectations and issues arise about the ability to service debt, credit ratings fall, cost of debt rises, and sometimes access to debt ends.

Rating agencies and creditors (investors) would shift their attention from the ability to rely on the U.S. government as a source of financial strength to the earnings power and capital structure strength of the privatized Postal Service. Rating agencies are interested in the ability to repay debt and the reliability of those sources of repayment, which contrasts with equity investors’ interest in earnings growth.

Under the current governmental structure the rating agencies would take considerable comfort from the Postal Service’s relationship to government. They assume there is a reasonable probability that government would step in and repay debts if the Postal Service failed to do so. They would also take comfort in the availability of funding from the Treasury’s Federal Financing Bank.

In the case of a Private Corporation Postal Service, the rating agencies would bias their analysis away from the relationship to the government and toward the fundamental ability of the organization to generate the cash needed to service its debt. They would also look at the reliability of external financing sources as well as other sources of liquidity inherent in the Postal Service balance sheet. Nevertheless, the rating agencies would probably continue to evaluate the Postal Service's public policy value and assume, to some degree, that the government could provide a source of repayment in the event of the Postal Service's inability to fulfill its public policy activities. Depending on the structure of the entity, this could be viewed as an “implicit” backing of the government, similar to the backing the rating agencies assume for the government-sponsored-enterprises, such as Fannie Mae and Freddie Mac.

In a Private Corporation, it is unlikely that the debt would receive any special status under the Securities Acts of 1933 and 1934, given the private status of this new entity. In that case, rating agencies and credit markets would look to the underlying strength of the organization and its actual or contractual relationship to the government, as well as the importance of its mission to the public.

As for any additional private company that might be established, it is likely that the company's debt would be treated as private debt, and analysts would give it a risk rating that reflects a further separation from the government. Consequently, the debt capacity and credit rating would depend on the expected cash flows to be generated by the business. Any limitations on access to capital would clearly be viewed negatively for purposes of determining debt capacity and credit rating.

The business model and business strategies of a Private Corporation Postal Service would have a significant impact on its ability to access private capital.

The Postal Service might also turn to more complex financing techniques to supplement its cash flow. These techniques might include asset sales and secured financing structures, such as leasing or securitization related to real estate, equipment and other assets. Depending on the circumstances, these transactions could prove more cost effective than other alternatives, provide more financing capacity than unsecured debt, and furnish access to financing when equity and debt markets are inaccessible.

Debt Capacity and Optimal Capital Structure

Companies use several methodologies to evaluate their overall debt capacity and their optimal debt levels. Key tools in these evaluations are forecasts that project financial performance based on prospective balance sheets, income statements, and cash flow statements. These forecasts take into account expected prices, volumes, expenses, investments, acquisitions, efficiencies, potential asset sales, competitive dynamics, macroeconomic conditions, the availability and cost of equity and debt, and other relevant information. Generally, multiple scenarios are forecasted to assess the potential for future results to vary from base case projections. Management judgement, however, is ultimately required to balance the risks and rewards of debt.

- Debt capacity measures how much debt a company can service (pay interest and repay principal). Forecasts are used to estimate the potential cash flow available to service debt, and therefore the maximum amount of debt that can be borne.

- Companies apply corporate finance theory to arrive at their optimal capital structure. These theories are built on balancing the market costs of equity and debt, the value of the tax shield, and the risk tolerances of shareholders, debt holders, and management to create the lowest cost capital structure for the company. In effect, companies balance the benefits of leverage and the tax shield against the cost of debt, the potential costs of bankruptcy, and the desire to retain access to additional financing at reasonable cost.

Corporate finance theory implies that companies with safe, tangible assets and taxable income to shield should have an optimal capital structure that relies more heavily on debt. Less profitable companies with risky, intangible assets should have an optimal capital structure that relies less heavily on debt financing.

Lessons from Foreign Posts

Numerous foreign postal administrations have been commercialized during the past decade. While the Postal Service is significantly larger than any of its foreign counterparts, it is instructive to look at the foreign experience implementing various deregulatory measures. Some recent work by McKinsey & Company for the Postal Service, focusing on Sweden, New Zealand, Germany, The Netherlands and Argentina, highlights a number of lessons learned on both the regulatory and business fronts. Successful foreign deregulatory initiatives have included the following key ingredients.

Regulatory Ingredients

- **Gaining agreement to place the issue of an appropriate transition period at the top of the agenda**. Foreign postal entities discovered that securing an appropriate transition period was their most important goal in the regulatory debate. The foreign experience indicates that a transition period can be both too long and too short. The immediate elimination of Deutsche Post’s monopoly on parcels 20 years ago caused its market share to drop from 100 percent to 25 percent in a very short period. This resulted in significant damage to the organization, and its parcels business took almost 15 years to recover. Deutsche Post’s experience with the lifting of its letter monopoly is also a good example of how an excessively long transition period can reduce an organization’s incentive to change. Uncertainty about whether the 2003 date for elimination of the letter monopoly would be extended resulted in the waning of pressure within Deutsche Post to reduce costs and prepare for competition. At the same time, competitors in the liberalized ad mail market gained time to start up new businesses, learn the trade, gain scale, and consolidate.
- **Providing immediate competitive freedoms but phasing out the monopoly over time.** The eventual success of a foreign post in a commercialized environment appears closely tied to how reforms are phased in during the transition period referred to above. Deutsche Post and TPG in The Netherlands gained broad competitive freedoms early in their transition periods. With certain regulatory restrictions and oversight, they could invest in new capabilities and enter new businesses prior to phasing out the monopoly. As a result, the two have been able to prepare for competition by acquiring and consolidating various parcel and express providers, investing heavily in logistic management and e-commerce capabilities, and fundamentally restructuring their retail networks.

- **A full embrace of the need for deregulation by postal administrations and affiliated government ministries.** By embracing rather than fighting deregulation, Deutsche Post in Germany and TPG in The Netherlands gained significant credibility and leverage in the regulatory debate. This allowed them to win important concessions, most notably broad competitive freedoms prior to losing their respective monopolies.
- **The successful completion by foreign posts of early "symbolic actions" which demonstrated a solid commitment to deregulation**. In Germany, Deutsche Post immediately relinquished its monopoly over advertising mail. In The Netherlands, TPG agreed to a major reduction in the price/weight limit that defined their letter monopoly. As a result, both posts were able to win competitive flexibility before a phase out of the monopoly.
- **A strong partnership between postal services and their employees to develop joint positions and build a common understanding of the forces driving deregulation and the advantages of embracing rather than resisting change.** While the unions in Germany, The Netherlands, Sweden, and New Zealand were concerned about job losses resulting from deregulation, a common understanding of electronic diversion, the clear political trend towards deregulation, and impending deregulation abroad convinced employees that the status quo was neither sustainable nor desirable. The Netherlands provides the best example of this dynamic.

Business Ingredients

- **Reducing labor cost.** Prior to deregulation, most foreign postal operators paid wages higher than those paid by the private sector. During and after deregulation, foreign posts cut their labor forces to become competitive. Deutsche Post reduced its workforce by 18 percent in three years. The New Zealand Post reduced its employment base by 40 percent over a ten-year period. Sweden Post reduced its overall cost base by 20 percent in two years. In addition to working closely with their employees and unions to develop a shared outlook and agenda (as described above), foreign posts have made provisions to project job security and wages for existing employees. The Swedish, German, and Dutch posts relied on early retirement, severance packages, and natural attrition to avoid job cuts. In addition, Deutsche Post and TPG grandfathered existing employees under the old wage system and put new employees on a new pay scale.
- **Introduction of a differentiated pricing structure.** Foreign posts have found that the uniform pricing structures left over from a regulated environment have exposed them to underpricing by new competitors with lower scale economies, particularly in low-cost market segments. While differentiated pricing has helped posts gain and/or retain market share, regulators have typically argued that some uniformity in pricing has to be retained. In addition, foreign posts have had difficulty administering differing price structures in different market segments. Avoiding price "spill-overs" from lower-priced to higher-priced markets has been particularly challenging.
- **Improving marketing and sales capabilities and stronger performance ethic.** Deutsche Post, TPG, and Sweden Post realized they needed to better meet the individual needs of each customer segment. They understood that a monopoly

environment with captive customers and uniform prices had not forced them to develop the skills and knowledge to perform high-quality market analysis. As a result, they made it a top priority to build better marketing, sales, and product development capabilities. All invested heavily in these areas and usually recruited outside talent to lead the efforts.

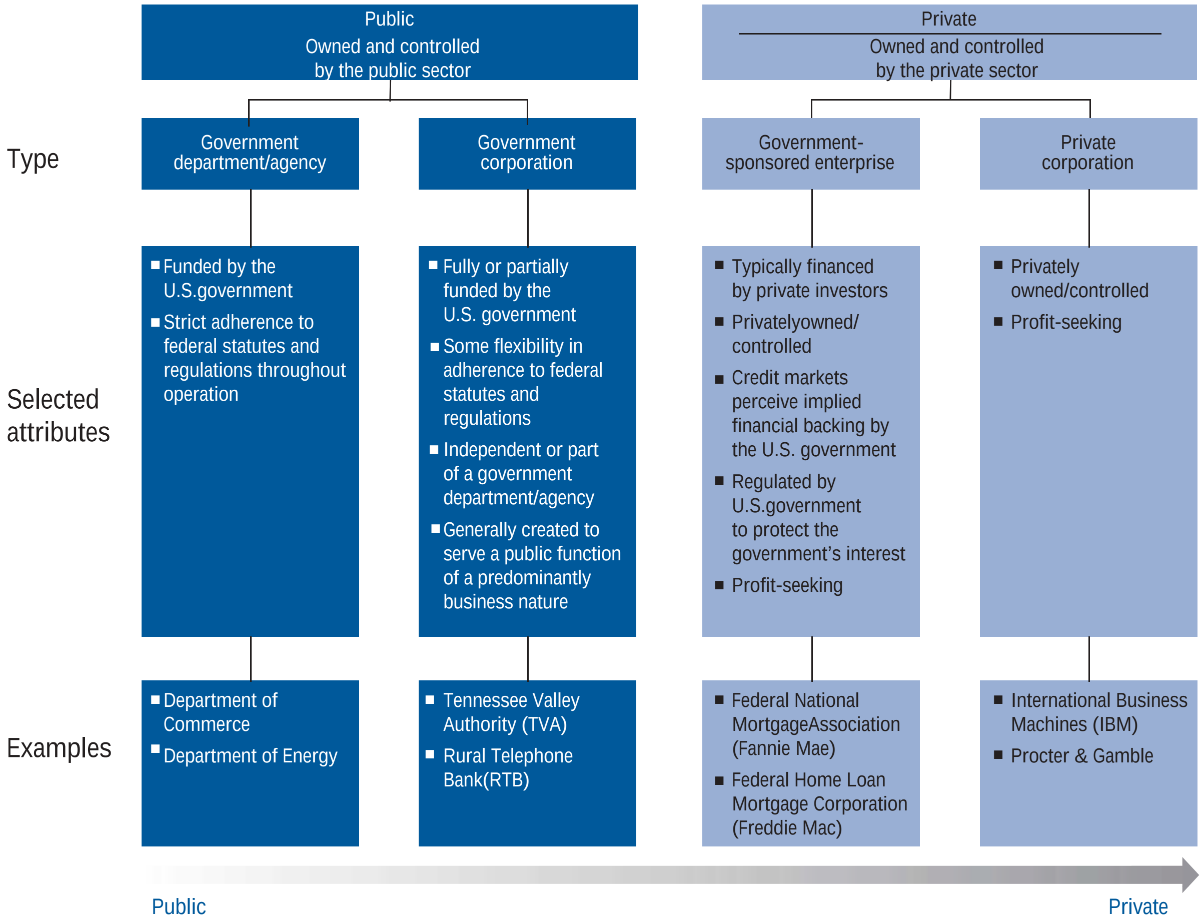
- **Reevaluating operations functions.** Despite having operations-focused cultures, foreign postal operators undergoing deregulation found that their operations functions were not well suited to a commercialized environment. As a result, foreign postal operators have performed initial rounds of cost-cutting coinciding with the start of the deregulatory process. More comprehensive reviews and restructurings have followed these steps.
- **Position for growth in new market.** Motivated by the slowing growth of letter mail volume, commercialized foreign postal operators have quickly entered new businesses to secure “first mover advantage” as soon as they have obtained new competitive freedoms. In general, these posts have focused on parcels, express, logistics, and e-commerce. The best examples are Deutsche Post and TPG. While still maintaining a letter mail monopoly, they have used the freedom to invest earnings, enter new businesses, and set up strategic alliances to buy various logistics, parcels and express mail providers in Europe with a goal of building European-wide networks and to position themselves as “complete logistics solutions providers.” Recently, Consignia in the United Kingdom was granted the ability to retain some of its earnings to invest in other businesses. They have used this authority aggressively to complete acquisitions and joint ventures, while, at the same time, commencing other new business initiatives.

Appendix T

APPENDIX T — Overview of Selected Government Entities and Government Sponsored Enterprises†

Although there are no real precedents in the United States for the corporatization/privatization of an entity the size and scope of the Postal Service, this document discusses the structure of government corporations and government sponsored enterprises and reviews seven modern-day cases in which U.S. federal government organizations were transformed from their government status to a more private form of ownership and governance.

FORMS OF OWNERSHIP: PUBLIC AND PRIVATE



	Public Owned and controlled by the public sector		Private Owned and controlled by the private sector	
Type	Government department/agency	Government corporation	Government-sponsored enterprise	Private corporation
Selected attributes	■ Funded by the U.S.government ■ Strict adherence to federal statutes and regulations throughout operation	■ Fully or partially funded by the U.S. government ■ Some flexibility in adherence to federal statutes and regulations ■ Independent or part of a government department/agency ■ Generally created to serve a public function of a predominantly business nature	■ Typically financed by private investors ■ Privatelyowned/ controlled ■ Credit markets perceive implied financial backing by the U.S. government ■ Regulated by U.S.government to protect the government's interest ■ Profit-seeking	■ Privately owned/controlled ■ Profit-seeking
Examples	■ Department of Commerce ■ Department of Energy	■ Tennessee Valley Authority (TVA) ■ Rural Telephone Bank(RTB)	■ Federal National MortgageAssociation (Fannie Mae) ■ Federal Home Loan Mortgage Corporation (Freddie Mac)	■ International Business Machines (IBM) ■ Procter & Gamble

Source: General Accounting Office

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†This appendix was prepared for the United States Postal Service by JP Morgan.

Structural Options/Corporatization

Government corporations have been created throughout history to perform commercial or market-oriented functions as well as to administer public programs. Their attributes vary enormously from one corporation to another. Interest in this type of structure has grown over the last two decades as policy-makers have sought ways to decrease the size of government by making it operate more efficiently using private sector principles. While the form and function of government corporations have received exhaustive review and analysis, the lack of any statutory definition of the term "government corporation" has made it impossible to determine the number of corporations that exist at any one time. A 1995 report by the Congressional Research Service (CRS) of the Library of Congress stated "there is presently no universally accepted definition of what constitutes a government corporation, hence there are several listings of government corporations, each different and based upon the definition employed by the compiler."

There are a wide variety of government corporations that exist today. Recent studies have identified anywhere from 15-47 government corporations depending on the definitions used. A comprehensive 1995 study conducted by the U.S. General Accounting Office listed 22 entities as government corporations[1]. A 1998 CRS report put the number at 24[2].

In a landmark 1981 study of government corporations commissioned by the U.S. Office of Management and Budget, the National Academy of Public Administration (NAPA), attempted to provide a comprehensive description and definition of the various types of government entities. NAPA stated that there are two "main, overlapping types of agencies," government enterprises and government corporations.

Government enterprise - a federal instrumentality or program which generates revenue from a commercial-type activity involving the provision of services or goods usually to the general public or a restricted segment thereof and which is intended to be substantially self-sustaining. It may or may not be incorporated; may or may not have special powers not granted to a normal government agency; may or may not have the right to retain revenues in a revolving fund and use them for operating expenses without regard to fiscal year limitations. The term government enterprise is used generically in this report to encompass the broad range of public enterprises whether incorporated or unincorporated.

Unincorporated enterprise - a term embracing a large body of enterprises ranging from those with few attributes distinguishing them from government agencies to those with most of the attributes of a government corporation except the separate legal identity acquired by incorporation. Examples range from such large enterprises as the U.S. Postal Service, which is a government corporation in nearly every sense but formal designation, to the [former] Alaska Railroad, and the many large and small revolving funds such as those established from the sale of surplus equipment by the Department of Defense and the General Services Administration.

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[1] U.S. General Accounting Office, Profiles of Existing Government Corporations (GAO/GGD-96-14, 1996)

[2] Congressional Research Service, Federal Government Corporations: An Overview (98-954 GOV, Nov. 24, 1998)

Incorporated government enterprise - a government corporation which generates revenue from a commercial or business-type activity and which is intended to be substantially self-sustaining. Since a number of government corporations have been formed in recent years which do not provide commercial-type services or goods or raise revenues, all government corporations are not enterprises. Examples of non-enterprises include the Inter-American Foundation, National Park Foundation, and Legal Services Corporation.

Government corporation - a government entity created as a separate legal person by, or pursuant to, legislation. It can sue and be sued, use and reuse revenues, and own assets; its liability is distinct from that of its officers and directors. Each government corporation is created by an act of Congress setting forth its legal powers, obligations, and mission.

According to the NAPA, three kinds of corporations have been established by federal statutes: government, or wholly owned government corporations; mixed public-private, or mixed-ownership corporations; and private corporations.

Government corporations pursue a governmental mission assigned in their enabling statute and are financed by appropriations. Their assets are owned by the government and managed by board members or an administrator appointed by the President or Secretary of a Department. Examples - Export-Import Bank, Government National Mortgage Association, St. Lawrence Seaway Development Corporation.

Mixed public-private corporations have a combination of governmental and private equity; hence their assets are owned and managed by board members selected by both the President and private stockholders. They are usually intended for transition to the private sector. Examples - Student Loan Marketing Association, National Consumer Cooperative Bank, Connie Lee, Fannie Mae, Freddie Mac.

Private corporations are established by federal statute but are privately financed and owned, with no government appropriations, loan or loan guarantee. All or most of their board members are chosen by private stockholders. Example - the Communications Satellite Corporation (COMSAT).

Depending on the specific provisions and ultimate policy goals of their enabling statutes, government corporations may or may not be subject to certain federal statutes related to personnel management, compensation, procurement, and a variety of other topics. The 1995 General Accounting Office study surveyed existing government corporations to determine which of the following 15 federal statutes they were subject to:

- The Privacy Act of 1974 (5 U.S.C. 552a)
- The Freedom of Information Act of 1966 (5 U.S.C. 552)
- Government in Sunshine Act (5 U.S.C. 552b)
- Chapter 51 of title 5, United States Code (5 U.S.C. 5101-5115)
- Subchapter III, chapter 53 of title 5, United States Code (5 U.S.C. 5331-5338)

- Federal Property and Administrative Service Act of 1949, as amended (41 U.S.C. 251-260)
- Federal Tort Claims Act, as amended (28 U.S.C. 2672)
- Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b), (c))
- Anti-Deficiency Act (31 U.S.C. 1341)
- Government Corporation Control Act of 1945 (31 U.S.C. 9101)
- Government Performance and Results Act of 1993 (Public Law 103-62)
- Chief Financial Officers Act of 1990 (Public Law 101-576)
- Inspector General Act of 1978 (5 U.S.C. 1341)
- Federal Credit Reform Act of 1990 (2 U.S.C. 661-661f)
- Ethics in Government Act of 1978 (Public Law 95-521, as amended)

The GAO found little consistency or uniformity with regard to the applicability of these requirements to existing government corporations. The GAO concluded:

Congress established GCs (government corporations) to carry out business-type programs that need more autonomy and flexibility than that provided by a conventional agency structure. Accordingly, GCs may be, but are not always, exempted in part, or in full, from certain statutes governing matters such as civil service pay scales and hiring rules, position ceilings, and procurement. These exemptions are intended to allow GCs to respond more quickly to changes in the marketplace and, in some cases, to take advantage of cost-saving opportunities. However, even when GCs are partially or fully exempt by law from the requirement to adhere to federal statutes, some GCs reported that they choose to adhere to some requirements as a matter of policy.

The GAO also found that the GCs varied widely in their adherence to the 15 federal statutes used in the survey. For example the Federal Housing Administration reported full adherence to 14 of the 15 statutes, while Amtrak reported full adherence to only 2 statutes. In addition, the number of GCs receiving full or partial exemption from Congress was high.

Case Studies

Seven cases of government entities that moved to corporatization/privatization are described below. Each case provides an overview and background on the entity and a description of: 1) the legislation enacting the privatization; 2) key drivers of change; and 3) the process by which the transfer to private ownership occurred and key lessons from the privatization. Discussed are:

- Conrail
- Amtrak
- U.S. Enrichment Corporation

- COMSAT
- Fannie Mae
- Freddie Mac
- Sallie Mae

Government Entities: Conrail, Amtrak, USEC and COMSAT

Consolidated Rail Corporation (Conrail)

Overview

Formed in 1975 as an amalgam of several bankrupt railroads, the Consolidated Rail Corporation ("Conrail") operated more than 15,000 miles of track in the Northeast and Midwest. Conrail was intended to be a transitional entity that would be fully privatized when it became a self-sustaining profitable corporation. After many years of government financial support, a transition to profitability, and protracted debate among policy-makers, Conrail was privatized in 1987 through an initial public offering of the government's ownership interest. Ten years later in 1997, CSX Corporation and Norfolk Southern Corporation acquired Conrail. CSX and Norfolk Southern began operating most Conrail lines and facilities in 1999 under an operating plan approved by the U.S. Surface Transportation Board.

Background

While the rest of the U.S. economy rebounded in the years following World War II, the nation's railroads went into serious decline, due largely to competition from long-distance trucking, but also because of expensive labor protections negotiated by powerful unions and inflexible government regulation. A series of mergers and bankruptcies ensued, the most serious of which was the failure of the Penn Central Railroad in 1970.

The creation of Conrail was one of several steps taken by Congress to reorganize and overhaul the passenger and freight railway system of the United States.

- The Emergency Rail Services Act of 1970 provided federal loan guarantees to support the national railroads.
- The Rail Passenger Service Act of 1970 led to the creation in 1971 of National Railroad Passenger Corporation ("Amtrak") and provided government guaranteed loans to a private, for-profit corporation owned in alliance by four national passenger rail systems.
- The Regional Railroad Reorganization Act of 1973 ("3R Act") established the United States Railway Association ("USRA") as a mixed-ownership government corporation under the District of Columbia Nonprofit Corporation Act to develop a plan to reorganize bankrupt railroads by forming Conrail. Four designated government officials (a Chairman, appointed by the President; the Secretaries of Transportation and Treasury; and the Chairman of the Interstate Commerce Commission ("ICC")) were incorporators and served on the USRA board along with seven non-government directors appointed by the President).

In November 1975, Congress gave its consent to the final USRA system plan for reorganizing the seven bankrupt railroads. The Railroad Revitalization and Regulatory Reform Act of 1975 (Public Law 94-210) implemented the plan and created the new, federally subsidized entity out of the bankrupt railroads. Conrail was to be the centerpiece of the sweeping plan to revive rail service in the Northeast and Midwest without resorting to a nationalized system. The plan embodied the largest corporate reorganization in U.S. history. Conrail was authorized to take over the operation of 15,000 miles of track that had previously been operated by the bankrupt carriers. The start-up costs of $2.5 billion were to be financed by the federal government through loans and stock purchases, but the plan envisioned that Conrail would become independent and operate at a profit by 1979.

The Railroad Revitalization and Regulatory Reform Act created a 13-member Board for Conrail, of which six members were to represent the holders of Conrail's debentures and "series A" preferred stock; three members to represent holders of "series B" preferred stock; two members to represent holders of common stock; and Conrail's chief executive officer and its chief operating officer. The members of the Board were to be appointed by the federal Department of Transportation (DOT) and the U.S. Railway Association.

The conveyance of rail properties to Conrail was to be completed by March 31, 1976, allowing Conrail to begin operations. Conrail's enabling legislation described it as a private, for-profit corporation and not an agency or instrumentality of the federal government. (USRA, on the other hand, was a government corporation subject to the Government Corporation Control Act and responsible for the oversight of Conrail.) All shares of Conrail were held by USRA. The Railroad Revitalization and Regulatory Reform Act of 1975 also provided substantial government support to Conrail in the form of 1) loans and grants in the amount of $2.1 billion which would be invested in Conrail through the purchase by USRA of Conrail's debt and equity securities, and 2) loan guarantees for capital investments and equipment purchases. The Treasury Department concluded at the time of granting this support that the financial community would not invest in Conrail "absent some type of Government involvement."

Conrail operated similarly to a private sector corporation, although it received financial support from the Department of Treasury and was under the auspices of a government corporation in the USRA. The company continued to receive financial support in the form of USRA's investment in the securities of Conrail until June 1981, after which time no direct federal funds were required for operations or capital investment.

Conrail obtained new management in 1981 bringing on the recently retired chairman of Southern Railroad, which had been named America's "ten best companies" just before his retirement. Because of his ability to keep the railroad solvent, this individual had gained a great deal of credibility with Congress.

A strong push to fully privatize Conrail was begun in 1981 when Ronald Reagan became President and had the support of a Republican-controlled Senate and many conservative House Democrats. However, the White House, Conrail, and the USRA each presented sharply different scenarios for the future of Conrail.

When the Reagan administration took office, it quickly determined that the government's involvement in Conrail threatened the budget and also violated President Reagan's principles forbidding government interference in the private sector. The Administration in its budget, submitted to Congress in March, announced that it wanted to end federal aid to Conrail by fiscal 1983, sell Conrail lines to private railroads and substantially scale back expensive employee benefits, a proposal that some union leaders warned could lead to a nationwide strike.

Despite the initial political opposition, the Reagan administration proceeded ahead with its plans to end federal subsidies by fiscal 1983 and to give the Secretary of Transportation free rein in selling portions of the system to private enterprise.

In 1986, five years after President Reagan had proposed returning Conrail to the private sector, Congress agreed to sell the government's 85 percent share of the freight railroad. However, instead of the direct sale to another railroad that the Administration had sought, the legislation enacted in 1986 mandated a public stock offering.

At its inception and until 1991, Conrail's rates and operations were virtually totally regulated by the ICC. These regulatory requirements made it difficult, if not impossible, for Conrail to compete. Conrail could not use negotiated rates, nor could it control costs through consolidations, line abandonment, nor innovative service management. The sweeping ICC deregulation in the Stagger's Rail Act of 1981 began a process in which Conrail was gradually freed to pursue these objectives, and under its new management was able to do so successfully. The process, however, took time and at the beginning it was unclear whether Conrail could succeed without federal funding.

Privatization Legislation

The Conrail sale provisions were included in the deficit reduction "reconciliation" legislation (Public Law 99-509) passed by Congress in October 1986 as "The Conrail Privatization Act of 1986". This was the fifth and final major piece of legislation over the 15-year period that was necessary to privatize Conrail.

Privatization Process

Pursuant to the Conrail Privatization Act, the public sale of all of the government's (i.e. USRA's) 85 percent equity share of Conrail occurred on March 26, 1987, through an initial public offering. DOT chose a lead underwriter and included six co-managers for the transaction. The transaction resulted in proceeds of $1.5 billion that with added cash payments from Conrail to the U.S. Treasury, produced approximately $1.9 billion for the government.

In October 1987, pursuant to the Privatization Act, Conrail's Employee Stock Ownership Plan was terminated and the remaining 15 percent of Conrail common stock was distributed to approximately 90,000 existing and former Conrail employees who participated in the plan.

Key Drivers of Privatization

The lengthy Conrail privatization process was driven by the need to rescue an essential public service that faced severe financial hardship and possible liquidation. The government's takeover did result in revitalization of the rail system and put it on solid financial footing, making the market receptive to Conrail's privatization through an IPO.

Ironically, the probable “winning” factor in the Administration’s decision to push through the privatization legislation had little to do with railroading, labor, freight service continuity, or any other aspect of Conrail that had dominated the debate for many years. In the end, the key to passage of the final stock sale legislation was the urgent need for congressional leaders to find revenue to avoid across-the-board spending cuts that might have been required under the Gramm-Rudman-Hollings antideficit law. The final privatization bill produced an estimated $2 billion dollars of savings in the form of revenue from Conrail’s sale.

Lessons

Conrail is a good example of the government corporation structure serving as a successful vehicle for transition to a private entity. A threshold level of sponsorship was provided to assist in the evolution of Conrail from a government-supported entity to one that ultimately had complete access to the capital markets and was viewed as a viable, self-sustaining private corporation. The argument for providing support was grounded in the importance to the national economy and the public interest in Conrail’s services. However, the private financial markets needed to be reassured that any ongoing federal involvement in the privatized entity should be reasonable but need not disappear.

The Conrail privatization process also proved the direct correlation between the complexity of an enterprise and the length of time needed to achieve full privatization.

Amtrak (National Railroad Passenger Corporation)

Overview

The National Railroad Passenger Corporation (“Amtrak”) provides intercity passenger rail service throughout the United States. Amtrak was established as a for-profit government corporation in 1970 by the Rail Passenger Service Act of 1970 (“RPSA”). Congress created Amtrak to relieve freight railroads from the financial burden of operating passenger rail service. Currently, Amtrak operates a 22,000-mile passenger rail network serving over 500 stations in 45 states, 21.5 million intercity passengers, and 58 million commuters under contract with commuter transit agencies. Amtrak’s business activities include core railroad operations (passenger, food service, and state-supported services); commuter (contract management of commuter agencies); reimbursable (project work for commuter agencies); and commercial business lines (real estate, ROW leases, air rights leases).

Amtrak is governed by an eight-member Board of Directors, with seven voting members appointed by the President of the United States and confirmed by the Senate (except in the case of the Secretary of Transportation, who may be appointed without Senate confirmation), and the president of Amtrak, who is an ex-officio nonvoting member.

Background

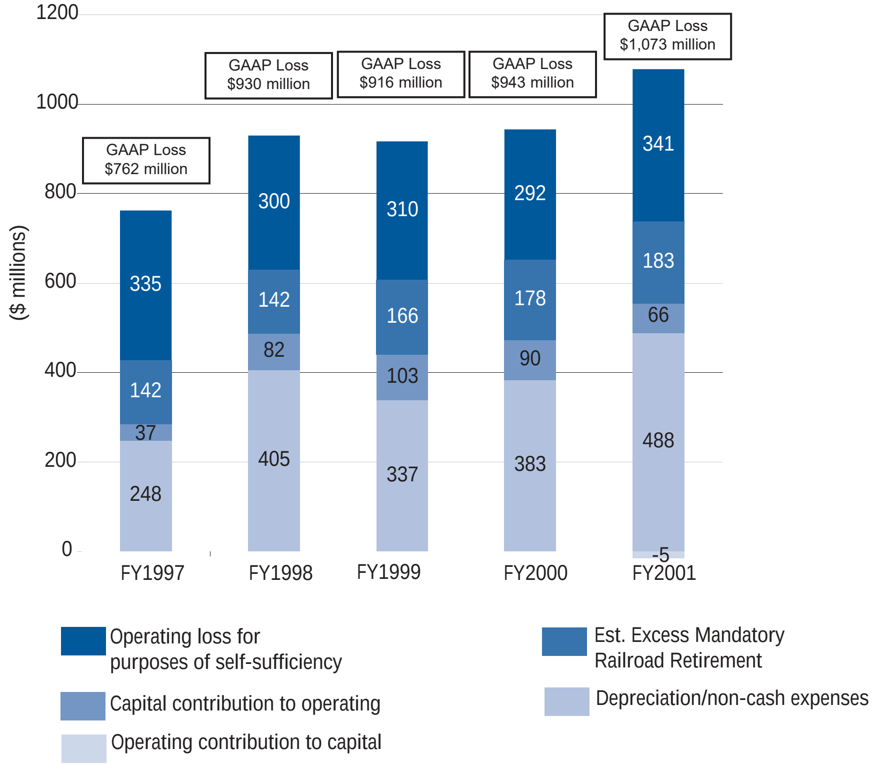
In 1970, the Congress created Amtrak to revitalize intercity passenger rail transportation. Before that time, individual railroads provided both passenger and freight rail service. Both passengers and the rail business suffered under this arrangement. Passengers lacked smooth connections between railroads, and the rail industry was losing money operating unprofitable passenger service. The combined losses of the railroads operating during 1970 were more than $1.7 billion in 1994 dollars. In 1971, most railroads willingly gave up their passenger service and provided the personnel, equipment, and infrastructure that became Amtrak. Amtrak was granted the right of access to the tracks owned by the freight railroads at incremental cost and with operating priority over freight trains. The Corporation was also granted a monopoly to provide intercity rail transportation over its route system and was to receive federal subsidies for the first years, but then was expected to make a profit. Initially, a 15-person Board of Directors was established. The President of the United States nominated eight people to serve on the Board and the remainder of the Board was selected by the corporation shareholders.

In 1994, the federal government established the goal that Amtrak reduce its need for operating subsidies and achieve operational self-sufficiency by the end of FY 2002. In 1995, Amtrak organized its operations into the three Strategic Business Units (SBUs) that exist today. The SBUs are arranged along geographic and market segment lines and consist of the Northeast Corridor (NEC), Amtrak Intercity and Amtrak West.

In 1997, after 26 years and approximately $22 billion in federal operating subsidies and capital investment, and an overall trend of stagnant ridership, Congress debated the viability of continuing to fund Amtrak, knowing that without federal funds, Amtrak would cease operations. As a result of this debate, Congress passed the Amtrak Reform and Accountability Act of 1997 (“Act”). Among other things, the Act created a new Reform Board to govern Amtrak, and created the Amtrak Reform Council (“ARC”) to oversee the company and to make annual reports to Congress. The new governing Reform Board replaced the existing Board of Directors. The Reform Board consisted of seven voting members appointed by the President for five-year terms with the advice and consent of the Senate. The Secretary of Transportation was included as a voting member, the President of Amtrak was an ex officio, nonvoting Board member. The Amtrak Reform Council was created as an eleven member bipartisan commission to serve Congress for a five-year term.

From FY1997 to FY2001 Amtrak's performance continued to worsen.

AMTRAK FINANCIAL PERFORMANCE, FY1997 – FY2001



In 2001, with the 1997 reauthorization approaching its expiration and with Amtrak's financial and operating performance deteriorating, Congress again began to focus on the corporation. The management of Amtrak and the Amtrak Reform Council expressed concerns about the future viability of Amtrak given its mission. During Congressional testimony in July 2001, Amtrak President George Warrington spoke of the difficulty of serving the public interest while trying to run a profitable business at the same time: "Now if you're a public service provider, you go where the community need is. If you're a business, you go where the money is. But if you're Amtrak — which way do you go?" On November 9, 2001, the Amtrak Reform Council, pursuant to its mandate under the Amtrak Reform and Accountability Act, found that Amtrak would not be able to reach operating self-sufficiency by December 2, 2002.

In January 2002, the Office of Inspector General of the Department of Transportation reported that Amtrak was no closer to being financially self-sufficient than it was when Congress ordered reforms in 1997. Additionally, in February 2002, the Reform Council submitted its congressionally mandated proposal to restructure Amtrak.

The Reform Council's plan calls on Congress to pass legislation that would significantly alter the current passenger rail system in the United States. The Council proposes that the current Amtrak be broken-up into three distinct organizations:

Federal Program Management and Oversight. The National Rail Passenger Corporation ("NRPC") would be restructured as a small government corporation, which would administer and oversee the national passenger rail program.

Train Operations. Amtrak would be a separate operating company that would provide train operating services.

Infrastructure. A third government corporation would be created to control the Northeast Corridor infrastructure assets.

Reform Legislation

As noted above, the most recent major Amtrak reform legislation occurred in 1997, after 26 years and approximately $22 billion in federal operating subsidies and capital investment, and an overall trend of stagnant ridership. Congress debated the viability of continuing to fund Amtrak, knowing that without federal funds, Amtrak would cease operations. The result was the passage of the Amtrak Reform and Accountability Act of 1997, which provided that Amtrak:

- Would no longer be a government corporation or hold a rail passenger monopoly;
- Would be allowed to add new routes and close money-losing routes;
- Would receive approximately $2.2 billion in Taxpayer Relief Act Funds; and
- Would have to achieve operating self-sufficiency (i.e. no longer receive federal operating grants) five years after the enactment of the Act.

Additionally, the Act also created the Amtrak Reform Council, an independent bipartisan federal commission of eleven members whose statutory mandate was to:

- Make recommendations to Amtrak to help it reach operational self-sufficiency;
- Report annually to Congress on Amtrak's performance in several areas;
- If ARC were to find that Amtrak would be unable to achieve its goal of operational self-sufficiency by December 2, 2002, then submit to Congress a plan for a rationalized and restructured national passenger rail system; and
- If such a finding were made by ARC, Amtrak would submit a plan for Amtrak's liquidation to Congress.

Key Drivers of Reform

Amtrak's chronic inability to gain solid financial footing has been the primary impetus for the series of legislative reform initiatives. The Amtrak Reform Council's November 2001 announcement that Amtrak would not achieve operational self-sufficiency by December 2, 2002 (as required by the Amtrak Reform and Accountability Act of 1997), led to the Reform Council's recent restructuring plan to create a rationalized and restructured national passenger rail system. Over the next year, Congress will debate this and other approaches as it struggles to determine whether Amtrak can meet desired service objectives at the same time it tries to become financially viable.

Historical Milestones

Year	Event
1970	Congress passes the Rail Passenger Service Act of 1970
1971	Amtrak begins operations on May 1, 1971
1973	Congress passes the Regional Rail Reorganization Act of 1973
1976	Congress passes the Rail Reorganization Act of 1976
1995	The federal government sets a goal for Amtrak to become more financially self-sufficient
1997	Congress passes the Amtrak Reform and Accountability Act of 1997
2001	The Amtrak Reform Council declares that Amtrak will not meet the congressional deadline to become financially self sufficient
2002	The Amtrak Reform Council submits to Congress its proposal to restructure Amtrak

United States Enrichment Corporation

Overview

The United States Enrichment Corporation (USEC) produces and markets uranium enrichment services to electric utilities that operate commercial nuclear power plants in the United States and abroad and is the world's leading supplier of enrichment services. USEC was established by the Energy Policy Act of 1992 as a wholly-owned government corporation to take over the responsibilities of the U.S. Department of Energy's (DOE) Uranium Enrichment Enterprise (UEE).

USEC was fully privatized in 1998 through an initial public offering of the U.S. government's complete ownership interest (NYSE listed). USEC was the first U.S. government privatization since Conrail in 1987. Though the government retained no ownership interest, USEC continues to serve as the U.S. government's executive agent for the Megatons to Megawatts program, the U.S.-Russian nonproliferation agreement to dilute highly enriched uranium taken from dismantled Russian nuclear warheads into low-enriched uranium fuel used by USEC's customers to generate electricity.

USEC serves approximately 86 percent of the domestic markets, approximately 40 percent of the world market, and is the sole marketing agent for uranium enrichment services on behalf of the U.S. government.

Background

Uranium enrichment is a multibillion dollar international industry which provides a vital service in the production of commercial nuclear reactor fuel required by electric utilities that operate nuclear power plants.

In the 1950s, the practice of enriching uranium expanded to meet the nation's growing defense needs. The commercial nuclear industry was born in the 1960s with the passage of the “Private Ownership of Nuclear Materials Act of 1964.” As a result, all phases of the nuclear fuel cycle became privately owned with the exception of the DOE’s Uranium Enrichment Enterprise (“UEE”). In 1969, the UEE began operation as part of the Atomic Energy Commission. The UEE utilized two gaseous diffusion plants at Paducah, Kentucky, and Portsmouth, Ohio, which the United States had operated since the 1950s. These plants originally served defense purposes, but were also equipped to enrich uranium as fuel for consumer electric power plants. The plants had been used in this capacity since the 1960s, and no longer produced weapons-grade enriched uranium.

The United States held a worldwide monopoly in enrichment services until 1974, when the United States, with its total enrichment capacity filled, stopped accepting new orders. Foreign competition emerged very quickly to meet continuing demand. By the 1980s, with the cancellation of many of the government’s contracts and the increase in foreign competition, the United States became the highest priced supplier of uranium enrichment services. From 1974 to 1992, the U.S. monopoly position eroded to 40 percent of total market share. When the threat to United States competitiveness in this industry and the vital national interest in self-sufficiency in alternative energy sources became obvious, United States support for corporatization and eventual privatization of the enrichment service grew significantly.

The 1992 Energy Act corporatized the UEE creating USEC as a wholly owned government corporation subject to the Government Corporation Control Act. The Act directed USEC to reorganize and operate the government’s uranium enrichment activities as a business, to compete globally, and to make a profit. USEC’s start-up date was July 1, 1993. The Act of 1992 mandated that USEC issue capital stock to the U.S. government equal to the greater of $3 billion or the net book value of assets transferred to the USEC as of July 1, 1993. USEC issued 30 million shares of $100 par value common stock equaling $3 billion to the U.S. Treasury. Until the privatization, all of the stock of USEC was held by the Department of Treasury.

As a wholly-owned government corporation, all profits accrued by the USEC were remitted to the U.S. Treasury in the form of a dividend. The DOE leased the two plants at Paducah and Portsmouth and the equipment necessary for production.

The President appointed a five-member Board of Directors in November 1993. The Board was confirmed by the Senate in February 1994. The Board was responsible for setting policy for the corporation, making sound business decisions, and guiding the transition to privatization.

USEC was required to operate as a self-financing corporation with no federal government appropriations or federal source of financing, including the Federal Financing Bank. USEC was granted the right to issue and sell bonds (not guaranteed by the U.S. government), but not for the purpose of constructing new uranium enrichment facilities or conducting pre-construction activities. The U.S. Treasury had the right of disapproval on issues.

The corporatization legislation tried to protect UEE’s labor force by protecting the rights, wages, and benefits of the employees in place prior to July 1993 through the two-year transition period. For benefit security, the Act provided that employees could opt to remain in the federal retirement benefit programs, CSRS and FERS, in lieu of coverage by the Corporation. The Corporation also maintained pro rata coverage of contracted employees.

USEC played an integral role in U.S. foreign policy and the United States' efforts towards global nuclear nonproliferation. The Energy Policy Act of 1992 designated USEC as the U.S. Executive Agent responsible for the U.S.-Russian agreement to sell highly enriched uranium (HEU) extracted from nuclear weapons, in the form of blended-down commercial-grade enriched uranium. USEC was contractually committed to purchase Russian uranium and convert it to commercial fuel to be sold in the global markets.

USEC had approximately 110 employees in its Bethesda headquarters and 13 employees at its two gaseous diffusion plants. The operation and maintenance of the two plants was contracted out to Martin Marietta Utilities Services (MMUS). Martin Marietta had about 4,400 operating personnel at the two plants. More than half of these employees were covered by collective bargaining agreements. USEC had in-place an incentive-based compensation system to reward employee achievement.

USEC was regulated by the Nuclear Regulatory Commission (NRC) and the Occupational Safety and Health Administration (OSHA). USEC had to invest approximately $35 million to bring plants into compliance with OSHA and $87 million to prepare the plants for regulation by the NRC. The Department of Energy agreed to reimburse USEC for current and future costs to bring the gaseous diffusion plants into OSHA and NRC compliance.

Privatization Legislation

Two separate pieces of legislation were required to fully implement USEC's privatization. The 1992 Energy Policy Act authorized USEC to implement its privatization plan as long as two conditions were met. First, the President had to approve the plan. Second, the USEC Board had to determine, in consultation with appropriate agencies of the United States, that privatization would satisfy four statutory criteria:

- A return to the United States at least equal to the net present value of USEC as a government corporation;
- Protection against foreign ownership, control, or domination of USEC;
- Protection of public health and safety and common defense and security; and
- A reasonable assurance of adequate enrichment capacity to meet the demand of the domestic electric utility industry.

In 1996, before the President approved USEC's privatization plan, Congress again passed legislation aimed at eliminating some key issues that might impede the sale or diminish the value of USEC. "The USEC Privatization Act" established additional requirements for the certification and licensing of USEC's uranium enrichment activities by the NRC and contained provisions to clarify the allocation of assets and liabilities between the government and a privatized USEC, including a section that provided for the transfer of substantial quantities of natural and enriched uranium from the DOE to USEC. The 1996 Act also enacted protections for USEC's workers, including a requirement that DOE provide benefits to certain USEC workers in the event of a plant closing or mass layoff.

Finally, the 1996 Act directed USEC to privatize, with the approval of the Secretary of the Treasury, in a manner that satisfied several additional statutory criteria of providing for:

- The long-term viability of USEC;
- The continued operation of the gaseous diffusion plants that USEC leases from DOE;
- The maintenance of a reliable and economical domestic source of uranium mining enrichment, and conversion; and
- To the extent not inconsistent with these three criteria, obtaining the maximum proceeds for the United States.

Key Drivers of Privatization

As a result of growing international competition in the enrichment service industry and the advancing technology in the domestic private sector, support began to grow for spinning off the government's enrichment services to secure future profits. In an environment of deficit reduction efforts, privatization of USEC gained solid support in the U.S. Congress. Although some of the labor unions opposed privatization, most tentatively supported the move, believing a private company would promote operating efficiencies and flexibility, and thus, provide greater job security.

A national interest element also played a role in the move toward privatization of the U.S. government's uranium enrichment activities. Nuclear energy provides 20 percent of the United States' electricity needs. Nearly 77 percent of all households receive a portion of their household energy needs from nuclear power plants. Therefore, a healthy and strong uranium enrichment service was deemed a vital national interest. To maintain a position in the world markets, as well as to satisfy domestic energy needs, support grew for a private uranium enrichment service that could be flexible and responsive to competitive market forces.

Privatization Process

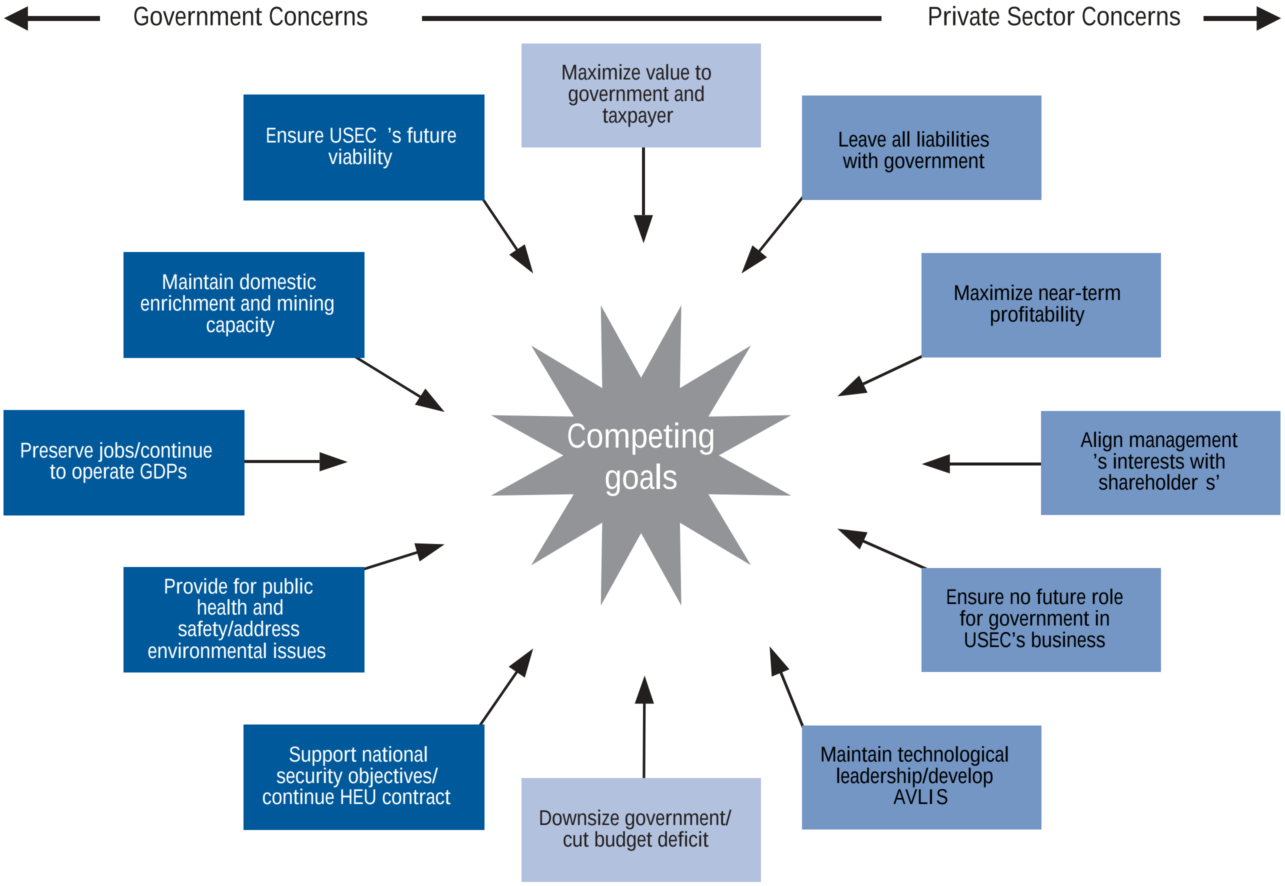
In 1995, USEC submitted its plan for privatization to the President and Congress. The plan accomplished the statutory requirement to evaluate alternative means of privatization by establishing a "dual-path" process, in which USEC simultaneously prepared for an initial public offering of stock and a negotiated sale to a third party. The plan concluded that such a dual-path process would allow decision makers to select the best means of privatization on the basis of concrete information about the relative merits of specific transaction alternatives. In July 1997, the President approved the privatization plan subject to the development of an adequate post-privatization oversight process.

The USEC Board considered third-party sale proposals from two potential buyers. The most attractive proposal was a leveraged buy-out that offered $1.9 billion for the acquisition of USEC, subject to a number of conditions. The second third-party sale proposal was also a leveraged buy-out, but it offered less attractive terms than either the first proposal or the public stock offering proposal.

In June of 1998, the USEC Board determined that both the first buy-out proposal and the public stock offering proposal satisfied the statutory requirements, but that the stock offering provided the superior method of addressing the special areas of concern identified in the two privatization statutes. The USEC Board unanimously approved privatization through the public stock offering.

Lessons

The USEC sale highlighted the importance of close cooperation and consensus building among key stakeholders. A close working relationship and effective communication between and among USEC management, its financial and legal advisers and key government players from the Administration and Congress were critical to assuring a successful sale transaction. The various interested parties had many competing goals and interests.



Reaching consensus required getting support from key government players and dealing with the concerns of outside parties.

Interested government entities

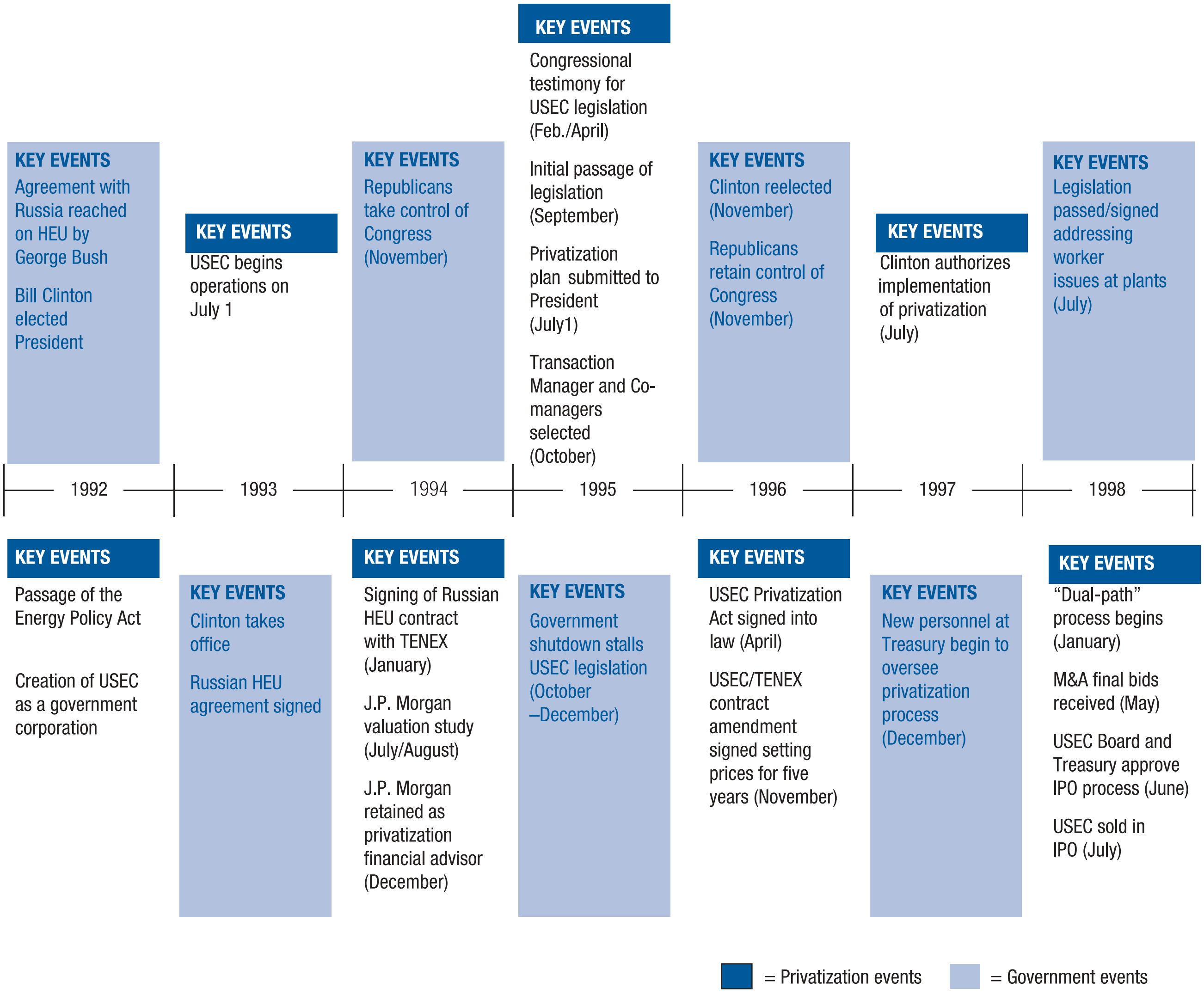
- Executive Office of the President
  - Office of Management and Budget (OMB)
  - National Economic Council (NEC)
  - Council of Economic Advisors (CEA)
- Cabinet Departments
  - Treasury
  - Energy
  - State
  - Justice
  - Defense
  - Commerce
- Nuclear Regulatory Commission (NRC)
- Central Intelligence Agency (CIA)
- U.S. Senate Committee on Energy and Natural Resources
- U.S. House Subcommittee on Energy and Power
- Other interested Senators and Congressman
- Congressional Budget Office (CBO)
- General Accounting Office (GAO)

Interested outside parties

- Unions representing workers at the GDPs
- Advocates for the uranium mining industry
- Russian government officials
- Academics with an interest in the privatization process
- Electric utilities
- Consumer advocates

USEC: Timeline of Key Events

Financial market concerns were addressed in a manner that balanced the government's interest in maximizing USEC's sales value while retaining its important, but less financially attractive national security obligations (i.e., purchasing Russian weapons grade uranium).



1992

KEY EVENTS
Agreement with Russia reached on HEU by George Bush

Bill Clinton elected President

KEY EVENTS
Passage of the Energy Policy Act

Creation of USEC as a government corporation

1993

KEY EVENTS
USEC begins operations on July 1

KEY EVENTS
Clinton takes office

Russian HEU agreement signed

1994

KEY EVENTS
Republicans take control of Congress (November)

KEY EVENTS
Signing of Russian HEU contract with TENEX (January)

J.P. Morgan valuation study (July/August)

J.P. Morgan retained as privatization financial advisor (December)

1995

KEY EVENTS
Congressional testimony for USEC legislation (Feb./April)

Initial passage of legislation (September)

Privatization plan submitted to President (July1)

Transaction Manager and Co-managers selected (October)

KEY EVENTS
Government shutdown stalls USEC legislation (October –December)

1996

KEY EVENTS
Clinton reelected (November)

Republicans retain control of Congress (November)

KEY EVENTS
USEC Privatization Act signed into law (April)

USEC/TENEX contract amendment signed setting prices for five years (November)

1997

KEY EVENTS
Clinton authorizes implementation of privatization (July)

KEY EVENTS
New personnel at Treasury begin to oversee privatization process (December)

1998

KEY EVENTS
Legislation passed/signed addressing worker issues at plants (July)

KEY EVENTS
"Dual-path" process begins (January)

M&A final bids received (May)

USEC Board and Treasury approve IPO process (June)

USEC sold in IPO (July)

■ = Privatization events □ = Government events

COMSAT

Overview

In 1962, Congress chartered the Communications Satellite Corporation (COMSAT) to help establish an international consortium to realize the United States' vision of a global satellite communications system. Though private sector parties were not willing to take the large financial and political risks associated with creating a global system, the United States wanted to have the greatest possible private sector involvement. As a result, COMSAT was created as a publicly-traded, for-profit corporation, and not as an agency or establishment of the U.S. government. Through COMSAT's efforts, the International Telecommunications Satellite Organization (INTELSAT) was established in 1964 as a cooperative between multiple member nations (132 prior to INTELSAT's privatization) to operate the global system of satellites. COMSAT was designated the U.S. signatory to INTELSAT and had exclusive rights to provide U.S. companies with access to the INTELSAT system. Full privatization of COMSAT was authorized in 2000 with the passage of legislation eliminating governance limitations and restrictions on the ownership of a majority of COMSAT stock. This legislation also moved INTELSAT toward full privatization.

Background

INTELSAT was formed as an international treaty-based organization in which governments ("parties") and telecommunications entities ("signatories") each had particular roles. The parties designated signatories, who were the actual owners and operators of the INTELSAT system and responsible for distributing INTELSAT services in their respective countries. Member nations hold an ownership interest in INTELSAT based on their percentage usage of the system, for which they are charged. Pursuant to the requirements of the 1962 Act, half of COMSAT's stock was sold to private telecommunications carriers and the other half was sold through a public offering.

COMSAT was incorporated in 1963. The President appointed the incorporators who were to serve as the initial board of directors and arrange the initial stock offering. NASA advised and assisted on research and development and furnished services, such as satellite launches on a reimbursable basis. The President of the United States appointed three of the 15 Directors on the Board. The remaining 12 directors were elected by 6 shareholders who were communications carriers and the remaining 6 by all other shareholders. COMSAT was regulated by the Federal Communications Commission, which authorized stock ownership of the publicly held company by common carriers and also oversaw the capital structure and debt guarantees of the business.

Through COMSAT's oversight of INTELSAT, the United States earned a return on its contributions, which were principally in the form of revenues to INTELSAT. INTELSAT's revenues were derived primarily from utilization charges, and after deduction of operating costs, INTELSAT distributed the remainder of utilization revenues to its members. The cooperative tapped external financing markets in order to promote a higher rate of return on members' contributions.

Privatization Legislation

In March of 2000, Congress passed and President Clinton signed "The Open-Market Reorganization for the Betterment of International Telecommunications Act" (ORBIT) (Public Law-106-180). The legislation abolished the Communications Satellite Act of 1962 and privatized the intergovernmental satellite organizations, INTELSAT and Inmarsat.

Key Drivers of Privatization

At the time of COMSAT's creation, private parties were unwilling to take the large financial risks associated with establishing a global satellite communications system. However, significant technological and market changes led to multiple private sector service offerings and a robust competitive satellite telecommunications market. While initially, the foreign signatories to INTELSAT were government-owned entities (posts, telegraph, and telecom), the global trend toward privatization resulted in a majority ownership stake of INTELSAT by fully or partially privatized signatories. In addition, INTELSAT had realized its vision of creating a global satellite network. A final privatization catalyst was Lockheed Martin's desire to acquire a majority stake in COMSAT and its need to eliminate the statutory impediments to doing so.

Privatization Process

The COMSAT privatization process was completed in two phases. In the first phase in 1998, Lockheed Martin announced its intention to acquire COMSAT. Lockheed made a cash tender offer for 49 percent of the outstanding shares of COMSAT common stock valued at $1.2 billion and committed to a one-for-one stock exchange. The preliminary phase was completed in September 1999 following COMSAT shareholder approval and initial Federal Communications Commission (FCC) approvals within the limitations placed on common carrier ownership of COMSAT's stock under the Communications Satellite Act of 1962. Lockheed lobbied Congress to change the laws preventing it from completing the purchase.

In January 2000, the ORBIT Act repealed the Communications Satellite Act of 1962 and set in motion the privatization of INTELSAT.

Shortly after enactment of the ORBIT Act, Lockheed Martin filed an application with the Commission for transfer of control of COMSAT's FCC licenses and authorizations. In July 2000, the FCC authorized the transfer to COMSAT as a wholly owned subsidiary of Lockheed. In August 2000, Lockheed Martin purchased COMSAT for $2 billion. The value of the exchange of common stock was approximately $790 million. The transaction was completed via a one-for-one tax-free exchange of Lockheed Martin common stock for COMSAT common stock for the remaining 51 percent of COMSAT stock Lockheed did not own.

COMSAT was integrated with Lockheed Martin Global Telecommunications (LMGT), a wholly owned subsidiary comprising Lockheed Martin's telecommunications services business. The new business planned to offer services in the United States as LMGT and retain offshore COMSAT International operation designations.

In 2001, as a result of several years of losses suffered by Lockheed Martin's telecommunications arm, the company announced its intention to sell some of the components of the unit and absorb others into its remaining businesses. Some pieces of the former COMSAT have already been sold.

Historical Milestones

Year	Event
1961	President Kennedy calls for international satellite communications system.
1962	Congress passes Communications Satellite Act. The Communications Satellite Corp.
1965	COMSAT launches Early Bird, the first satellite designed for commercial communications.
1975	COMSAT joins IBM Corp. and Aetna Life & Casualty Co. to form Satellite Business Systems (SBS), a network for private data and television communications.
1984	COMSAT drops out of money-losing SBS after an investment of $250 million. COMSAT abandons plans to enter the direct broadcast satellite television market, which has 7 million customers.
1989	COMSAT acquires a majority share of the NBA's Denver Nuggets, an example of the company's move into the sports and entertainment industry.
1992	COMSAT President becomes CEO and increases the company's investment in entertainment. In July, COMSAT announces that its entertainment holdings lost $6.4 million for the quarter. CEO resigns and successor is named.
1999	COMSAT was acquired by Lockheed Martin Corporation.

Government Sponsored Enterprises: Fannie Mae, Freddie Mac, and Sallie Mae

Government Sponsored Enterprises (GSEs) are corporate entities created by law for important public policy purposes. Of all the various organizational formats/structures in place in the U.S. government (i.e. wholly owned corporations, independent agencies, etc.), GSEs are the furthest removed from government. GSEs are in essence hybrids — mostly private entities with certain special “governmental” benefits. During the last 30 years, several government entities have been transformed into or created as GSEs. In some cases, GSEs have been fully privatized to remove all governmental ties. While there is no strict “legal” definition of a GSE, the working definition of a GSE is an entity which has the following characteristics:[3]

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[3] Budget Enforcement Act of 1990, sections 13112 and 13501. Also Moody’s Special Report, “U.S. Government Sponsored Enterprises (“GSEs”), October 1993. According to the Budget Enforcement Act of 1993, GSEs include Fannie Mae, Freddie Mac, Farmer Mac, the Federal Home Loan Banks, Sallie Mae and the Federal Farm Credit Banks. Though TVA is often listed as a GSE, it is a wholly-owned government corporation, though its debt is not explicitly backed by the U.S. Government.

- A federal charter;
- Private ownership, as evidenced by capital stock owned by private entities or individuals;
- Governance by a board of directors, a majority of whom are elected by shareholders;
- Is a financial institution authorized to make loans or loan guarantees for limited purposes (credit for specific borrowers or one sector) and raise funds by borrowing (without a government guarantee) or to "guarantee the debt of others in unlimited amounts";
- Does not exercise powers reserved to the U.S. government as a sovereign (power to tax, regulate commerce);
- Does not have the power to commit the government financially;
- Has employees who are paid by the enterprise and are not Federal employees subject to Title 5 of the U.S. Code.

Following is a description of Fannie Mae, Freddie Mac, and Sallie Mae. Fannie Mae and Freddie Mac are two GSEs created through the "privatization" of existing government entities. Sallie Mae was created de novo as a GSE and then fully privatized.

Fannie Mae

Overview

Fannie Mae (The Federal National Mortgage Association) is a federally chartered and stockholder-owned GSE. Fannie Mae's public mission is to increase the liquidity and stability of the U.S. residential mortgage market and to help increase the availability of mortgage credit to low and moderate income families and underserved areas. Fannie Mae and its main competitor, Freddie Mac, are the largest investors in home mortgage loans in the United States. Fannie Mae's current market capitalization is approximately $80 billion.

Background

During the 1930s, few new mortgage loans were being made because of the uncertain economic conditions during the Great Depression. Thrift institutions, which were the principal mortgage lenders, were failing in large numbers and foreclosure rates were high because unemployed workers were no longer able to meet their loan commitments. In 1934, the federal government addressed the lack of mortgage credit availability and other problems in the mortgage market by enacting, among other initiatives, the National Housing Act (NHA). The NHA established a system of federal insurance for qualified home mortgage loans. Under the NHA, the new Federal Housing Administration (FHA) was authorized to guarantee repayment of up to 90 percent of acceptable home loans, encouraging private lenders to lend more of a home's market value, accept longer terms on home mortgages, and charge lower interest rates.

In passing the NHA, Congress hoped that a system of private secondary market associations would develop to bring the benefits of lower capital costs to home buyers. In the ensuing years, no such organizations formed and in 1938 the President asked the Reconstruction Finance Corporation (RFC) to form one as a subsidiary. It was chartered as the National Mortgage Association, which soon changed its name to the Federal National Mortgage Association (FNMA).

Fannie Mae remained an RFC subsidiary until 1950, when it was transferred to the Housing and Home Finance Agency. Structured as a government corporation, it was only permitted to buy and sell mortgages insured by the FHA. Fannie Mae funded its activities through the Treasury and the national capital markets.

In 1954, Fannie Mae was restructured because Congress wanted it to act more as a conduit than a holder of loans. As part of the restructuring, Fannie Mae began liquidating its mortgage portfolio. The 1954 Act also transformed Fannie Mae into a mixed-ownership corporation (with a combination of government and private ownership) and provided for its gradual transfer to private ownership. The Treasury Department's stock became preferred stock. Firms selling mortgages to Fannie Mae were required to purchase nonvoting common stock which could be resold to the public. The Secretary of Treasury determined the dividends to be paid into the Treasury by Fannie Mae. Fannie Mae could issue its own debt, but with no explicit federal backing. The Fannie Mae Board was comprised of five members. The Housing and Home Finance Administrator served as the chairman and he appointed the other board members who were Fannie Mae or other government employees.

Privatization Legislation

In February of 1968, President Johnson sent a "Message on Cities" to Congress, in which he requested passage of a variety of urban-aid initiatives. Among them were amendments to Fannie Mae's charter designed to "transfer the secondary mortgage market operations of Fannie Mae on an orderly basis to completely private ownership." Later that year, President Johnson signed the congressionally enacted legislation and Fannie Mae was established as a private, shareholder-owned company.

In 1992, Congress amended Fannie Mae's charter to reaffirm and clarify its role in the housing finance system. The 1992 Act also established a safety and soundness regulator for Fannie Mae and Freddie Mac (the Office of Federal Housing Enterprise Oversight) and gave the Department of Housing and Urban Development (HUD) the responsibility of regulating Fannie Mae and Freddie Mac's mission requirements. The Act established capital rules and affordable housing goals for both GSEs.

Key Drivers of Privatization

The macroeconomic disruptions of the late 1960s significantly diminished the flow of credit from traditional lenders to housing. In order to increase the availability of mortgage credit, Fannie Mae was granted the authority to begin purchasing conventional loans (non-FHA/VA). This resulted in significant additional mortgage purchase activity. Under new unified budget rules passed in 1967, Fannie Mae's mortgage purchases were to be counted as budget outlays. By establishing Fannie Mae as a privately owned corporation, these mortgage purchases were kept off-budget. As such, Federal budget reforms were also a key reason for splitting up Fannie Mae and structuring part of it as a GSE.

Privatization Process

The transfer to private ownership was completed by dividing Fannie Mae into two parts: a privately owned corporation (which retained the name Federal National Mortgage Association), and a new government corporation, the Government National Mortgage Association (Ginnie Mae) within the Department of Housing and Urban

Development. The new Fannie Mae thus became a GSE with a narrowly defined mission. Ginnie Mae became responsible for bolstering the secondary market for special housing programs and liquidating Fannie Mae's remaining mortgage portfolio.

The 1968 charter amendments provided that Fannie Mae would assume responsibility for its own management after a transitional period, which could end at any time on or after May 1, 1970. This could not occur, however, until the board of directors found, with the concurrence of the Secretary of HUD, that at least one-third of Fannie Mae's common stock was owned by persons or institutions in the mortgage lending, home building, real estate or related businesses. In February of 1970, the board of directors made this finding and the transitional period was declared at an end. The board was then restructured to consist of 15 persons, 10 elected annually by the stockholders and five appointed by the President of the United States.

Pursuant to the legislation, Congress sold the government's remaining interest in Fannie Mae. Fannie Mae paid the Treasury $216 million for the government's preferred stock and its other interests using proceeds from the sale of subordinated debentures. The preferred stock was retired and Fannie Mae was taken off the federal budget. In 1970, Fannie Mae stock was listed for trading on the New York Stock Exchange making its transformation to private shareholder ownership complete. Fannie Mae's earnings are exempt from state and local income tax but it does pay federal income tax.

Privatization Lessons

Federal budget imperatives often provide a compelling rationale for privatization. In this case, Fannie Mae's privatization demonstrated that by using the GSE model, a government entity could be privatized and moved off-budget while retaining a number of valuable government related characteristics as well as a public mission where the value of the GSE status can accrue to private shareholders.

Historical Milestones – Fannie Mae

Year	Event
1934	Federal government creates National Housing Act, forming a system of federal insurance for qualified home mortgage loans.
1938	Fannie Mae established under New Deal program. Initial purpose was to provide liquidity and bring stability to residential mortgage market and to ensure that funds for housing would be available on a continuing basis. Incorporated under Title III of the National Housing Act. Wholly owned government corporation. Borrows operating funds directly from Treasury. Purchases and resells mortgages insured by FHA.
1948	Fannie Mae begins to purchase and resell mortgages insured by Veterans Administration.
1950-65	Fannie Mae acts as constituent agency of Housing and Home Finance Agency.
1965-68	Fannie Mae operates under Department of Housing and Urban Development.

Historical Milestones – Fannie Mae

Year	Event
1968	Charter Act (the "Act of 1968") enacted. Allows Fannie Mae to: Conduct secondary market operations in FHA/VA insured home mortgage loans; Perform "special assistance functions" in the purchase of mortgage loans as authorized by the President or Congress to assist in financing home loans in instances where established home financing facilities were inadequate; Manage and liquidate certain mortgage loans. President Johnson requests transfer of the secondary market functions of Fannie Mae to "private ownership". Congress passes Act of 1968: Splits old Fannie Mae into Government National Mortgage Association ("Ginnie Mae") and today's Fannie Mae; Changes each share of outstanding non-voting common stock (old par value of $100 per share) into one share of voting common stock; Shares authorized to be sold to public; transitional period given to allow for public control of Fannie Mae; all federal ownership of Fannie Mae is removed.
1969	Emergency Home Finance Act expands Fannie Mae's purchase authority to include conventional mortgages (i.e., those mortgages without a federal guarantee).
1970	Fannie Mae shares listed on NYSE.
1989	Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") gives General Accounting Office ("GAO") authority to audit Fannie Mae.
1992	Office of Federal Housing Enterprise Oversight created as part of HUD to oversee Fannie Mae and Freddie Mac.

Freddie Mac

Overview

Similar to Fannie Mae in its structure and mission, Freddie Mac (The Federal Home Loan Mortgage Corporation or FHLMC) is a federally chartered and stockholder-owned GSE. Established in 1970, Freddie Mac's public mission is to increase the liquidity and stability of the U.S. residential mortgage market and to help increase the availability of credit to low and moderate income families and underserved areas. Freddie Mac purchases, guarantees, and securitizes conventional residential mortgages. Though today Fannie Mae and Freddie Mac's businesses are almost identical (though Freddie Mac's balance sheet is roughly two-thirds the size of Fannie Mae's), Freddie Mac was originally mandated to establish a secondary market for conventional residential mortgages, while Fannie Mae was charged with creating products and services to facilitate home ownership, as well as purchasing and providing a secondary market for FHA/VA mortgages. Freddie Mac's current market capitalization is approximately $45 billion.

Background

As Fannie Mae proceeded with its mission of providing a secondary market for FHA and VA mortgages, it became apparent throughout the 1950s and 1960s that a secondary market for conventional mortgages was also needed. The thrift industry launched a limited attempt to develop such a market in a partial effort to correct the regional imbalances in mortgage money supply and demand. However, this activity was confined mostly to private sales of mortgages by one savings and loan association to another.

By 1970, the U.S. economy was experiencing a new round of inflation, which pushed FHA mortgage rates to the almost unheard level of 8.5 percent. The housing industry and aspiring homebuilders were caught in a situation where the Federal Reserve Board was attempting to discourage borrowing in order to control inflation. Despite a record number of housing starts in 1969, the country was 2.5 million units behind projected production by the early 1970s. In the meantime, mortgage lenders (mainly savings and loan associations) were unable to generate a sufficient number of new loans because of Federal Reserve Board policies to discourage such borrowing. Public and industry pressure began to mount for President Nixon and the Democratically controlled Congress to alleviate the effects of inflation and rising interest rates on the housing industry.

Both the Administration and members of Congress realized that a robust secondary market for conventional home mortgages was required, and they advocated legislation to create a “facility” that would handle such mortgages, either in the Federal Home Loan Bank system or Fannie Mae. Both the Nixon Administration and members of Congress had proposed separate legislation for this purpose, and the concept was incorporated into the housing bill compromise, with both the House and Senate passing nearly identical secondary market provisions.

All the major components of the housing and thrift industries supported expansion of the secondary market. The Federal Reserve Board opposed conventional mortgage purchase authority for Fannie Mae because it would increase the costs and risks to Fannie Mae of purchasing mortgages that had no federal backing, but the Federal Reserve Board’s view on this and other matters was ignored by elected officials and constituencies angry with the Federal Reserve Board over its existing monetary policies.

The Emergency Home Finance Act (the Act), passed in 1970, established another secondary mortgage market entity, the Federal Home Loan Mortgage Corporation (FHLMC, later Freddie Mac). The FHLMC was placed under the direction of the Federal Home Loan Bank Board, which was also the federal regulator for savings and loan institutions. Freddie Mac’s mission was to relieve the often-chronic regional mismatch between savings deposits and demand for mortgage credit by creating a national secondary market for conventional mortgage loans.

Privatization Legislation

In 1989, Freddie Mac’s governance structure and operations were altered significantly under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), a sweeping overhaul of federal laws governing savings and loan institutions. FIRREA was prompted by the massive failure of hundreds of savings institutions in the early to mid-1980s. Among other things, FIRREA eliminated and shifted the functions of Freddie Mac's umbrella agency, the Federal Home Loan Bank Board, and spun Freddie Mac off on its own, on equal footing with Fannie Mae. Freddie Mac's three-member board (the Federal Home Loan Bank Board) was replaced with an eighteen member Board of Directors with thirteen elected annually by shareholders and five annually appointed by the president. Like Fannie Mae, Freddie Mac's earnings were exempt from state and local income tax, though not from federal income tax.

In 1992, Congress amended Freddie Mac's charter to reaffirm and clarify its role in the housing finance system. The 1992 Act also established a safety and soundness regulator for Fannie Mae and Freddie Mac (the Office of Federal Housing Enterprise Oversight) and gave the Department of Housing and Urban Development (HUD) the responsibility of regulating Fannie Mae and Freddie Mac's mission requirements. The Act established capital rules and affordable housing goals for both GSEs.

Key Drivers of Privatization

In the wake of the thrift crisis, The Federal Home Loan Bank Board — the thrift industry's main regulator — was blamed for fostering a lax regulatory environment that allowed thrifts to operate in an unsafe and unsound manner. Inherent conflicts in the mission and structure of the Bank Board often placed it in a position of being both industry regulator and advocate. Freddie Mac was wholly owned by the Federal Home Loan Banks and its members, and the Bank Board was Freddie Mac's Board of Directors and regulator. Congress sought to eliminate these various conflicts by dissolving the Bank Board and restructuring Freddie Mac to be a GSE in the same form as Fannie Mae. In addition, Freddie Mac's restructuring in FIRREA took it off the federal budget.

Privatization Process

When it was established in 1970, Freddie Mac was granted initial maximum capital stock of $100 million. Initially, Freddie Mac stock was held by the twelve Federal Home Loan Banks (which were in turn owned by member thrifts). Freddie Mac's ownership was broadened in 1984 when the thrifts were allowed to recognize their ownership interest on their books. The 1989 FIRREA legislation simply converted the 60 million shares of Freddie Mac non-voting, senior participating preferred stock into voting common stock and removed the law's provisions restricting ownership of FHLMC stock to FHLB member institutions.

Lessons

As in the case of Fannie Mae, Freddie Mac's transformation to a GSE demonstrated that by using the GSE model, a government entity could be effectively privatized but still retain a number of valuable government-related characteristics along with a public mission where the value of the GSE status can accrue to private shareholders. A legislative response to a crisis (in this case the thrift debacle) often provides the opportunity to enact significant changes which might not be politically feasible during more prosperous times.

Historical Milestones – Freddie Mac

Year	Event
1970	Compromise housing legislation, "Emergency Home Finance Act of 1970", enacted by Nixon Administration and Congress to alleviate housing shortage: Establishes Freddie Mac under direction of FHL Bank Board; Sets goal for creation of national secondary mortgage market; Gives initial capital of $100 million to Freddie Mac; Empowers Freddie Mac to buy, hold, and sell mortgages; Allows Freddie Mac to borrow funds and issue mortgage obligations; Freddie Mac is initially federal tax exempt.
1984	Deficit Reduction Act of 1984 repeals Freddie Mac's federal tax exemption.
1989	Financial Institutions Reform, Recovery and Enforcement Act splits Freddie Mac from FHLBank Board. Freddie Mac shares begin to be actively traded on NYSE.

Sallie Mae

Overview

Sallie Mae was established in 1972 as a federally chartered stockholder-owned GSE to provide liquidity for federally insured student loans made by lenders (including educational institutions) under the Guaranteed Student Loan Program, (now known as the Federal Family Education Loan Program or FFELP).

Sallie Mae provides financial and related operational and technological services to participants in the nation's education market. Sallie Mae makes a secondary market in education loans and provides secured advances, as well as operational support, to originators of such loans. It is the largest single source of financing for loans originated under the FFELP. Sallie Mae is also the largest servicer of education loans, administering loans for its own account, as well as for many of its client loan-selling institutions. In addition, Sallie Mae provides other educational-related financial services such as financing for colleges and universities for academic plant and equipment.

Sallie Mae's secondary market activities generally involve the direct purchase of guaranteed student loans by the corporation as well as issuance by the corporation of commitments to purchase student loans in the future. Warehousing operations involve the making of loans, called "warehousing advances," to lenders, collateralized at 100 percent by student loans, U.S. Treasury or agency securities, or other acceptable collateral. Sallie Mae also offers credit support to state agencies that make or buy educational loans, providing, for example, letters of credit which lend the highest investment grade rating to the agencies' student loan revenue bond issues. Sallie Mae competes directly with the federal government's direct lending program (resurrected in 1993) for a share of the federally-backed student loan market.

Background

Congress approved the first federal aid to higher education in 1867 by creating land grant colleges. Until 1950, programs of federal aid to higher education remained targeted on vocational education and aid to veterans. During the 1950s and 1960s, Congress enacted a variety of higher education aid programs to assist the large number of World War II and Korean War veterans, and later, the post-World War II "baby boom" generation that entered college in the mid-1960s. The federal government began making direct education loans to students in 1958. The most important of the higher education programs, popular among veterans and middle-income families, who aspired to higher education for their children in ever increasing numbers, were authorized by the National Defense Education Act, the Higher Education Facilities Act, and the Higher Education Act of 1965.

While public desire for a college education was expanding dramatically, colleges and universities were attempting to accommodate greater numbers of students through increased admissions. However, these institutions were finding it difficult to provide the same level of financial aid to deserving students than had been possible when fewer students were seeking college admission. As a result, many colleges and universities were experiencing significant financial troubles and sought the expansion of federal higher education assistance programs. Sallie Mae was thus created.

Sallie Mae's enabling legislation provided for a 21-member Board of Directors, 14 of whom were elected by shareholders. The remaining seven were appointed by the President of the United States, who also designates the Chairman of the Board from among the 21 directors. Sallie Mae voting stock was issued to qualified Guaranteed Student Loan Program lenders and educational institutions. The legislation also provided initial financial support for Sallie Mae by authorizing appropriations of up to $5 million for start-up operations through the Department of Health, Education and Welfare. The government also gave Sallie Mae debt a full faith and credit guarantee until 1984. Sallie Mae never received the direct appropriations but did issue government guaranteed debt securities in the capital market until 1975. From 1975 to 1982, Sallie Mae issued debt through the Federal Financing bank under a Department of Education guarantee. In 1981, Sallie Mae began issuing nonguaranteed debt and stopped issuance of explicitly guaranteed debt altogether in 1982. In 1992, amendments to the Higher Education Act converted all outstanding Sallie Mae equity classes to unrestricted voting common stock.

Although like other GSEs, Sallie Mae enjoyed an implicit government guarantee that allowed it to borrow at lower rates than private sector entities, Congress singled out Sallie Mae in trying to mitigate the value of the GSE funding advantage. In the Student Loan Act of 1993, Congress imposed on Sallie Mae an "offset fee" equal to 30 basis points of the "principal amount of each loan made, insured or guaranteed".

Privatization Legislation

On September 30, 1996, President Clinton signed The Student Loan Marketing Association Reorganization Act of 1996 (20 U.S.C. 1087-3) authorizing Sallie Mae to restructure itself as a fully private, state-chartered corporation.

Privatization Process

Pursuant to the privatization legislation, Sallie Mae's board of directors developed a plan for full privatization that was submitted to and approved by Sallie Mae shareholders. The common shares of the Student Loan Marketing Association (the GSE) automatically were converted, on August 7, 1997, on a one-for-one basis to shares of SLM Holding Corp., a Delaware-chartered corporation, with a 15-member shareholder-elected Board of Directors. Simultaneously, the GSE became a wholly owned subsidiary of SLM Holding Corp. SLM Holding Corp. was renamed USA Education, Inc. on July 31, 2000. The 1996 Act requires the GSE to wind down its operations and be liquidated no later than September 30, 2008. Under legislation passed in 1998, if USA Education, Inc. affiliates with a depository institution, the GSE must wind down within two years (unless extended by the Secretary of Treasury). Sallie Mae recently announced that it will wind down the GSE two years ahead of the 2008 deadline.

Lessons

Sallie Mae's establishment as a GSE and its privatization 24 years later showed that legislation can be structured to provide a transition to GSE status as well as a complete separation from the government. Sallie Mae's charter provided direct financial support in the form of appropriations authority and a full faith and credit guarantee on its debt for up to 10 years after its creation. The 1996 privatization legislation provided a 10-year phase out of its GSE status.

Historical Milestones – Sallie Mae

Year	Event
1971	Senate and House subcommittees consider extending higher education assistance programs.
1972	Nixon Administration proposes Higher Education Opportunity Act and Congress/Senate pass legislation: Authorizes additional funds for education; Creates Sallie Mae and gives federal government backing of Sallie Mae until 1982; Allows Sallie Mae to borrow from Federal Financing Bank; Sallie Mae issues voting common stock to qualified Guaranteed Student Loan Program lenders and educational institutions.
1980	Education Amendments of 1980 broadened Sallie Mae's product and financing capabilities. Authorized non-voting common stock.
1982	Agreement reached in 1981 that allowed Sallie Mae to borrow outside of Federal Financing Bank once $5 billion in total borrowings reached; $5 billion level reached in 1982. Sallie Mae Technical Amendments Act reassures private lenders that they would have chance to get their money back in unlikely case that Sallie Mae went bankrupt.
1993	The Higher Education Amendments Act of 1992 allows Sallie Mae to convert all of unrestricted voting and unrestricted nonvoting common stock into single new class of unrestricted voting common stock on a share for share basis.
1994	Clinton Administration enacts direct student lending program.
1995	Sallie Mae announces intention to become a "fully privatized" institution.
1996	Student Loan Marketing Association Reorganization Act of 1996 mandates full privatization of Sallie Mae and phase out of GSE.

COMPARISON OF GSES' LINKS TO THE GOVERNMENT

	Fannie Mae	**Freddie Mac**	**Sallie Mae**
Chartered by Congress	Yes	Yes	Yes
Ownership	Private	Private	Private
President or presidential appointees appoint some board members	Yes	Yes	Yes
Treasury lending authorized	$2.25 billion	$2.25 billion	$1.0 billion
Treasury approval of debt issuance	Yes	Yes	Yes
Eligible for Fed open market purchase	Yes	Yes	Yes
Use of Fed as fiscal agent	Yes	Yes	Yes
Eligible to collateralize public deposits (all U.S. Government; most State and local)	Yes	Yes	Yes
Exempt from SEC registration (1933 Act)	Yes	Yes	Yes
Government securities for purposes of the Securities Exchange Act of 1934	Yes	Yes	Yes
Eligible for unlimited investment by national banks and State bank Federal Reserve members	Yes	Yes	Yes
Eligible for unlimited investment by thrifts regulated by FDIC or OTS	Yes	Yes	Yes
Exemption of corporate earnings from Federal income tax	No	No	No
Exemption of corporate earnings from State and local income tax	Yes	Yes	Yes
Exemption of interest paid from State income tax	No	No	Yes
Subject to GAO audit	Yes	Yes	No
Federal regulator	OFHEO and HUD	OFHEO and HUD	Treasury

Appendix U

APPENDIX U — The Universal Service Obligation and the Postal Monopoly[†]

Part 1 — Defining and Measuring the Postal Universal Service Obligation

Introduction

Historically, Congress has provided the Postal Service a legal monopoly over the delivery of letters in order to provide financial support for universal service to all areas of the United States. This universal service obligation, or USO, as summarized in the Postal Reorganization Act of 1970, requires the Postal Service to “provide prompt, reliable, and efficient services to patrons in all areas and…render postal services to all communities” at “fair and equitable” rates. The Act further requires the Postal Service to “receive, transmit, and deliver throughout the United States written and printed matter, parcels and like materials…”. The extent of the Postal Service’s universal service obligation is quite broad. It must serve “as nearly as practicable the entire population of the United States.” Additional requirements specify that the Postal Service must offer a uniform rate for sealed letters.

Other forms of public service obligations arise in different contexts. For example, the Postal Service assumes responsibility for fulfilling the Acts of the Universal Postal Union (see Appendix I). In the context of rate making, one of the statutory criteria consists of consideration of educational, culture, scientific and informational value of the mail. This criterion generally weighs in favor of low rates for socially valued types of publications. By law the Postal Service also fulfills other social policy objectives, ranging from reduced rates for nonprofit mail and non-zoned rates for books, films, and like matter,[1] to specialized labor protections.

The government imposes universal service obligations on a firm or industry when socially desirable services are unlikely to be provided in sufficient quantities or at affordable rates. USOs arise in a number of industries and are funded in a variety of ways: by a direct governmental subsidy, by assessments on providers or customers, or internally with strong contributions by a “reserved area” of products or services somewhat protected from competition.[2] The Postal Service USO is funded internally, through cost averaging and differential markups, with First-Class Mail carrying the largest total share of institutional or overhead costs. The Private Express Statutes grant the Postal Service the exclusive right, with limited exceptions, to carry letters for compensation.[3] These laws, which establish the Postal Service’s “reserved area,” protect the revenue base that enables the Postal Service to meet its USO. In addition, the network of mailboxes approved by the Postal Service for its use is not available to other services without paying postage.

[†] This appendix was prepared for the United States Postal Service by Laurits R. Christensen Associates, Inc., an economics consulting firm in Madison, WI, that specializes in regulated industries, including natural gas, electricity, telecommunications, transportation, and postal services.

[1] 39 USC 101(a), (d); 39 USC 3626; 39 USC 3683.

[2] “Reserved area” refers to the products and services over which a postal service has a monopoly.

[3] A discussion of the Private Express Statutes can be found in *“The Postal Service Monopoly”* on page 10 of this appendix.

In recent years, this system of internally funding the postal USO has come under closer scrutiny. Some have questioned whether the cost of maintaining the USO is large enough to warrant the current monopoly restrictions. Others have expressed concern that increased competition in delivery and the expansion of electronic communication may erode the postal monopoly to the point where funding from the reserved area will not be sufficient to cover the USO cost and maintain other social obligations.

One of the difficulties, in addressing these issues, is that while postal obligations are broadly defined by legislation, the USO today permeates the postal system and does not comprise separate services or distinct pieces. In addition to providing service across the United States, the Postal Service “averages” rates across a number of mail pieces with different cost characteristics to provide a uniform rate for letters as required by law as part of the USO. The cost of the USO depends upon the USO definition. A definition that includes an extensive list of obligations will generally be associated with a high cost, while a limited definition will have a lower cost. Finally, even the more commercial of the services offered by the Postal Service are sometimes accorded USO valuation by customers who depend on them, or by their elected representatives. For example, parcel shipments of live animals, or Express Mail service to comparatively remote communities, once established, cannot be curtailed without arousing some controversy.

Universal service obligations have been an issue in a number of regulated industries. Universal service is a key element in the regulation of the telecommunications and electric power industries. As these industries are being restructured and deregulated, important issues have arisen about the maintenance of universal service. Various transportation industries also have universal service as an objective. Prior to the deregulation of the rail and airline industries, the Interstate Commerce Commission and Civil Aeronautics Board established mechanisms to maintain service to small communities. After the industries were deregulated, new legislation was put into place to help maintain service in small communities. The programs developed to address universal service concerns differ across industries. This is due to differences in the economic structure of the industries and differences in regulatory objectives.

In the past few years, a number of countries have begun addressing the postal USO. In particular, formal undertakings in Australia, the European Union, and the United Kingdom have attempted to define the scope of universal service and measure its cost. These efforts have been driven by the objective of introducing competition in the postal industry. Evaluating and costing the USO are important elements in weighing the risks and benefits of allowing greater competition.

While there have been no official undertakings addressing the U.S. Postal Service’s comparatively nonspecific USO, a number of studies have been published in the past few years that attempt to make a start at estimating USO costs. These studies have produced widely varying cost estimates, as well as different policy conclusions. The differences in these studies are largely due to different assumptions about the impact of competition and cream skimming on Postal Service finances, and differences in data availability. Furthermore, these studies focus on mail delivery, ignoring other potential dimensions of universal service and other social obligations of the Postal Service.

This section reviews the universal service obligation in various U.S. industries. It also reviews the formal undertakings to define and measure the cost of the USO in other countries, as well as reviewing the recent literature on Postal Service USO costs.

The conclusion to be drawn from this review is that an accurate cost evaluation of the Postal Service USO would incorporate the following elements. First, there must be a comprehensive and precise definition of the universal service obligation. Second, realistic assumptions must be made about the competitive environment that the Postal Service will face. Third, universal service cost calculations must be derived from data that are much more detailed than those currently available in the Cost and Revenue Analysis or other public data sources. These requirements set a challenging target for universal service cost studies, but without these elements one cannot accurately measure the cost of universal service.

Universal Service in Various U.S. Industries

Telecommunications. Some have suggested that the process of defining and attributing cost to the U.S. Postal Service USO might follow the pattern established for the much more technology-intensive telecommunications sector under the Telecommunications Act of 1996 (the Telecom Act). But there are significant differences between the two industries. The biggest difference arises from the fact that customers are physically connected to the telecommunications network, and customers pay monthly fixed charges for that physical connection. In contrast, there is no physical link between customers and the postal network. At the same time, there is fixed cost in setting up the postal network that parallels the fixed cost associated with the physical telecommunications network, but customers do not pay monthly subscription charges to be “linked” to the network. Instead, postage rates are set high enough to recover the fixed cost. If mail volume declines, rates must be raised, or else the fixed cost will not be covered.[4]

The telecommunications universal service obligation is also different from what is generally considered the postal USO. Universal service in the telecommunications industry has always been based on providing some amount of service to as many households as possible, but not every household has service. The provision of these services at “affordable” rates has been the primary means of achieving the telecommunications universal service goals. Before 1996, telecommunications universal service was thought of as connecting as many households as possible to the network. Since 1996, the USO definition has focused on particular telecommunication “services” that are widely used (e.g. touch-tone service and 911 service). In contrast, the current Postal Service universal service obligation is to deliver virtually all of its services to every address, but the type of delivery service can vary by household; some households have service to the door while others have service to cluster boxes.

The Telecom Act was designed to promote full competition in the local exchange segment of the telecommunications industry. It encourages the entry of “competitive local exchange carriers” into markets currently served by “incumbent local exchange

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[4] This discussion focuses on wire-line telephony. The cellular telephone network does not have a physical connection to the customer, but it has substantial fixed costs associated with linking the customer to the network, and the customer pays a fixed monthly subscription charge.

carriers." The Telecom Act recognizes that this increased competition will make it infeasible to finance universal service through a system of internal subsidies, therefore it establishes an explicit funding mechanism for universal service. Furthermore, competitive bidding is encouraged for the provision of universal service. While there have been proposals to restrict the Postal Service monopoly, these proposals do not go as far as the Telecom Act to encourage competition in all sectors of the postal industry, including universal service.

Airlines. Before the Airline Deregulation Act of 1978, the Civil Aeronautics Board maintained universal service by awarding routes to particular carriers. As part of airline deregulation, Congress established the Essential Air Service program to ensure that small communities would retain some level of air service. The U.S. Department of Transportation pays a subsidy, if necessary, to ensure that a specified level of service is provided to eligible communities. The Federal Aviation Administration funds these airline subsidies from general appropriations that amount to approximately $50 million per year. This program is less formally structured than the telecommunications industry's approach to universal service and is not very large in its scope. For the few communities that receive it, the subsidy amounts to approximately $100 per passenger.

The airline industry is an example of an industry that has been deregulated for many years. The current scope of the airline USO is minimal, as is its funding. Unlike the expansive postal USO that requires the Postal Service to deliver to every address, the Essential Air Service program does not mandate service to all communities, and relatively few communities receive subsidized airline service. In addition, the source of future funding for the airline USO is always subject to changing political priorities.[5]

Railroads. U.S. railroads were historically not permitted to abandon freight services to small communities. This changed in 1980 when the Staggers Act substantially reduced railroad regulation. Since then, the federal government has fostered the maintenance of freight service to smaller communities through the Local Rail Freight Assistance Program. Communities may apply for funding for three types of projects: 1) acquisition of lines that have been authorized for abandonment; 2) rehabilitation of low-density lines; and 3) construction of rail facilities with respect to low-density lines. All community proposals must pass a cost-benefit test in order to receive funding. In recent years, funds have not been authorized for this program, so its future appears in doubt.

There are also numerous state and local programs that have subsidized the provision of rail service to communities. These programs are often thought of more as economic development initiatives than universal service programs.

Similar to the Postal Service's obligation to serve all delivery points, railroads were once forced to serve many high-cost and unprofitable areas. This created widespread financial instability in the industry. Since the Staggers Act, railroads have abandoned thousands of miles of unprofitable lines (some of which were eventually taken over by small, regional railroads). These abandoned lines are a visible representation of the scope and cost of the industry's former universal service obligations, which have since been eliminated.

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[5] When the external source of USO funding is the United States government, the availability of funds depends upon a political process. Funds are not always authorized even if legislation is passed that provides for such expenditures. See the discussion of the railroad industry below.

Electric Power. A number of programs in the electric power industry are related to universal service goals. These include programs that provide funding to electric power providers to construct facilities in high-cost, largely rural areas; programs that assist low-income consumers; and programs that assist distribution companies that provide universal service to customers. To the extent rates are averaged, low-cost customers subsidize high-cost customers (although high-cost customers are not necessarily customers who have difficulty paying for service).

Universal service programs that assist low-income consumers are administered at the state level and vary across states. While these programs have existed for a number of years, many states now use these programs in conjunction with industry restructuring. For example, Maryland has established an Electric Universal Service Program authorized by the Maryland General Assembly to assist low-income electric customers with arrearage retirement, bill assistance, and weatherization.

Under electric power industry restructuring, the USO is accomplished through the designation of default electric power suppliers. In general, electric industry reform legislation gives the states' public service commissions the responsibility to determine the methodology for selecting default suppliers. There have been a number of bills before Congress that address competition and universal service in the electric power industry. However, at the current time, a federal bill has not been enacted.

The electric power industry is another traditionally regulated industry that is moving toward a competitive market structure. While there are some programs to fund infrastructure development, the primary focus of universal service programs is the provision of assistance to customers who have difficulty paying their bills. This industry is adopting many options for funding universal service that do not involve maintaining a reserved area. The electric power industry programs also focus on the ability of low-income customers (who are not necessarily the protected high-cost customers) to pay for service. Under the current Postal Service rate structure, the ability to pay is not an issue because there are no explicit network connection fees, and postage fees are a small part of the average household's expenditures.

Postal Universal Service in Australia and Europe

Australia, the European Union, and the United Kingdom have all undertaken formal reviews of their postal USOs in recent years. Generally, these studies have estimated a relatively low level of USO cost. The low estimates are due to a number of factors including narrow definitions of the USO relative to the United States, data limitations, and poor data quality. Because of these limitations and shortcomings, and the fact that postal services are provided under a number of different institutional frameworks, the results of these studies are of limited use in addressing postal USO costs in the United States.

Australia. The Australian Postal Corporation Act requires that Australia Post operate for profit and that its USO be internally funded.[6] The USO embodied in Australia Post's legislative mandate requires that it provide universal letter service with prescribed minimum service standards, reasonable access, and a uniform price.

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[6] In Australia, the cost of the USO is generally referred to as the community service obligation.

In 1998, Australia Post released its Customer Service Charter, which outlines its customer service standards. That same year, the National Competition Council conducted a review of postal operations, in order to determine whether any legislative changes were necessary.[7] The Council looked at a number of issues including the specification of the USO and its cost. As part of this process, Australia Post submitted a USO cost estimate of $67 million (Australian), or about 4.2 percent of Australia Post's revenue from letters (and about 2.5 percent of its total mail revenue). While the National Competition Council had concerns about some of the details of the Australia Post study, by not providing alternative estimates of the USO cost, the Council implicitly accepted the results.

In estimating the USO cost, Australia Post had limited data, and had to make a number of assumptions. In particular, it assumed that all delivery points served by the same facility had the same delivery cost, and that upstream costs (i.e., acceptance, transportation, and mail processing costs) did not vary across offices. These assumptions may have led to an understatement of the USO cost, inasmuch as the estimate did not capture the actual cost variation. One should also note that the USO definition is restricted to letters. As such the results may not be projected to a more expansive USO.

European Union. The European Union has undertaken a process of liberalizing postal markets in its member countries. In May of 2000, the European Commission (EC) issued a proposal for the opening of postal services to competition. This proposal, if adopted, would provide for new limits on the regulation of postal services in member countries. One element of the EC proposal is a more restricted reserved area. The EC's discussion of its proposal states that on average for the countries studied the cost of the USO is estimated to be five percent of total revenue. This relatively low cost of universal service is cited as a reason for opening postal services to further competition.

The five percent estimate is derived from a Commission-sponsored study, conducted by National Economic Research Associates (NERA).[8] The Commission retained NERA to identify how postal USOs are defined and provided in European Union (EU) member states, develop a methodology for calculating the USO cost, and develop benchmarks for member countries. The NERA study included a survey of the postal USO for 15 EU countries.[9] NERA found that the USO varied widely across these countries, and decided to focus on five common USO elements:

- Universal delivery;
- Saturday delivery;
- Concessions for press and other printed matter;
- Free delivery of Braille and related materials; and,
- Post office counters.

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[7] "Review of the Australian Postal Corporation Act," February 1998.

[8] Universal Service Obligations in the Postal Sector in the European Union, Final Report for EC DG XIII, November 1998.

[9] The EU countries were: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

Not all countries in the study possessed the necessary data to measure the USO cost for each of these five factors. Even in cases where a factor was part of a particular country's definition of the USO, data were not always available to measure the cost. In its final analysis, NERA focused its empirical work only on the cost of universal delivery. Six of the EU countries did not possess the data needed to determine the cost of this one element of universal service. For the remaining countries, NERA estimated that the cost of universal delivery ranged between 0.7 percent and 14.3 percent of revenue, with the estimates "clustered around" five percent. NERA recognized that the data used in the analysis were very crude for some countries. In addition, the degree of aggregation of the data likely contributed to the relatively low estimates of USO cost.[10] Finally, the validity of simple, cross-country comparisons is questionable due to differences in the countries' universal service obligations, operating practices, and methods for providing universal service. For example, a USO cost estimate is of little use if the postal administration is not free to abandon or restructure services and pursue strictly commercial ends outside the bounds of the USO as defined for the estimate. The USO dimension actually analyzed by NERA was only one element of what potentially would be the U.S. Postal Service USO. For all of these reasons, the NERA estimates are of very limited use in understanding the cost of the Postal Service USO in the United States.

United Kingdom. In June of 2001, Postcomm, the new regulator of postal services in the U.K., issued a discussion document to assess whether the universal service obligation compels Consignia[11] to provide loss-making services that it might otherwise avoid if it were not required to provide the universal service.[12] Postcomm commissioned Andersen Consulting to update estimates generated by NERA for the U.K. in its EU study. Andersen used data for the period 1999/2000 to focus on the delivery of letter mail. Andersen found that the total cost across all routes where revenue does not cover long-run marginal cost is £81 million. This result was substantially above the NERA estimate of £22.6 million. The difference between these two estimates can largely be explained by the fact that NERA aggregated data by delivery office before estimating the USO cost. By ignoring cost differences within offices, the NERA estimate had a downward bias. Andersen conducted a sensitivity analysis and found that the cost estimate could be as high as £539 million, but it concluded that the USO cost was unlikely to be greater than £81 million. Andersen's reason for concluding that the £81 million figure represented an upper bound was that it included the entire range of postal letter products, some of which are provided at service standards higher than those required under the USO.

To summarize, the Australian and European USO studies employ relatively narrow definitions of the USO. The definitions are restricted to the delivery of mail and, in the case of Australian and the U.K. studies, only focus on letter delivery. When one compares the results for different countries, one concludes that differences in institutions, public expectations, geography, and operational practices can lead to vastly different USO cost estimates. For this reason, the empirical results from these countries should not be used as a benchmark for measuring the U.S. Postal Service USO cost.

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[10] See the following discussion of U.K. USO study for a discussion of the relationship between data aggregation and the size of the cost estimate.
[11] Consignia is the new name for the U.K. Post Office.
[12] "An Assessment of the Costs and Benefits of Consignia's Current Universal Service Provision," A Discussion Document, June 2001.

Studies of the U.S. Postal Service

In recent years, there have been a number of studies of the U.S. Postal Service. Below is a representative list of such studies.

Bradley and Colvin, "Measuring the Cost of Universal Service for Posts," *Current Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2000, pp. 29-46.

Bradley and Colvin, "The Role of the Monopoly Product in the Cost of Universal Service," *Future Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2001, pp. 163-180.

Cohen, Ferguson, and Xenakis, "Rural Delivery and the Universal Service Obligation: A Quantitative Investigation," in *Regulation and Nature of Postal and Delivery Services*, Crew and Kleindorfer (eds.), Kluwer, 1993, pp. 161-176.

Cohen, Ferguson, Waller, and Xenakis, "An Analysis of the Potential for Cream Skimming in the United States Residential Delivery Market," *Emerging Competition in Postal and Delivery Services*, Crew and Kleindorfer (eds.), Kluwer, 1999, pp. 141-158.

Cohen, Ferguson, Waller, and Xenakis, "Universal Service Without a Monopoly," *Current Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2000, pp. 69-88.

Cohen, Pace, Robinson, Scarfiglieri, Scocchera, Comandini, Waller and Xenakis, "A Comparison of the Burden of Universal Service in Italy and the United States," presented at the ninth Conference on Postal and Delivery Economics, Sorrento, Italy, June 6-9 2001.

Haldi and Merewitz, "Cost and Returns from Delivery to Sparsely Settled Rural Areas," *Managing Change in the Postal and Delivery Industries*, Crew and Kleindorfer (eds.), Kluwer, 1997, pp. 237-257.

Kolin and Smith, "Mail Goes Where the Money Is: A Study of Rural Mail Delivery in the U.S.," *Emerging Competition in Postal and Delivery Services*, Crew and Kleindorfer (eds.), Kluwer, 1999, pp. 159-180.

Kolin, "Worksharing, Residential Delivery, and the Future of the USO," *Current Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2000, pp. 89-106.

The nine studies all address one or more of the following questions:

- What products and services are provided by the Postal Service at a loss (i.e., have revenues that are insufficient to cover their costs)?
- What is the total revenue shortfall incurred for all products and services whose revenues fail to cover costs?
- What products and services are vulnerable to competition in a liberalized postal market?
- What are the financial consequences of mail volumes lost to competitors? Or, what is the value to the Postal Service of restrictions on competition?

The studies provide a limited analysis of the Postal Service USO in that they focus on only one element of a possible universal service definition: delivery.[13] Furthermore, each of these studies assumes that the current frequency of delivery (six days per week) and the current delivery standards (i.e., standards for determining whether delivery is made to the house, to the curb, or to a cluster box) represent the only universal service obligation.[14]

These studies all rely on Postal Service city and rural delivery route data sets, although there are significant differences in the data used and the methods employed. Some of the earlier studies use data sets that have become outdated. The studies also use different levels of detail when conducting the analysis. Even the most carefully specified studies do not have enough detailed cost information to precisely answer the four questions listed above. Typically mail flows are aggregated to conduct an analysis, and mail pieces within each aggregate category are assumed to be identical when the cost calculations are made. This aggregation masks a considerable amount of cost variation between mail flows on different routes, with the estimated cost of universal service possibly understated by a significant amount.[15] Finally, the studies have a wide range of assumptions regarding the estimated impact of competition and cream skimming on Postal Service mail volume. These different assumptions result in different estimates of universal service cost. Competition and cream skimming will focus on mail volumes that make a significant contribution to the Postal Service's overhead cost. If this contribution is lost, then the Postal Service must cover its overhead cost with the contribution from remaining volume. In such a scenario, fewer routes generate enough revenue to cover their own costs, and maintaining universal delivery service becomes more difficult. By assuming that competition is limited, one can reduce the universal service cost estimate.

Because of these differences, the studies produce a wide range of results. At one end of the spectrum, Cohen, Ferguson, Waller, and Xenakis (1999 and 2000) conclude that the Postal Service would not be vulnerable to significant volume losses if competition were allowed. They also conclude that the delivery USO cost to the Postal Service is relatively minor. At the other end of the spectrum, Bradley and Colvin (2001) conclude that competition targeted at the Postal Service's highest contribution mail plus the Postal Service's requirement to fully maintain the delivery network could lead to losses up to $17.2 billion, potentially undermining universal service if not the viability of the Postal Service.[16] Because the studies use a limited definition of universal service and limited data sets, the range of these estimates does not necessarily bracket the actual USO cost. Using a more comprehensive definition and more detailed data could produce a USO cost estimate that is above this range.

To summarize, the empirical studies of the U.S. Postal Service USO to date have significant shortcomings, including the use of obsolete or inadequate data, unrealistic competitive entry assumptions, and unspecified or incompletely specified USO definitions that do not correspond to the real socio-political expectations and

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[13] The Bradley and Colvin (2000) study is an exception to this generalization inasmuch as it considers both delivery and retail window service.

[14] Haldi and Merewitz (1997) consider the impact of less frequent delivery and use of independent contractors for rural delivery.

[15] It is noteworthy that the studies with the most detailed analysis, such as Bradley and Colvin (2000 and 2001) tend to produce the highest estimates of universal service cost.

[16] Bradley and Colvin (2001) report cost per delivery day. The figure presented here is obtained by multiplying the Bradley and Colvin (2000) USO cost estimate of $9.8 billion by the ratio of cost per delivery day for the scenarios in these two papers ($297.18/$169.26).

constraints on the commercial freedom of the Postal Service as presently constituted. Many dimensions of universal service and its cost have received little or no empirical analysis. These include the collection, processing, and transportation networks; the uniform pricing of First-Class Mail; and service characteristics of delivery other than frequency—e.g., to what extent delivery to PO boxes and/or cluster boxes might meet delivery obligations for addresses that currently have curbside or door delivery. Little attention has been given to other socially derived constraints, including those which prevent optimal pricing or drive significant portions of labor costs.

Conclusion

The U.S. Postal Service provides a wide array of services to the public on a universal basis. Some of these services were mandated as part of the Postal Reform Act of 1970, while others have been taken on by the Postal Service over the years. As competition and electronic diversion have presented new challenges to the Postal Service, the maintenance of these services has become an important question.

Defining and attributing cost to the USO in the postal sector is a challenging exercise, still in its infancy. As the cited studies show, one can arrive at a wide range of estimates for USO costs, depending upon the definition of the USO, data quality, and assumptions about the economic environment that the Postal Service faces. Careful thought should be given to policy objectives in further work on the USO. Empirical studies need data and methodologies that accurately represent the current postal environment and provide the detail necessary for improved understanding in this contentious area.

Part 2 — The Postal Service Monopoly

Introduction

Historically, all postal systems had legal monopolies. The justification for the postal monopoly has been the maintenance of postal universal service, which is vulnerable to selective, cream-skimming competition. In recent years there have been discussions in a number of countries about the costs and benefits of maintaining the postal monopoly. Two countries, Sweden and New Zealand, eliminated the monopoly. In other countries, such as Australia, Germany, the Netherlands, and the United Kingdom, the scope of the monopoly has been reduced by liberalizing the laws on delivery, and reopening consideration of the extent of universal service constraints. Some have suggested the U.S. postal market be liberalized.

Another recent development with significant implications for the postal monopoly is the increased use of the Internet for communication. While e-mail can be thought of as the most recent technology that competes with the Postal Service (following the telephone and facsimile machine) there is concern that electronic messaging may erode mail over which the Postal Service has a monopoly. The substitution of electronic messaging for mail is generally referred to as electronic diversion.

This section reviews the nature of the postal monopoly and reasons for its existence. It also reviews how the postal monopoly is being addressed in other countries.

The Nature of the Postal Monopoly and Reasons for Its Existence

The postal monopoly in the United States includes exclusive rights preserved to the Postal Service to deliver letters. The exclusive rights to deliver letters are commonly called the Private Express Statutes.

The Private Express Statutes are federal civil and criminal laws that, except in special circumstances, prohibit the private delivery of letters for compensation over post routes. These laws are found in Titles 18 and 39 of the United States Code.[17] The Private Express Statutes were originally enacted by Congress in 1792, and similar laws were in force during colonial rule and under the Articles of Confederation. Under the Private Express Statutes, delivery of letters by firms other than the Postal Service is prohibited, unless the letters have affixed to them the amount of postage the Postal Service would charge for delivery. Letters are broadly defined to be messages between parties, although the statutes and regulations list a number of exceptions.[18] Some of these exceptions are newspapers and periodicals; books, catalogs, and telephone directories; financial instruments, when sent between financial institutions; and letters sent within a company when carried by the company's employee. Furthermore, the Private Express Statutes provide exemptions to "extremely urgent letters." A mail piece is presumed to be urgent if the amount paid for private carriage is at least the greater of $3 or twice the applicable postage for First-Class Mail (including Priority Mail).

In addition to the Private Express Statutes, the Postal Service has the exclusive right to use the mailboxes, collection boxes, and post office boxes which it has incorporated into its system. Since 1934 deposits of mailable matter in these boxes to avoid postage has been prohibited in Title 18 of the U.S. Code.[19] Insofar as these restrictions help ensure the security of the mail, they provide substantial benefits to the public. At the same time, the restrictions serve to protect the operational and financial integrity of the system. Under these restrictions, both monopoly material and newspapers, advertising flyers, and other material that does not fall under the Private Express Statues cannot be legally deposited in the mailbox without postage. Other delivery firms are free to establish their own network of boxes, but as a result of the letter monopoly, no one else has the routes to do so on the delivery side, other than portions of the newspaper industry, which does not carry letters. Delivery firms typically leave items at the recipient's doorstep, which may create additional costs or reduce the security or value of service for the materials being sent.[20]

Congress has justified the Private Express Statutes as supporting the basic mission of the Postal Service:

- To bind the nation together through the correspondence of the people;
- To provide services in all communities;
- To establish uniform postage rates; and
- To ensure the safety of the mails.[21]

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[17] The laws are found in title 18 U.S. Code, 1693 through 1699, and title 39 U.S. Code, 601 through 606. Regulations implementing these statutes are found in title 39, Code of Federal Regulations, parts 310 and 320.

[18] The United States Postal Service Publication 542, Understanding the Private Express Statutes, June 1998, provides a more detailed description of the Private Express Statutes.

[19] Title 18, U.S. Code, 1702, 1705, 1708, and 1725.

[20] For example, some municipalities have ordinances that require delivery services to collect items left on the doorstep after 24 hours.

[21] See Understanding the Private Express Statutes, p. 2.

This mission as stated in Title 39 of the U.S. Code may be thought to set out the core elements of the Postal Service's universal service obligation (As discussed in the Universal Service Obligation section of this Appendix, the scope of the Postal Service's universal service obligation at any particular time is a policy matter subject to discussion, interpretation, and some discretion).

The rationale behind the Private Express Statutes is that the exclusive right to provide letter mail delivery services granted to the Postal Service creates a revenue base with which the system is maintained and the universal service obligation is funded. While the Postal Service sets rates to break even overall, services will generate net revenue ("contribution") in some areas and generate net losses in others. Under the umbrella of the Private Express Statutes, the Postal Service is able to support the USO through a degree of "cross-subsidizing" on a geographic basis, as various routes are more or less expensive to serve than others. Without the Private Express Statutes, competitors not facing universal service requirements would have an incentive to undercut the Postal Service to attract "profitable" (contribution producing) mail, thereby taking away the revenue that the Postal Service relies on to keep rates low in the high cost areas.

The Private Express Statutes primarily provide protection for First-Class Mail, Standard Mail, and a significant portion of Priority Mail.[22] While there is no precise line that distinguishes protected volumes from unprotected volumes, there have been efforts to estimate how much Postal Service volume is covered by the Private Express Statutes. In 1998, Price Waterhouse conducted a study for the Postal Service that estimated about 90 percent of domestic volume and about 80 percent of revenue was protected by the Private Express Statutes.[23] Within the protected area, First-Class Mail and Priority Mail generate the greatest financial contribution to Postal Service overhead costs (i.e., the difference between revenue generated by these services and their attributable cost is greatest).

Over the years, various parties have reviewed the need for the Private Express Statutes. In 1973, pursuant to Section 7 of the Postal Reorganization Act,[24] the Postal Service Board of Governors presented a report to the President of the United States and the U.S. Congress. In that report, the Board concluded that the Private Express Statutes were essential to maintaining universal service and that no changes should be made to existing law. At the same time, the Board recommended that the regulations and administrative practices be changed in order to provide clearer guidelines to the public and to adopt certain suspensions, or exceptions.

In 1998, the General Accounting Office (GAO) released a report on the issues relevant to changing the Private Express Statutes.[25] That report surveyed potential competition and found that it had increased since 1971. This included the growth of private parcel delivery, as well as the development of the "expedited delivery" market. Furthermore, the report identified electronic communication as a competitive threat to the Postal Service. The report also addressed the potential losses from liberalizing the Private

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[22] Even within these subclasses, there are mail items that already face competition from close substitutes. For example, Standard Enhanced Carrier Route Mail faces competition from newspapers and neighborhood shoppers in the market for advertising information.

[23] Price Waterhouse, Volume and Revenue at Risk: 1996 & 1997 Postal Service Volumes and Revenues Not Covered by the Letter Monopoly, 1998.

[24] United States Postal Service, The Private Express Statutes and Their Administration, A Report by the Board of Governors to the President and the Congress, Pursuant to Section 7 of the Postal Reorganization Act, June 29, 1973.

[25] United States General Accounting Office, Postal Service Reform: Issues Relevant to Changing Restrictions on Private Letter Delivery, Report to the Ranking Minority Member, Subcommittee on Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate, September 1996.

Express Statutes. The GAO developed a simulation model based on 1995 rate case evidence to assess the impact on the price of a First-Class Mail stamp under various volume loss scenarios. These lost-volume scenarios varied between five percent and 25 percent of total First-Class Mail volume. The model predicted fairly modest changes in postal rates, as the worst-case scenario led to only a ten percent increase in the stamp price.

The Postal Service's reply to this GAO report pointed out that moving from a monopoly environment to a nonmonopoly environment represents a significant change in the postal market and that conventional models of Postal Service cost and revenue would be inappropriate in such scenarios. In particular, customer responsiveness to price changes ("price elasticities") and the Postal Service cost structure would change. The Postal Service conducted alternative simulations, using a model that it felt contained more realistic assumptions, and it concluded that a 25 percent loss in First-Class Mail volume translated to a 20 percent increase in the First-Class stamp price, and when volume losses spread to Priority and Standard mail, the First-Class stamp price increased 54 percent.[26]

The Postal Monopoly in Other Countries

In recent years, a number of other countries have reviewed the status of the postal monopoly. In many instances, these countries have liberalized their restriction on mail delivery. In this liberalized environment, the restricted area is determined by a weight or price limit. Mail that falls within the limits can only be delivered by the postal administration. Mail outside the limit is open to competition. Often this liberalization is part of a contract between the government and the postal service, in which the universal service obligation is specified and limited along with the degree of postal monopoly. This section discusses some of the changes that have been made in various countries.

Australia. The 1995 Australian Postal Corporation Act explicitly set universal service obligations and the restricted area. The universal service obligation includes: service for domestic and international letters; single uniform rates within Australia for standard letters; service that is reasonably accessible to all Australians; and performance standards for posting boxes, delivery timetables, on-time delivery, retail access, delivery frequency, price, and complaints. The restricted area was set at 8.8 ounces and four times the price of a standard letter ($0.92).[27] In 1998, the government announced a postal reform package that would reduce the restricted area to 1.8 ounces and the price of a standard letter ($0.23), without a reduction in the USO. Legislation was not enacted, and in March 2001 the package was withdrawn.

Germany. The Postal Act of December 22, 1997, set up a license system for delivery and universal service. Delivery of letters under 2.2 pounds is subject to regulation. Through 2007, Deutsche Post has an exclusive license to deliver items weighing no

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[26] Also relevant to the discussion are the various cost studies cited in the Postal Service Universal Service Obligation section of this Appendix.

[27] Except in the United States, reserved area weight limits are specified using the metric system. This appendix reports the weight limits using the English weight equivalents. Price limits have been converted from local currencies to U.S. dollars [using exchange rates as of February 5, 2002].

more than seven ounces and costing less than $2.45. The remaining letter mail can be delivered by private carriers, if those carriers secure licenses from the regulatory authority. The universal service requirements include the delivery of letter items up to 4.4 pounds, parcels up to 44.1 pounds, and newspapers and magazines. The requirements also include standards for locations of post offices and collection boxes, as well as delivery times. To date the Deutsche Post monopoly has been large enough to fund the universal service obligation without additional subsidies. The monopoly is expected to expire in the future, at which time potential entrants will be able to bid on licenses for all letters weighing less than 2.2 pounds. While the intent of the legislation is to have the cost of universal service absorbed by the carriers, provisions are made for external funding, as needed.

The Netherlands. In October of 1999, the government substantially amended its Postal Act, and the changes came into force in June of 2000. Under the amended act, TPG is granted a monopoly for domestic letters weighing no more than 3.5 ounces, unless the price is more than three times the tariff for the first weight step. Mail sent to other countries is not included in the monopoly. The universal service obligation includes domestic letters and addressed printed matter up to 4.4 pounds, and parcels up to 22 pounds (with size restrictions). All international mail falls within the universal service obligation.

Both the monopoly and the universal service obligation are narrower than what was in force before June of 2000. Prior to June of 2000, the monopoly included all domestic and international mail up to 17.6 ounces. The universal service obligation included all mail up to 44 pounds.

New Zealand. The Postal Services Act of 1998 removed the statutory monopoly on the delivery of letters. Prior to the act, the monopoly was extended to letters weighing less than 7.1 ounces. With the monopoly removed, any licensed firm may deliver mail. During 1998, New Zealand Post signed a Deed of Understanding with the New Zealand government. This Deed sets out standards with regard to frequency of delivery, number of post offices, and open access to the mail stream, and sets a price ceiling for standard mail. The delivery frequency standards require 95 percent of the delivery points to have six day per week delivery, 99.88 percent of the delivery points to have either five day or six day per week delivery, and the remaining delivery points to have between one and four deliveries per week.

Sweden. In 1993, Sweden became the first country to eliminate the letter monopoly. A universal service obligation was still imposed on Posten AB, however, and through a contract with the Swedish government, it was required to fund the USO through its profits. The USO currently includes: mail service for items under 44.1 pounds; reasonable and cost-based rates, five-day delivery and retail service, and service standards for overnight mail.

In May of 2001, the National Post and Telecom Agency reviewed the status of the liberalized postal market. It found that while there had been increases in competition since 1993, Posten AB still held 95 percent of the market for letters.

United Kingdom. The Postal Services Act of 2000 (“the Act”) sets out a system of licenses for mail weighing less than 12.3 ounces or costing less than $1.42. The Act also provides definitions and standards for universal postal service. In April of 2001 Postcomm (the regulator) granted a license to Consignia for letter delivery throughout the United Kingdom. As part of the license, Consignia assumes universal service obligations that include daily delivery, delivery of packets up to 44.1 pounds, and delivery service standards.

On January 31, 2002, Postcomm released a proposal to quickly open the U.K. postal market to competition. Under the proposal, beginning in April 2002, mailers sending more than 4,000 pieces in a mailing could use private carriers for delivery. Furthermore, mail consolidators would be able to compete on upstream operations (collection, processing, etc.) by taking advantage of Consignia's worksharing discounts. This would immediately expose about 30 percent of Consignia's domestic letter revenue to competition. By April of 2004, an additional 30 percent of Consignia's revenue stream would be open to competition, with consolidators allowed entry into delivery. By April of 2006, Consignia would lose its monopoly. With this liberalization, Consignia would also be given more commercial flexibility in terms of how it provides universal service. In the long run, an explicit subsidy mechanism for universal service would be considered, if it were necessary. The proposal is currently undergoing review and comment by the public.

Conclusion

Two points should be highlighted. First, some, but not all, countries have moved to reduce the restricted area and to contract for universal service. Canada is a notable example of a country that has not gone down this road. Second, much of the activity in Germany, The Netherlands, Sweden, and the United Kingdom can be seen as either stimulating or responding to efforts by the European Union to harmonize postal services across member countries and encourage greater competition in the provision of postal services. In March 2002, the European Parliament is due to vote on a plan to increase postal competition in the member countries. Liberalizing the postal market would take place in two steps, beginning in 2003. In the first step, all member countries would be required to open up the market for all mail weighing more than 3.5 ounces or costing more than three times the price of a standard letter. In 2006, the market would be opened for letters weighing more than 1.8 ounces, or costing more than 2.5 times the price of a standard letter. At that time, a review would be initiated that would investigate the feasibility of fully opening up the postal market by 2009.

There are substantial differences in how countries have gone about opening up their postal markets to competition. At one end of the spectrum, Sweden and New Zealand have eliminated the restricted area. These are small countries able to deliver most of their mail across the country in one day. Germany and the United Kingdom have moved in the direction of licensing delivery of restricted area products. The ultimate objective of the licensing system is to open the delivery of restricted mail to competition, with both the government post and private firms bidding for the licenses. While TPG continues to be the monopoly provider in The Netherlands, the scope of the monopoly and the universal service requirements have changed over time. In Australia, there appears to have been little change since 1995. Canada is similar to the United States in that it has not undertaken major efforts to reduce the restricted area.

Appendix V

APPENDIX V — Alternative Collective Bargaining Models

Introduction

There are a number of collective bargaining models other than the one employed currently by the Postal Service. This appendix provides a broad description of various types of collective bargaining processes (models) currently being used and identifies elements of those processes that may be utilized to improve the negotiating process used in the Postal Service.

Types of Models

All collective bargaining processes utilize different mechanisms to create incentives to encourage parties to reach agreements. Typically, a critical component of these incentives is a penalty that will be imposed on both parties in the event that they are unable to reach agreement. Additionally, each of the collective bargaining processes contains mechanisms that are supposed to assist the parties in narrowing and clarifying disputed issues as well as facilitating a resolution of those issues.

Models representing different types of collective bargaining processes can be placed along a continuum depending upon the type of penalty or negative situation that the parties will face if they do not reach an agreement:

Private sector model. This model utilizes the avoidance of economic self-help (strike/lock out) as the ultimate incentive for the parties to reach agreement. A series of notice and mediation requirements are used to assist parties in coming to an agreement.

Public sector model. This model is used principally by states and municipalities where public employees are prohibited from striking. Under this model, if negotiations reach an impasse and mediation attempts have been unsuccessful, an interest arbitrator decides the unresolved collective bargaining issues and effectively writes the collective bargaining agreement for the parties. In theory, the threat of having an outsider who is not as familiar with the issues as the parties themselves make critical decisions is supposed to provide an incentive for the parties to come to an agreement. Depending on the statutory scheme, a variety of different intermediate steps are used to assist the parties in narrowing and sharpening issues, as well as facilitating a resolution of disputes. In addition, some state statutes contain “guidelines” which attempt to limit the arbitrator’s discretion by enumerating considerations that arbitrators must take into account in arriving at their decision.

Hybrid model. This model contains aspects of both public and private sector models. The Railway Labor Act (RLA), which governs labor relations in the airline and railroad industries, is perhaps the best known example. Under the RLA, the parties have the right to engage in strikes and lockouts if they are unsuccessful in negotiating an agreement. However, the RLA has an elaborate system of “hurdles” that the parties must surmount before the right to engage in economic “warfare” is triggered. These hurdles serve the purpose of assisting the parties in reaching agreement, as well as subjecting them to various sorts of pressure from interested groups. The process is especially long and drawn out, creating an additional incentive for the parties to voluntarily reach agreement prior to exercising self-help.[1]

Variants of these models. The descriptions above are not intended to provide an exhaustive list of all types of collective bargaining processes. As described below, elements of various different processes can be (and have been) combined in any number of ways. However, whatever elements are chosen, they should perform one or more of the following functions: 1) assist the parties in sharpening and narrowing the issues; 2) facilitate the parties in reaching agreement; and/or 3) make the failure to reach agreement sufficiently onerous that the parties will have an incentive to reach an agreement.

Problems with the Current Postal Service Collective Bargaining Process

The current collective bargaining process used by the Postal Service does not have an incentive or penalty sufficient to induce the parties to negotiate agreements. In addition, it permits one individual, a third party who is not accountable, to decide critical economic issues, while the interest arbitration process also encourages parties to take extreme positions in negotiations in anticipation of the fact that disputes will ultimately be resolved by an interest arbitrator.

Elements to Be Considered for Possible Solution

The following elements can be “mixed or matched” in any number of combinations. The introduction of most of the elements described below would require legislative action.

Hybrid (RLA) model. While this hybrid (RLA) model might be attractive to unions, since it offers the possibility of striking, it is also a long and arduous collective bargaining process. It often culminates in a Presidential Emergency Board (PEB) process, whereby third parties effectively decide issues, and there is a danger that the process may be politicized as a result of the presidential selection of neutrals and the possibility of Congressional enactment of PEB recommendations.

Statutory guidelines for interest arbitrators. A series of statutory guidelines would limit the discretion of an arbitrator to issue awards by requiring arbitrators to consider certain factors and might well clarify the arbitration process.

Judicial review. The possibility of a decision being judicially overturned would provide some mechanism to ensure that arbitrators stay within guidelines.

Multiple neutrals sitting on the same interest arbitration panel. Using the model of a PEB, it is possible that several neutrals would be selected for the interest arbitration panel. Presumably, this would provide a check on any one neutral making an unreasonable decision.

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[1] Under the RLA, the National Mediation Board (NMB) will appoint a mediator to work with the parties upon the request of either party. If the NMB does not believe that further mediation efforts will be successful, it will offer the parties an opportunity to proceed to interest arbitration. If either party rejects the proffer of interest arbitration, the NMB will release the parties into a 30-day cooling off period. After such time, self-help is permitted, unless the president appoints a presidential emergency board (PEB) which delays the right to self-help until 30 days after the PEB issues its award. The PEB proceeding resembles an interest arbitration, except that the recommendation of the PEB is not binding. However, these recommendations frequently form the basis of settlement or provide the government and the public with a way of evaluating the merits of the parties’ positions. After issuance of the PEB award, the parties have 30 days to attempt to reach a peaceful solution. If unsuccessful, the parties have the right to engage in self-help. However, when the resumption of hostilities has threatened the economy, Congress has on occasion intervened and either imposed a legislative solution based on the PEB award or established another procedure to assist the parties in reaching an agreement.

Appendix W

APPENDIX W — Glossary[1]

Air Contract Data Collection System (ACDCS) – A network of equipment at airport mail facilities that collects information on weight, destination, and routing of air shipments.

Air Contract Transportation Tag (ACT) – A printed barcoded tag that bears barcoded information for routing mail containers to be transported by contracted air carriers.

Board of Governors (BOG) – The group that directs the exercise of the powers of the Postal Service. Nine Governors are appointed by the President of the United States, with the advice and consent of the Senate. The remaining members are the postmaster general (appointed by the Governors) and the deputy postmaster general (appointed by the Governors and the postmaster general). The Board directs and controls the expenditures and reviews the practices and policies of the Postal Service.

Bound Printed Matter (BPM) – A subclass of Package Services that consists of permanently bound sheets of which at least 90 percent are printed with advertising, promotional, directory, or editorial matter (or a combination of such matter).

Breakthrough Productivity Initiative (BPI) – The Breakthrough Productivity Initiative, implemented in 2000, is a comprehensive and integrated method for achieving productivity improvement by identifying causes for poor productivity, and providing diagnostic and corrective tools to support areas for improvement.

Bulk Mail Center (BMC) – A highly mechanized mail processing plant that distributes Standard Mail in piece and bulk form.

Carrier Sequence Bar Code Sorter (CSBCS) – An automated machine that sorts an individual carrier's mail, allowing the mail to go directly from the automation equipment in delivery sequence to the carrier for delivery to postal customers. The CSBCS is a smaller BCS designed for delivery units with 10 or more routes.

Chief Executive Officer/Postmaster General – The official position title created during the 1991 postal reorganization that designates the highest ranking officer in the United States Postal Service.

CIOSS – Technology that links PARS mail with the appropriate forwarding order.

Collect on Delivery (C.O.D.) – A service for mailers who need to mail an article for which they have not received payment. The amount due the sender is collected from the addressee, and the Postal Service returns the amount due to the sender.

Commercial Receiving Agency (CMRA) – A private business that acts as the mail receiving agent for specific clients.

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[1] This glossary provides a selected list of terms found in the *Transformation Plan.* A more extensive list of postal terms can be found at www.usps.com/cpim/ftp/pubs/32html/.

Contract Postal Unit (CPU) – A postal unit that is a subordinate unit within the service area of a main post office, e.g., stations, branches, and Community Post Offices (CPOs). A CPU is usually located in a store or place of business and is operated by a contractor who accepts mail from the public, sells postage and supplies, and provides selected special services (for example, postal money order or registered mail).

Delivery Sequenced Mail – Mail that is arranged by a mailer in delivery order for a particular carrier route. This mail requires no primary or secondary distribution.

Delivery Unit – A post office, post office station, or post office branch that has mail delivery functions.

Destination Delivery Unit (DDU) rate – A rate available for Periodicals, Standard Mail, Parcel Post, and Bound Printed Matter that is properly prepared and entered by the mailer at the delivery unit that serves the delivery address on the mail.

Deutsche Post (DPWN) – Deutsche Post World Net is one of the largest logistics companies in the world. Deutsche Post World Net holds the majority stake in DHL International, the pioneer and market leader in the global express industry. DPWN offers worldwide mail, parcel, express, logistics services, eBusiness solutions and a broad range of financial services solutions for domestic and international customers.

DHL – DHL Worldwide Express is the world's largest international air express network with service to more than 675,000 destinations in the world. On a yearly basis, DHL sends more than 140 million shipments to destinations throughout the world. DHL serves virtually every city in 228 countries around the world.

Domestic Mail Classification Schedule (DMCS) – The basic framework for classifying domestic mail categories (mail classes) and postal services and for setting postal rates and fees. It represents the recommendations of the Postal Rate Commission as adopted by the Postal Service Board of Governors, under the classification and rate-setting mechanism prescribed by the Postal Reorganization Act (39 U.S.C.).

Domestic Mail Manual (DMM) – The Postal Service manual that contains the basic standards governing domestic mail services; descriptions of the mail classes and services and conditions governing their uses; and standards for rate eligibility and mail preparation. Domestic mail is classified by size, weight, content, service, and other factors.

European Union (EU) – The European Union is a union of fifteen independent states, founded on November 1, 1993, based on the European Communities and founded to enhance political, economic and social co-operation. It was formerly known as European Community (EC) or European Economic Community (EEC).

Executive and Administrative Schedule (EAS) – A salary structure that applies to most managerial and administrative Postal Service employees.

Express Mail® – A mail class that provides expedited delivery service for mailable matter subject to certain standards. It is available in five basic domestic service offerings (Custom Designed Service, Next Day Service, Second Day Service, and Military Service). Express Mail International Service is available between the United States and most foreign countries.

Firm Holdouts – Distribution process strategy to isolate firms receiving large volumes of mail.

Flat – The general term for flat-size mail, so called because the large mail is sorted without bending it so that the mail remains flat.

Fraud Complaint System (FCS) – An automated system comprised of complaints received by the Postal Inspection Service alleging mail fraud.

Global Priority Mail® (GPM) – An expedited international service for the shipment of documents, correspondence, and merchandise, featuring a 4-business-day delivery standard to selected countries in Europe, the Pacific Rim, and Canada.

House Resolution (H.R.) 22 – The Postal Modernization Act of 1999 originally introduced on June 25, 1996. The legislation, sponsored by Congressman John M. McHugh, R-NY, was designed to modernize and reform the nation's postal laws for the first time since 1970. The bill was not reported from Committee in 2001, and a new version is expected to be introduced in 2002.

Initial Public Offering (IPO) – The first stock sold by a company in going public. IPOs are a standard feature of runaway bull markets, since there is proven demand for stock and it makes sense to sell shares when they are likely to bring the highest prices.

Labor Distribution Code (LDC) – A two-digit code designing personnel costs for specific activities at all postal organizations and installations.

Letter – According to the Private Express Statutes, a message directed to a specific person or an address and recorded in or on a tangible object.

Letter-Size Mail – A mail processing category of mail pieces, including cards, that do not exceed any of the dimensions for letter-size mail (that is, 11-1/2 inches long, 6-1/8 inches high, 1/4-inch thick).

Library Mail – A subclass of Package Services for items sent to or from or exchanged between academic institutions, public libraries, museums, and other authorized organizations. Books, sound recordings, academic theses, and certain other items may be mailed at the Library Mail rate if properly marked.

Local Management Improvement Initiatives (LMI) – A budgeting plan, developed at the local level, to align planned cost reductions with the operating plan to ensure breakthrough productivities are attained.

Mail Transport Equipment (MTE) – Containers used for mail processing or transportation within or between facilities by the Postal Service, its customers, or contractors. These include general purpose mail containers, tray carts, bulk mail center containers, platform trucks/trailers, hampers, special purpose containers, in-plant and surface trays, pallets, sacks, and pouches.

Mail Transport Equipment Service Center (MTESC) – A field installation designated to receive, store, ship, examine, sort, pack, and condemn mailbags. It also issues, stores, and ships locks for mailbag equipment.

National Labor Relations Board (NLRB) – The National Labor Relations Board is an independent federal agency created by Congress in 1935 to administer the National Labor Relations Act, the primary law governing relations between unions and employers in the private sector. The statute guarantees the right of employees to organize and to bargain collectively with their employers or to refrain from all such activity. Generally applying to all employers involved in interstate commerce—other than airlines, railroads, agriculture, and government—the Act implements the national labor policy of assuring free choice and encouraging collective bargaining as a means of maintaining industrial peace. Through the years, Congress has amended the Act and the Board and courts have developed a body of law drawn from the statute.

Network Integration and Alignment (NIA) model – The output of the Network Integration and Alignment process will produce a set of network optimization and simulation models that will enable the Postal Service to analyze a variety of network alternatives that address the complexities and uncertainties of the operating environment. These models will also determine which facilities remain viable and necessary within a future infrastructure and what distribution and transportation roles may be performed by those facilities that remain as parts of an optimal, fully integrated network.

Optical Character Reader (OCR) – An automated mail sorting machine that interprets the address information on a letter-size mail piece and sprays the corresponding ZIP Code information onto the piece as a barcode. The OCR consists of a mail feed unit, transport, unit, stackers modules, computer with a control system, video monitor, and printer.

Parcel Post® – A subclass of Package Services with rates based generally on weight and zone.

Parcel Sorting Machine (PSM) – A large machine with an input station controlled by a computer that sorts and discharges parcels from transport trays to primary and secondary positions.

Postal Career Executive Service (PCES) – A staffing category that develops and maintains a group of employees for key management positions. There are two levels in PCES: Level I includes district, area, and Headquarters executives, and Level II consists of Postal Service officers, including vice presidents.

Postal Inspection Service – The federal law enforcement agency of the Postal Service that investigates criminal acts against the mails and misuse of the postal system; protects mail, postal funds, and postal property.

Postal Rate Commission (PRC) – An independent federal agency that makes recommendations on Postal Service requests for changes in postal rates and classifications. The five commissioners are nominated by the President and approved by the U.S. Senate.

Postal Reorganization Act (PRA) – Title 39 of the United States Code, which created the United States Postal Service on August 12, 1970 from the Post Office Department, moving postal operations from a cabinet-level agency to a self-sustaining, independent establishment of the federal government.

Priority Mail® – First-Class Mail that weighs more than 13 ounces and, at the mailer's option, any other mail matter weighing 13 ounces or less. Priority Mail provides expedited delivery. Any mailable matter may be sent as Priority Mail.

Processing and Distribution Center/Facility (P&DC/F) – A central mail facility that processes and dispatches part or all of both incoming mail and outgoing mail for a designated service area. It also provides instructions on the preparation of collection mail, dispatch schedules, and sorting plan requirements to mailers. The facility is usually a sectional center facility or a general mail facility, but it can also be a dedicated mail processing facility without a station or branch.

Remote Encoding Center (REC) – A Postal Service unit that uses advanced technology to assign barcodes to hand-addressed mailpieces physically located at a general mail facility. After the mailpiece image is displayed on a computer terminal, an operator, who is at the center, keys in the ZIP Code and the street address in order to match this information with that in a database. This allows for the imprinting of the barcode and automated mail processing at the general mail facility.

Retail Facility – A postal unit (a post office and its subordinate units as well as military post offices) that sells postage stamps and provides other postal retail services to customers. The subordinate units are within the service area of a main post office and include post office stations, post office branches, contract postal units, and nonpersonnel units.

Single-Piece Rate – A postage rate available for individual pieces of Express Mail, First-Class Mail, Priority Mail, and Packaged Services. It is not available for Periodicals except under the rate category of basic. This type of rate contrasts with rates available for bulk mail and presorted mail.

Small Parcel Bundle Sorter (SPBS) – A modular machine that sorts small parcels and packages or bundles of letters and flats to 100 specific bins for either delivery or processing.

Standard Mail – A class of mail consisting of mailable matter that is not required to be mailed as First-Class Mail or is not mailed as Periodicals.

Station & Branches – Multiple retail and or delivery units within a post office.

Total Factor Productivity (TFP) – Total Factor Productivity is a measure of efficiency. It is calculated at the national level only. The Postal Service uses Total Factor Productivity (TFP) internally to measure the changes in the relationship between outputs and the inputs expended in producing those outputs. The Postal Service's main outputs are mail volumes and servicing an expanding delivery network. TFP weights different types of mail volumes to account for variations in workload content due to factors such as size (e.g., letter vs. parcel), weight, preparation (e.g., prebarcoding and presorting), and mode of transportation (e.g., air vs. highway). Inputs include all labor, capital and materials inputs, such as mechanized and automated equipment, facilities, transportation, and other nonpersonnel costs. By tracking outputs and resource usage, TFP provides a measure by which current performance can be compared to prior periods.

Tray – A container used to transport multiple pieces of mail.

Undeliverable As Addressed (UAA) – Mail that the Postal Service cannot deliver as addressed and must forward to the addressee, return to the sender, or send to a mail recovery center.

United Parcel Service (UPS) – United Parcel Service (UPS), headquartered in Atlanta, Georgia, is the world's number one package delivery company and the third largest private company in the United States.

Universal Postal Union (UPU) – An international postal organization that is a specialized agency of the United Nations. Its 189 member countries form a single postal territory for the reciprocal exchange of letter-post items. Its Convention establishes the common rules applicable to the international postal service and the provisions governing letter-post services.

Universal Service Obligation (USO) – Postal policy set forth in Title 39, Section 101 of the Postal Reorganization Act of 1970 that the United States Postal Service shall have as its basic function the obligation to provide postal services to bind the nation together through personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to all patrons in all areas and shall render postal services to all communities. The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people.

Voice of the Employee (VOE) – An assessment of Postal Service employee issues that will strengthen the company, shape the business future, and improve employees' roles in its success.

Video Coding System (VCS)– An image of an individual mailpiece is captured for coding when software cannot decipher the proper sort.

ZIP (Zone Improvement Plan) Code – Established in 1963, the system of 5-digit codes that identifies the individual post office or metropolitan area delivery station associated with an address. The first three digits identify the delivery area of a sectional center facility or a major-city post office serving the delivery address area. The next two (the fourth and fifth) digits identify the delivery area of an associate post office, post office branch, or post office station. All post offices are assigned at least one unique 5-digit code. ZIP + 4 is an enhanced code consisting of the 5-digit ZIP Code and four additional digits that identify a specific range of delivery addresses.

Acronyms

Below is a list of some of the acronyms in this *Transformation Plan.*

Advanced Leadership Program – (ALP)
Area Mail Processing – (AMP)
Automated Flat Sorting Machine – (AFSM 100)
Automated Package Processing Systems – (APPS)
Automated Postal Center – (APC)
Automated Postal Printers – (APP)
Automatic Tray Handling System – (ATHS)
Barcode Reader – (BCR)
Business Management Guide – (BMG)
Collection Box Units – (CBU)
Complement Accounting System – (CAS)
Complement Information System– (COINS)
Complement Planning, Tracking and Management – (CPTM)
Computerized Forwarding System (CFS)
Crisis Management Team – (CMT)
Customer Satisfaction Measurement – (CSM)
Delivery Barcode Sorters – (DBCS)
Delivery Office Information System – (DOIS)
Delivery Performance Achievement and Recognition System – (DPARS)
Delivery Point Package – (DPP)
Delivery Point Sequence – (DPS)
Destination Bulk Mail Center – (DBMC)
Destination Delivery Unit – (DDU)
Distribution and Routing – (D&R)
Electronic Data Exchange – (EDI)
Employee Assistance Program –– (EAP)
Employee Stock Ownership Plan –(ESOP)
Equal Employment Opportunity – (EEO)
Executive Administrative Schedule – (EAS)
Federal Employees' Compensation Act – (FECA)
Flats Remote Encoding System – (FRES)
Flat Sorting Machine – (FSM)
Freedom of Information Act – (FOIA)
Function 1 Plant Performance Achievement System – (F1PAS)
Global Express Guaranteed™ – (GXG)
Global Express Mail™ – (GEM)
Global Marketing Solutions – (GMS)
Government Fiscal Year – (GFY)
Hazardous Materials Program – (HAZMAT)
Highway Contract Support System – (HCSS)
Jobs Information Monitoring System – (JIMS)
Leaderships Excellence At the Desktop – (LEAD)
Low Cost Tray Sorter – (LCTS)
Managed Service Points – (MSP)
Management Intern – (MI)
Mobile Data Collection Device – (MDCD)
National Air & Surface System – (NASS)
Negotiated Service Agreements – (NSA)
Neighborhood Delivery Collection Box Unit – (NDCBU)
Office of Consumer Advocate – (OCA)
Parcel Sorting Machine – (PSM)
Pieces Per Hour – (PPH)
Point of Service – (POS)
Point of Service One – (POS1)
Postal Automated Redirection System – (PARS)
Postal Fiscal Year – (PFY)
Prequalified Wholesaler Program – (PWP)
Priority End-to-End – (PETE)
Prior Year Losses – (PYL)
Product Tracking System – (PTS)
Professional Specialist Intern – (PSI)
Remote Bar Code Sorting – (RBCS)
Remote Encoding Centers – (REC)
Request for Proposal – (RFP)
Same Period Last Year – (SPLY)
Segmented Inventory Accountability – (SIA)
Segway Human Transporter – (Segway HT)
Semi-Automatic Tray Take-Away Mechanism – (SATTAM)
Singulate, Scan, Induction Unit – (SSIU)
Surface Air Management System – (SAMS)
Surface Air Support System – (SASS)
Threat Assessment Teams – (TAT)
Transportation Contract Support System – (TCSS)
Transportation Optimization Planning and Scheduling – (TOPS)
Tray Management Systems – (TMS)
Universal Tray System – (UTS)
Web Executive Information System – (WEBEIS)

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