EXAMINATION OF POTENTIAL POSTAL BUSINESS MODELS

REPORT FOR
THE UNITED STATES POSTAL SERVICE

ALAN ROBINSON
DIRECT COMMUNICATIONS GROUP
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2408 COLSTON DRIVE, #103 • SILVER SPRING, MD • 20910
PHONE: (301) 589-6273 • CELL: (301) 240-463-4163
E-MAIL: alan.robinson@directcomgroup.com

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EXECUTIVE SUMMARY

In choosing a potential business model for the Postal Service, policymakers are as much choosing a path for the entire industry within which the Postal Service operates as choosing a path for the Postal Service itself. The United States Postal Service is only one supplier within a much larger communications and parcel delivery market. This industry supplies households, businesses, government entities, and other organizations that need to:

- Solicit, conduct, and complete transactions
- Distribute advertising, news, and other types of information
- Communicate with friends, family, and business associates
- Deliver packets and parcels.

The public face of the Postal Service is its service to individual citizens through its 6-day delivery service and local retail post offices. However, the survival of the Postal Service, and for that matter the ability of individuals, governments, non-profits, and businesses to send hard-copy communications and parcels rests on the Postal Service's ability to serve the business customers that generate over 88% of all revenue, a proportion which has grown as increasingly individuals have chosen electronic alternatives offering more convenient and cost-effective solutions. With non-household derived revenue likely to determine the long-term viability of the Postal Service, policy makers need to focus on ensuring that the future business model of the Postal Service can provide non-household mailers with a positive return on their mail spending in order that there is sufficient volume in the system to make the continuing use of mail by the general public affordable, reliable, and convenient.

Potential business models all have to deal with eight challenges. They are:

1. **Maintaining Mail's Importance to the Economy –** The mail industry is responsible for over eight million jobs and $800 billion in economic activity. The business model can accelerate or retard economic growth depending on how well it serves customers that need mail delivery.

2. **Minimizing Financial Risks to the Federal Treasury –** At the end of the third quarter of 2009, the Postal Service's obligation to the Treasury for debt, retiree health benefits and workers compensation payments is $ 72.7 billion.

3. **Ensuring Financial Self Sufficiency –** Since the passage of the Postal Reorganization Act, financial self sufficiency has been an objective of postal policy but was never defined much beyond the concept of accounting break even. While the Postal Accountability and Enhancement Act (PAEA) has as its objective that revenue and retained earnings of the Postal Service should be sufficient to endure financial stability, the current operating losses and limited cash reserves suggest that the Postal Service faces a significant challenge of being truly self sufficient.

4. **Adjusting to New Market Realities Serving Wholesale Customers –** With the decline of the Postal Service's business handling transactions and correspondence, both

the Postal Service's ability to provide universal service and its financial viability will depend upon meeting the service needs of its wholesale customers that send 500 or mail pieces at a time and will in the future generate more than 70% of revenue and 80% of the volume that the Postal Service handles.

5. **Adjusting to New Market Realities Serving Retail Customers –** Over the next decade the Postal Service will see demand from retail customers declining below the 30% of revenue it is today. Adjusting the retail interface and operating network serving these customers creates significant financial, operating and political challenges.

6. **Adjusting Operating Costs to New Competitive Realities** – The market realities of serving postal customers requires a leaner processing and transportation network and a modernized retail network.

7. **Funding Transition and Modernization Costs –** Rationalizing Postal Service operations to reflect new market realities in wholesale and retail markets will require substantial cash outlays to cover the costs of right-sizing the network and workforce, modernizing the retail network and optimizing the processing network. The business model must find ways to raise this cash when operating losses, retiree healthcare payment schedules, and debt to cover prior-year losses provide few options

8. **Creating a Workforce for the Long Term –** The new market realities and the operating and retail networks that serve them can provide good jobs for postal employees. However, the existing civil service based employment law framework, labor agreements and consultative requirements with management associations all reflect significantly different market and operating realities and the labor-management environment that existed four decades ago.

These challenges are not unique to the Postal Service. Similar challenges existed for nearly every foreign postal administration that has gone through a transformation of their business model. In addition, the Federal Government has had experience in dealing with the bankruptcy of Conrail and other railroads in northeast.

The range of potential business models include nearly a continuum of options that run the gamut from a government department to a corporation owned by private shareholders. How close a particular model is to one end of the continuum or the other depends on choices regarding to corporate governance, employment and labor law, financial management, operations management and marketing management. This paper divides potential models into two groups, governmental and corporate models, depending upon whether the characteristics of the model are more similar to the characteristics of the models on either extreme of the continuum. In total five models were looked at:

- Governmental Models
  - **Government Department** – This is how the federal government currently provides air traffic control, weather, agricultural marketing, national parks, museums and other services to businesses and consumers. In all of these examples, the service is provided under standard federal government law, civil service and all or a significant portion of revenue is generated from the users of the government service or private donations.

  - **Government Enterprise as defined by current US Postal law** – This is the existing model under which the Postal Service operates
  - **Government Enterprise with relaxed human capital, financial, and operating constraints –** This model maintains the governmental characteristics of the enterprise but modifies specific characteristics in a manner similar to other government enterprises.

- **Corporate Models**
  - **Government Owned Corporation** – The Postal Service operates under standard private-sector law and is owned by the federal government. This is most similar to the structure of municipal owned utilities and publicly owned commuter railroads. Many foreign postal operators fall under this business model. A government-owned private-law corporation can be loss making or profit making.
  - **Private Sector Corporation with or without government shareholders** – A private sector corporation would include private sector owners and operate under a charter granted by the federal government. Services provided on behalf of the federal, state or local governments would be provided under contract and could include services that fall within the charter that are not sufficiently remunerative to justify their provisions (GM, Chrysler, Ford)

The three governmental models reflect the general approach that the federal government has taken with business-oriented services. The corporate models reflect what foreign posts have chosen. The corporate models also reflect the models of all of the Postal Service's competitors including those offering physical and electronic delivery, and those that compete by providing sortation or transportation of mail.

The table below summarizes how well each of the models handles the challenges facing the postal service and policymakers. Examination of how well each of these models would handle the challenges facing the Postal Service finds all of the governmental models wanting. While relaxing the some of the constraints of the current model would be a reasonably safe choice, it would not be sufficient to serve the Postal Service's retail and wholesale customers, and ensure that the Postal Service's obligations to the Treasury are paid. Instead, the best solutions would involve preparing the Postal Service to operate as a government corporation, working under private sector law.

Making this transition will not be easy. The Federal Government has done this only twice with the US Enrichment Corporation and ICAAN. Neither organization was as large as the Postal Service. In particular, neither had the challenge of transferring more than a few hundred employees from civil service to private sector employment, nor did the have significant financial needs to cover modernization, debt and unfunded. However, the experiences of foreign posts, many which employ tens of thousands of employees and had similar financial woes illustrates how this can be done, and how it can be done with minimal disruption of the careers of postal employees.

CHALLENGES FACING BUSINESS MODEL	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Impact on the Economy	Retards economic growth	Retards economic growth	Could either retard or promote growth	Promotes economic growth	Promotes economic growth
Financial Risks to the Federal Treasury	Significant default risk	Significant default risk	Significant default risk	Reduced default risk	Minimal default risk
Self Sufficiency	Appropriations required in long run	Appropriations required for transition and in long run	Appropriations may be required for transition and in the long run	Federal loans required for transition	Federal loans required for transition
Challenge of Serving Wholesale Customers	Unlikely to sufficiently control costs or gain pricing flexibility to prevent rapid exit of customers	Unlikely to sufficiently control costs or gain pricing flexibility to prevent rapid exit of customers	Possibly capable to sufficiently control costs and gain pricing flexibility to prevent rapid exit of customers	Likely capable to sufficiently control costs and gain pricing flexibility to prevent rapid exit of customers	Likely capable to sufficiently control costs and gain pricing flexibility to prevent rapid exit of customers

CHALLENGES FACING BUSINESS MODEL	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Challenge of Serving Retail Customers	Unlikely to modernize due to funding constraints and congressional interference	Unlikely to modernize due to funding constraints and congressional interference	Could modernize but funding constraints and congressional interference would delay	Would likely modernize to reflect customer needs and USO obligations	Would likely modernize to reflect customer needs and USO obligations
Adjusting Operating Costs to the New Competitive Reality	Unlikely in a timely fashion due to funding constraints and congressional interference	Unlikely in a timely fashion due to funding constraints and congressional interference	Possible in a timely fashion but could be delayed without appropriate transition funding	Likely in a timely fashion with appropriate transition funding	Likely in a timely fashion with appropriate transition funding
Funding Modernization and Restructuring	Unlikely to provide funding in a timely fashion	Unlikely to provide funding in a timely fashion	Could provide funding in a timely fashion with creation of appropriate funding entity	Should provide funding in a timely fashion with creation of appropriate funding entity	Should provide funding in a timely fashion for modernization required private sector funding sources

CHALLENGES FACING BUSINESS MODEL	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Creating a Workforce for the Long Term	Unlikely to provide sufficient flexibility for required transition and	Unlikely to provide sufficient flexibility for required transition	Somewhat likely to provide sufficient flexibility for required transition depending upon which civil service restrictions are removed	Likely to provide sufficient flexibility for required transition and beyond	Likely to provide sufficient flexibility for required transition and beyond

PRINCIPAL AUTHOR

The principal author is Alan Robinson, President of the Direct Communications Group. He has over twenty-five years experience working on the regulatory, policy, marketing, human capital and management issues associated with changes in competition within transportation, parcel delivery and postal markets. His clients have included trade associations, transportation companies, postal operators, parcel carriers, shippers, and suppliers to transportation companies and postal operators. He is the author of the blog **Courier Express and Postal Observer**. http://courierexpressandpostal.blogspot.com/

Prior to starting the Direct Communications Group, Mr. Robinson was employed by Ernst & Young and provided services to Arthur D. Little, A. T. Kearney, Andersen Consulting, and KPMG Peat Marwick. Mr. Robinson has also assisted Congress as a staff member of both the Congressional Research Service and the Motor Carrier Ratemaking Study Commission.

Mr. Robinson has an undergraduate degree in Mathematics and Political Science from Macalester College and a Masters Degree in Public Policy from the University of Rochester.

Mr. Robinson has published over 40 articles on topics of interest to the postal, transportation and logistics industry. He has been a frequent speaker at transportation and postal conferences including presentations at the North American Transportation Employee Relations Association Annual Conference and Center for Research in Regulated Industries' conferences on postal economics.

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1. UNDERSTANDING THE POSTAL MARKET

United States Postal Service is only one supplier within a much larger communications and parcel delivery market. This industry supplies households, businesses, government entities, and other organizations that need to:

- Solicit, conduct, and complete transactions
- Distribute advertising, news, and other types of information
- Communicate with friends, family, and business associates
- Deliver packets and parcels.[1]

The Postal market itself is the sub-market that includes firms that provide physical delivery of these items.[2] The broader market includes numerous modes including over-the-air radio and television, cable television, internet including e-mail, display advertising, paid search placement, blogs, social networking sites, and twitter, telephone and facsimile. This section of the report briefly looks at the postal market with a focus both cyclical and secular trends affecting the Postal Service's ability to compete in this market and meet the financial and other objectives that Congress has directed it to meet.

1.1. WHO ARE THE POSTAL SERVICE'S CUSTOMERS

The question, "who are the Postal Service's customers," sets the framework for understanding the postal market and evaluating public policy and economic issues associated with business models and regulatory models that make sense for the Postal Service. Customers of the postal service are its raison d'être. Without customers, and in particular customers willing or able to pay the full cost of the service it offers, policy options are limited.

1.1.1. Is the Customer the Sender or the Receiver?

All network industries have both senders and receivers. In all of them, the customer is the purchaser of the service provided by the network. Depending on the nature of the network, the customer can be the sender, the receiver or both.[3] The customer of entities providing transmission of electricity, gas and petroleum products are the purchasers of the product transported, the recipient of the item transported. The customer of entities providing telecommunications services are both the sender and the recipient with the sender the customer on land-line services, both the sender and recipient the customer in wireless and internet services. For transportation services, the sender is the

[1] Packets are defined as packages less than two pounds, parcels are defined as packages over two pounds. The USPS only handles parcels weighing less than 70 pounds but there are other members of the industry that handle the heavier weight packages.

[2] Clearly the national, regional and local parcel, express, and courier companies fall within this submarket. In addition, newspapers delivered to the door, in street boxes, or at newsstands and magazines sold through retail channels fall into the physical delivery submarket.

[3] Merriam Webster defines a customer as "one that purchases a commodity or service." Dictionary by Merriam Webster, AOL.

customer as they generally pay for the service, although their choice of suppliers may be limited by the ability or willingness of the recipient to accept delivery from a particular supplier.[4]

For the Postal Service, the party that pays the postage bill, and therefore the customer, is generally the sender of the mail, or purchaser of the counter service.[5] The party that receives the mail pays for the service only in cases of parcel returns and business reply mail where the receiver sees an economic value in picking up the mail charges and makes arrangements to pay postage, including having cash on account prior to the mail being tendered to the Postal Service.[6] As the customer in the mail market is usually the sender, the mail market customers are more similar to transportation service customers and less similar to customers in power and telecommunications markets.

Identification of the sender as the postal customer has existed since the creation of the penny post when Roland Hill first recognized that senders valued the delivery of messages more than recipients valued receipt and unless senders were charged for the delivery, recipients would refuse receipt of messages. The efforts of individual customers for removal from mailing lists of advertising mail suggests that the difference in the value of the mail to senders and recipients that influenced Roland Hill is still a characteristic of the mail market.[7]

1.1.2. Non-Household Customers are the Principal Senders

Non-household customers send the vast majority of mail handled by the Postal Service. These customers include businesses; non-profit organizations; and federal, state, and local governments. The Postal Service has reported that over the past decade and a half, non-household originating mail has remained at just under 90% of all mail sent. While mail has grown dramatically during that period, the differences in percentages associated with particular mail flows illustrates that mail has increasingly become a primary means for non-households to communicate and send parcels to households and for households to communicate back to these entities. The biggest losses have been mail sent only between two households or two non-households.

[4] In transportation services, the sender became the default customer due to difficulty getting the recipient to pay for transportation charges. This is a situation similar to what drove the creation of the penny post.

[5] The Postal Service also rents Post Office Boxes for customers for a limited number of customers who prefer that mail not be delivered to their home or business address.

[6] The customer for free services, such as mail for the blind, is less clear as the sender may have an institutional interest in sending the mail, and the recipient clearly desires what is being sent.

[7] In some instances, individuals have begun lobbying state legislatures to promote do-not-mail legislation that would make refusing mail even easier.

Table 1: Mail Flows of Domestic Mail

Percentage of Total Domestic Mail by Source and Destination

	1987	2002	2007	2008
Household to Household	4.8%	3.6%	2.7%	2.9%
Household to Non-Household	6.4%	8.0%	6.7%	6.9%
Household to Unknown	1.0%	1.0%	1.3%	1.6%
Non-Household to Household	56.6%	66.1%	68.8%	70.2%
Non-Household to Non-Household	30.9%	20.6%	20.0%	17.7%
Unknown to Household	0.3%	0.7%	0.5%	0.7%
Total	100.0%	100.0%	100.0%	100.0%
Total Mail to Households	61.7%	70.4%	72.0%	73.8%
Total Mail Sent by Non-Households	**87.5%**	**86.7%**	**88.8%**	**87.9%**
Total Mail Sent to or from Non-Households	93.9%	94.7%	95.5%	94.8%

Sources: USPS, *2003 Household Diary Study*, Table A1-1.
USPS, *2008 Household Diary Study*, Table A1-1.

Non-household originating mail differs from household mail as around three-quarters of non-household mail have real economic value.[8] Seventy-two percent of all mail sent to households contains advertising.[9] At least another four percent contains bills without advertising. However, the economic value for advertising is different from that for bills and payments sent by non-household mailers. For advertising, mailers expect a return (i.e., return on investment in mailing) based on sales generated by the advertising, or in reducing customer churn, so the value of the mail depends on the amount of sales generated or its impact on slowing customer churn.[10] For bills and payments the economic value is more complicated. The bill presentment and payment process is part of the transaction costs of completing a sale or providing a service. As such, mail and other expenses related to sending bills and statements and collecting payments are considered an overhead expense. Mail remains a viable method of completing the transaction only as long as profit or budget pressures do not drive a company or non-profit to find an alternative method of handling transactions.[11] Consumers may compare their economic costs of using the mail to pay bills when looking at

[8] United States Postal Service, *The Household Diary Study: Mail Use and Attitudes*, 2008. The percentage is based on information contained in Table A1-3 which identifies 72.1% of all household mail as containing advertising and 12.5% containing bills. As some bills also contain advertising, the figure assumed that only 35.2% of bills do not contain advertising, which is equal to the ratio of advertisement insert figure divided by the sum of the figures for bills and financial statements.

[9] States Postal Service, *The Household Diary Study: Mail Use and Attitudes*, 2008. Table A1-3

[10] Nonprofits that use mail for solicitations face the same return issues that commercial advertisers do. The non-solicitation mail of non-profits may have advertising purposes similar to that of commercial mailers, as is the case in mail from hospitals keeping nearby residents informed about their specialties. Even communications with members that help keep members informed of a non-profit's schedule or activities help keep members feeling part of the non-profit's community, reducing the non-profit's costs of maintaining the organizations members as well as providing information.

[11] The choice of mail verses alternative media may look at other factors beyond just the cost of the transaction itself. The section below "how is demand changing?" will illustrate recent research on the effectiveness of competing modes on customer retention, payment cost, and payment reliability.

alternatives as well but they are by nature not as regularly focused on minimizing the costs of the billing portion of the transaction as non-householders are that send the bills.[12]

Non-household originating mail also differs in a second important respect; non-household mail most often involves sending a significant quantity of identical or similar items to multiple recipients at one time. In mail industry language these are "bulk" senders of mail. Table 2 shows that 90% of the mail sent by non-households is what the Postal Service calls bulk mail. These mailers use a different transaction process that avoids the retail infrastructure of the Postal Service. Because these customers use a non-retail transaction process and purchase the service in quantities, they act in a manner similar to wholesale customers in other industries. This paper will use the term wholesale customers to refer to this subset of customers and will refer to the remaining non-household and all household customers as retail customers as their mailing needs employ the use of brick-and-mortar or electronic retail outlets.[13]

Table 2: Mail Volume by Type in Fiscal Year 2007

Customer Type	Volume (million pieces)	Percentage
Retail Customers		
Single Piece Household	23,677	11%
Single Piece Non-household	19,373	9%
Retail Total	43,050	20%
Wholesale Customers		
Bulk Non-household	168,351	80%
Wholesale Total	168,351	80%
All Customers	211,401	100%

Source: RPW Fiscal Year 2007
USPS 2007 Household Diary Study Table A1-1

1.1.3. Retail and Wholesale Customers

The Postal Service has always served retail and wholesale customers but has never explicitly described them as such. This section will focus on a number of differences between the two categories of customers that will likely affect decisions relating to the business model and regulatory framework choices. These are the differences in the sender's production process, the transaction and

[12] This is not to say that consumers do not look at the cost of stamps, and the time that it takes to pay bills by mail, as opposed to the costs to pay bills in person or electronically, it just suggests that that non-households on the other end of the transaction have greater interest in the transaction cost.

[13] For the purposes of this report, business customers that mail in volumes that are too low to use bulk rates are considered retail customers even though the Postal Service and its competitors often offer these customers different methods of transacting business and discounts for their loyalty to a particular carrier that are not offered to occasional senders of mail or parcels.

the Postal Service's production processes employed to serve each type of customers, and the impact that secular and cyclical trends have had on the business generated by the two market segments.

Retail customers compose the smaller of two customer segments. Retail customers today generate just under 30% of Postal Service revenue and 20% percent of mail volume. [14] The twenty percent of mail volumes that retail customers generate today is split between households and non-households with household generating 55% of the volume.

Retail customers generate mail in small quantities, most often one at a time. With the exception of some mail sent to multiple recipients at one time, as is the case with wedding invitations, business advertisements, bills, and statements, most of the mail sent by retail customers is self produced and nearly all is self addressed. Unavailable just a few years ago, lower-cost and better quality laser and ink-jet color printers give retail customers the opportunity to self-produce high-quality print documents for mail delivery.

The Postal Service sells services to the retail market through Postal Service operated post offices, contracted facilities, postage sales on consignment at grocery stores and other retailers, through the mail, over the phone, and over the internet directly and through third parties that allow customers to print their own postage. Nearly three-quarters of all retail revenue is generated at a Postal Service operated post office including revenue generated at a counter and revenue generated at an automated postal center and vending machines located in the post office. About 16% of revenue comes from stamps sold under consignment or alternative access programs such as sales at supermarkets.[15] About 12% is sold over the web, most through private-sector PC postage vendors, with the remainder sold as part of the Postal Service's Click-N-Ship program for parcels products.[16] Less than 3% of retail revenue is generated at contract units.[17] The remainder of revenue comes from sales by mail, phone, fax, catalog sales or stamped envelopes at Postal facilities or elsewhere.[18]

Retail customers tender mail to the Postal Service that puts unique demands on mail handling infrastructure in addition to the multi-modal customer interface. Given that most retail customers infrequently use mail for services beyond sending single piece letters and cards, they may require that a clerk assist in weighing the mail or parcel and determining the proper postage. Every piece of retail customer mail that is not tendered to the Postal Service at the same time that postage is sold has to be collected from the sender at a delivery point, collection box or post office and transported to an originating processing facility. At that point, retail must be separated by shape and go through facing, cancelling, and outgoing sortation before it is co-mingled with some of the mail tendered by wholesale customers for transportation and further sortation that is required to prepare all mail for delivery. Retail customers create two additional challenges. First, the Postal Service has limited ability to ensure that a customer use a full and accurate address, write or print the address in a machine

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[14] United States Postal Service, Response to Chairman's Information Request No. 1 (Questions 1, 14, 17, and 19 filed august 31, 2008, p. 5.

[15] Ibid.

[16] Ibid.

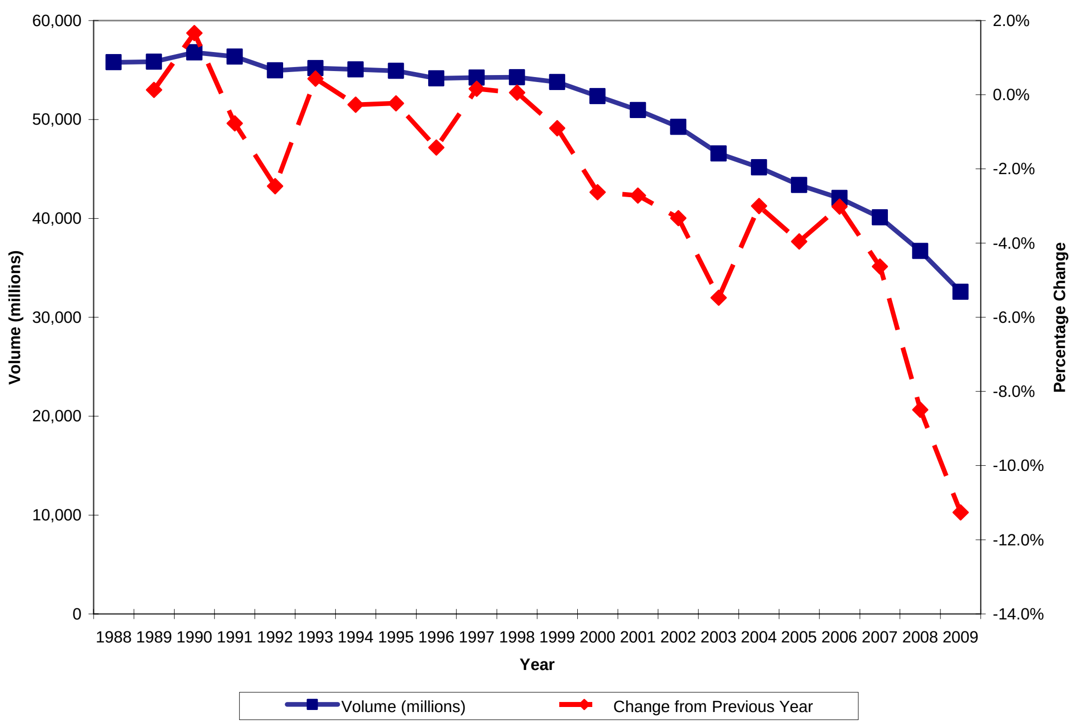
[17] Ibid.

[18] Ibid.

readable format, or limit the physical characteristics of the mail in order to minimize production costs.[19] Second, retail customers create unique workforce and transportation management challenges due to the differences between the demands that these customers place on postal operations from what wholesale customers do.

The retail market is a declining market because of expanding acceptance of electronic alternatives for correspondence and transactions and new methods of inter-personal communications. The Postal Service has seen a decline in retail volumes for the past decade. Exhibit 1 illustrates the decline in the largest retail product, single-piece First Class letters, flats, and parcels. The Exhibit shows that demand in the retail market has declined for 16 of the past 21 years with the rate of decline increasing in the more recent period. The effect of this extended period of decline is that the Postal Service now handles less than 60% of the retail mail that it handled in the peak year of 1990.

Figure 1: First Class Single-Piece Letters, Flats, and Parcel Volume and Year-to-Year Change (1988-2000)



The decline in retail single-piece volume raise two product costing and pricing issues: 1) stranded capital and labor costs, including transition costs to excess labor and capital, that are caused by the decline in retail volumes, and 2) setting rates to pay for retirement and workers compensation obligations when rate setting proceedings treat payments on these costs as current expense resulting

[19] For a description of some of the extra costs associated with serving retail customers see Haldi, John and John T. Schmidt. 2000. "Controlling Postal Retail Transaction Costs and Improving Customer Access to Postal Products," published in *Current Directions in Postal Reform*; edited by Michael A. Crew and Paul R Kleindorfer Boston, MA. Kluwer Academic Publishers

in the postal Service having to spread each annual payment over a lower level of volume each year rather than allowing the Postal Service to set rates in a manner that allows more of the costs to be born by the larger volumes of today instead of the lower level of volumes tomorrow

Wholesale customers compose the larger of the two customer categories and generate over 70% of the Postal Service's revenue.[20] These customers generate 80% of the mail volume as well.

While some wholesale customers generate their own mail, particularly mailers producing bills, statements and parcels, most use third-parties to physically print and prepare what they want delivered. There are extensive postal rules on how wholesale mailers must prepare their mail for postal acceptance and mail preparation is complex. Either the mailers themselves or their third party supplier must have significant knowledge and skills to get the best value from the Postal Service. Wholesale customers often turn to third-party printers/sorters/mail preparers as the lower cost method of obtaining the sophisticated knowledge of postal operations, mailing prices, and mailing rules and regulations that is required to minimize mailing costs and ensure the best possible service rather than developing that expertise in house. Wholesale customers and the printers and mail preparation companies that they employ constitute the participants in the Mailers Technical Advisory Committee, Postal Customer Councils and the most active participants in regulatory proceedings before the Postal Regulatory Commission.

Wholesale mailers pay postage using a combination of computer based, meter-based, and permit, or trust account based methods. The exact postage charged for any mailing is determined through an "acceptance process" during which the mail examined by a postal employee to verify postage, quantity and full payment before the mail is processed. The examination can occur at the production facility, in the case of large-scale production facilities, or at a mail processing plant.[21]

Compared to that for retail customer, the mailing process for wholesale customers differs in that wholesale customers tender their prepared mail in bulk and their mail is accepted by the Postal Service either at one of the postal plants or at the mailer's production facility (in the case of either postal plant load or mailer drop ship arrangements). With the exception of postal plant loads, the wholesale mailer or its representative determines where mail enters the postal system in order to produce the best service at lowest costs.[22] Once mail is tendered to the Postal Service, it goes directly to the appropriate sortation process or transport to another facility for sortation. With the exception of small volumes of mail destined to ZIP Codes where the mailer has few pieces to be delivered, most wholesale mail can skip origination sortation processes used by retail mail and go directly to destination sortation processes.

[20] United States Postal Service, Response to Chairman's Information Request No. 1 (Questions 1, 14, 17, and 19 filed august 31, 2008, p. 5). In this response the Postal Service reported that retail revenue was 29.27% of all postal revenue. Therefore the remaining 70.67% of revenue must come from the Postal Service's wholesale customers. It is not clear if this figure includes retail revenues from Express Mail and Priority Mail that are competitive products and are often not reported in Postal filings on revenue and volumes.

[21] In this way the Postal Service's dealings with its wholesale customers differs from the billing process used by private sector competitors. In limited instances, the Postal Service allows whole mailers to tender mail to a retail counter.

[22] Even in the case of postal plant loads, the mailer/representative may have located its own processing plant so that it would be near the postal-designated entry point in order to ensure required mailing service levels at lowest cost.

Until the current recession, the demand for mail services among wholesale customer has been steady or shown low single digit growth. The different in trends between retail and wholesale markets means that the wholesale market's 80% in mail volume is ten percent higher than what it was a decade ago. Figure 2 illustrates the change in year-to year volumes in retail and wholesale mail.

The difference in the trends in wholesale and retail mail create a unique operational and financial challenge for the Postal Service. From an operational standpoint, the decline in retail customer mail reduces the use of the Postal infrastructure from completion of the postage sale through origination sortation and transport to facilities further down in the network. Ideally the Postal Service should be shrinking its operating capacity and costs in this area at a rate equal to or greater than the decline in demand in order to prevent losses in the handling of retail products.[23] The decline in retail products also create opportunities to compete for the physical sortation now done by third parties. Finally the differences in the rate of decline of retail and wholesale mail may result in shifting the burden of retiree benefits to wholesale mailers as their share of the Postal Service's business increases.

Figure 2: Year-to-Year Change in Retail and Wholesale Mail since 1999

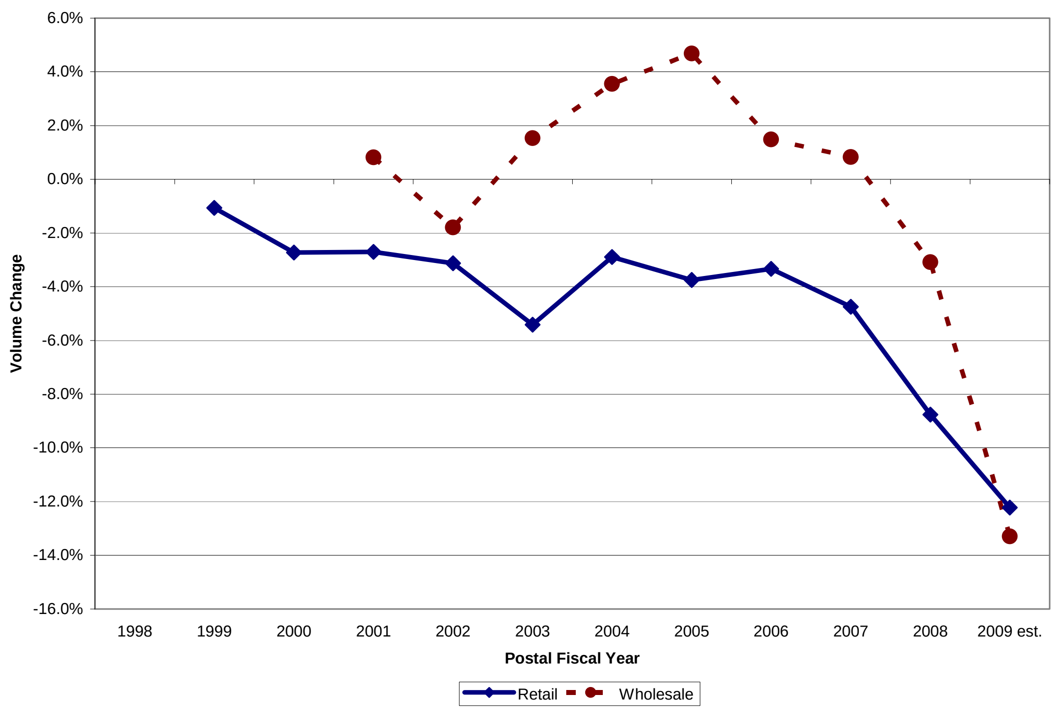


Figure 2 also illustrates that the severe economic downturn since 2007 has had a dramatic impact on both market segments but an even greater impact on wholesale customers. The Postal Service has recognized the difference in economic sensitivity between retail and wholesale customers in its volume forecast models, although it is not publicly known whether the models projected the dramatic downturn in volume illustrated above. Table 3 shows the difference in sensitivity of the

[23] Another option would be to use this excess capacity to provide physical sortation and transportation services that wholesale customers are not paying third-parties to perform.

various postal product volumes to the economic variable used in its forecast.[24] All of the wholesale products are more sensitive to the economy and the rapid decline in economic activity, and in particular activity in segments of the economy that are heavy users of mail products, provide a clear explanation of the decline in demand for wholesale products in 2008 and 2009.

Table 3: Sensitivity of Retail and Wholesale Products to Economic Activity

Postal Product	Economic Variable	Elasticity Relative to Economic Variable
Retail Products		
First Class Single Piece	Employment	0.370
Wholesale Products		
First Class Workshared Letters	Retail Sales	.534
First Class Workshared Cards	Retail Sales	1.663
Standard Regular	Retail Sales	0.386
	Private Investment	0.170
Standard ECR	Retail Sales	0.446
	Private Investment	0.256
Standard Nonprofit	Retail Sales	0.800
Standard Nonprofit ECR	Retail Sales	0.477
Periodicals - Regular	Employment	0.875
Periodicals – Within County	Employment	0.876

Source: "Direct Testimony of Thomas E. Thress on Behalf of the United States Postal Service," filed with the Postal Rate Commission in Docket No. R2006-1, May 3, 2006.

The greater economic sensitivity of wholesale mail reflects the return on investment focus of senders. Weakened economic conditions reduce the return for each dollar of mail spending thereby reducing the willingness of mailers to spend on mail products. For businesses and non-profit organizations that use the mail in a way that does not generate a measurable impact on sales and profits (e.g. newsletters, statements, bills, payments and payments acceptance) mail was an overhead

[24] The forecast only estimates the impact of economic variables on volume. For some products, the weight of each piece, and therefore the postage paid depends on the numbers of advertisements sold and in a weak economy reduced advertising spending will not only reduce the number of pieces sent but the average weight per piece as well.

cost to be tolerated in good times. In bad times, it becomes an overhead cost that needs to be reduced to minimize the impact of the economy on profits or in the case of non-profits, budgets.

The dramatic impact that economic cycles have on mail volume raises another issue in trying to project mail volumes, especially if the time-series models underestimated the volume decline. If the changing value of mail during economic cycles explains the sensitivity of mail volume to the economic cycle, then could it change the sensitivity of customers to mail price as well?

2. CHALLENGES FACING ALL BUSINESS MODELS

All business models face the following challenges that derive from the needs of postal customers, the current financial position of the Postal Service and the existing constraints set by law, regulation or contract. These challenges are:

- Maintaining a mail service that continues to drive economic growth;
- Minimizing the financial risks to the Federal Government for postal debt and unfunded workers compensation payments, retiree health benefits and other obligations;
- Ensuring that the Postal Service is self sufficient;
- Meeting the challenge of serving wholesale customers;
- Meeting the needs of retail customers while adjusting the access model to reflect market decline;
- Adjusting the operating model to both serve customer needs and meet financial objectives;
- Funding the adjustments to the operating manner within a sufficiently speedy time frame given current financial constraints; and
- Creating a workforce whose size, makeup, and skills reflect the new market realities and long-term job secure job prospects for employees.

2.1. MAINTAINING A MAIL SERVICE THAT CONTINUES TO DRIVE ECONOMIC GROWTH

The importance of the mail industry to the economy is such that just allowing it to disappear is not an option. As such choosing a new business model is similar to the process of choosing a new business model for most railroads under bankruptcy.

Moving hard copy communications from concept to delivery and parcels from the seller to the buyer employs over 8 million people and generates at least $800 billion in economic activity.

Creating a business model that ensures that the Postal Service is a strong long-term participant in the mail market would provide its wholesale customers with an improved confidence in their business relationship with the Postal Service.

Moving to a new business model will likely have some transition issues and each model under consideration will need to ensure that the transition issues do not interfere with meeting customer needs. This is most critical in two areas that could see significant changes. First, as the Postal Service's largest customers require delivery to every address in the United States, complicating their process of getting delivery would increase the mailer's costs, raise the possibility of coordination problems, and reduce the value of mail to them. Second, retail customers will need assurance that they will still have access to mail services even if the process of receiving that service changes.

The potential economic impact of change requires that 1) evaluation of business models and regulatory frameworks include an evaluation of the potential economic impact and 2) the transition to any new business model not cause a disruption in mail service that causes a national economic disruption while the United States comes out of the deepest recession since the Great Depression.

2.2. MINIMIZING THE FINANCIAL RISKS TO THE FEDERAL TREASURY

All of the Postal Service's obligations are in essence obligations to the Federal Treasury. Without any change in legislation, the Treasury would be on the hook for $72.7 billion should the Postal Service cease operations. The total comes from $53 billion for retiree health benefits, $10 billion in debt, and $9.7 billion in workers compensation liability.

Traditionally, the Postal Service has funded its obligations to the U.S. Treasury through its operating revenue. But the combination of an accelerated payment schedule for the Postal Service's retiree health obligations contained in the Postal Accountability and Enhancement Act and an unprecedented decline in revenue due to the recession has caused it to borrow from the Treasury to meet these obligations. So while the new funding schedule may have improved the federal government's budget, it did not change the financial risk to the Treasury

Legislation in Congress to change the funding schedule for the retiree health benefit obligations leaves the obligation on the books and only reduces the Postal Service's immediate cash outlays. It does not change the actual obligations or risks to the Treasury.

Given the recent trends in mail volume, the Postal Service incurred significant operating losses that were funded through debt, expense reductions, and tightening of capital spending. Unless mail revenue increases and the Postal Service can further cut costs quickly, the prospects exist for additional losses. In addition, the Postal Service under most models will likely require additional funding for transition expenses and deferred capital projects. Given the Postal Service's current cash position, future losses, and spending on transition expenses and deferred capital projects would require additional debt that would increase the risk to the federal treasury.[25]

2.3. ENSURING SELF SUFFICIENCY

The Postal Service has had the requirement that it generate nearly all revenue from the users of its service since it was created by the Postal Reorganization Act. Under the Act, the Postal Service

[25] The additional debt could require an increase in the $15 billion debt limit.

set and the Postal Rate Commission approved a revenue requirement that was designed to ensure that the Postal Service broke even in an accounting sense over time. The revenue requirement included the capital expenses of the Postal Service and the debt service associated with the capital spending plan. In its decisions, the Commission rarely conducted a significant investigation as to whether the capital spending was sufficient for sustaining the Postal Service, limiting itself to ensuring that the revenue requirement was accurately presented. During this period, it was expected that the annual borrowing limits plus prior year cash flows were sufficient for capital investments and covering operating losses that regularly occurred in the year prior to a rate increase. The PRC never considered that USPS should receive a "return on equity investment" that other regulated utilities always received in their revenue requirements. In many ways the definition of self-sufficiency under the Postal Reorganization Act, and the Rate Commission's review of the revenue requirement, maintained a government oriented definition of self sufficiency as focused on the budget-like revenue requirement that the Postal Service presented.

With the passage of the PAEA, the Postal Service no longer had a specific "break even" requirement tied to an accounting based budget. Two sections reflect the Act's approach to the issue of self sufficiency.

In its direction to the Board of Governors, the Act states:

> Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services in accordance with the provisions of chapter 36. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.[26]

In its direction to the new Postal Regulatory Commission, the PAEA has as one of its objectives a system of modern rate regulation that "assure[s] adequate revenues, including retained earnings, to maintain financial stability."[27]

Not since prior to the passage of Postal Reorganization Act has there been a serious external examination of whether rate levels, operating plans or capital investment plans are sufficient to "maintain financial stability." Given the outsized operating losses in 2008, 2009, and most likely in 2010 and the elimination of cash available for anything but absolutely critical capital spending, there are substantive questions about whether the current postal business model and regulatory framework can ever generate sufficient levels of cast to ensure long-term postal financial self sufficiency.

2.4. MEETING THE CHALLENGE OF SERVING WHOLESALE CUSTOMERS

Wholesale customers create three challenges for any business model. First, wholesale customers are oriented toward making a return on their communications investment and are therefore sensitive to both the mail preparation costs, postal rates, and the costs of competitive communications alternatives. This means that mail will retain its viability as long as its total cost is competitive with

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[26] Title 39 U.S.C. Sec. 404(b)

[27] Title 39 U.S.C. Sec. 3622(b)(5)

the cost of alternatives and wholesale mailers can generate reasonable returns on their mailings. As noted earlier, this is true even for mail that is perceived to be part of overhead costs as the use of mail will be retained as long as the mailer perceives that his relationship with a customer is worth allowing the recipient to continue to receive and send documents, bills, statements, and payments by mail. The return orientation of this market segment puts intense cost pressure on operations of all parties involved in moving mail from concept to delivery to ensure that this effort costs less than the value that the value the sender places on the mail.

The second challenge in serving this market is the cyclicality of demand. As most of this market involves the handling of advertising and parcels, the level of demand and production resources will rise and fall with economic cycles. In addition, it is possible that wholesale senders of mail will be more price sensitive during tough economic times when the return possibilities are weak and less price sensitive during good times. As such, pricing models that use a constant understanding of price elasticity may have the effect of underestimating demand in boom times and overestimating demand during recessions unless price adjustments are made to deal with changes in customer valuations of mail over the course of an economic cycle.

The third challenge is finding new ways of attracting the business of wholesale mailers in order to replace transaction mail that is leaving the mailstream. To do so, the business model and regulatory framework must have the ability to look at options to increase volume and revenue with a focus on five types of marketing/product innovation initiatives:

1. expanding the use of the postal network used by existing and new customers (e.g., increasing revenue per piece by doing more of the work now provided by third-parties; offering new products and services at retail offices);

2. expanding demand for postal services in geographic markets that are underutilizing postal products with a particular focus on geographic markets that are poorly served by broadcast media, newspapers, and high-speed internet services;

3. creating unique products that can be treated in a manner to satisfy their unique market requirements of advertising customers with limited volumes that require high delivery date certainty;

4. identifying new products and alternative pricing options to serve medium and large volume mailers that use the postal network in non-traditional ways (e.g., make use of intelligent mail to create new products); and

5. Maintaining pricing flexibility to respond to seasonal and economic cycles in order to maximize profit and utilize fixed network costs.

2.5. MEETING THE CHALLENGE OF SERVING RETAIL CUSTOMERS

Retail customers require:

- Convenient access points from which to purchase services and postage;
- Convenient points to tender mail and parcels to the Postal Service;

- A simple means of accessing postal services – one stop shopping for delivery to all points;
- A clear understanding of the service quality offered by the various products;
- Payment terms comparable to that offered by other merchants; and
- A pricing scheme with a level of complexity similar to that employed by other carriers and/or the purchase of other low priced items.

Managing a retail postal business and meeting these requirements is particularly challenging given the steady decline in demand within this market segment. Retail customers using the Postal Service's "mail" products increasingly find alternative delivery modes more attractive, less costly, and more convenient. As the price of many alternatives is near zero, and the product and business transaction is quite simple, the Postal Service has few strategic options to grow the mail portion of this business from households. For non-households, the Postal Service needs to consider developing simpler products that allow them to use the mail as an advertising and communications media in volumes that fall below the minimums that wholesale customers must meet.[28]

Retail customers create a unique pricing challenge due to the expected decline in volume and the consequences of the decline on operations and financial management. Declining volume reduces requirements for labor and capital resources used by retail products. The postal operator under all models will have to deal with transition costs associated with reducing labor and capital resources. These costs include unused depreciation of excess capital, termination costs of leases, retirement incentives, severance payments, and unemployment costs for employees Current thinking about marginal, incremental, attributable and other economic and regulatory cost concepts; product pricing; the relative mark-up for products used by retail and wholesale customers; workshare pricing models; and price cap application were not designed to take into account these costs when they are linked to the decline in demand for only a subset of postal products.[29]

The parcel portion of this business (e.g. Parcel Post, Express, and Priority Mail) can grow but may require reexamination of how the Postal Service serves the non-household customers of this business to ensure that it competes on price, service and convenience grounds with services offered by its competitors. The Household Diary Study indicates that household customers already prefer the Postal Service and are three times more likely to use the Postal Service to send a parcel than a private sector retail outlet. However, the Postal Service's competitive position in serving low-volume non-household customers is not known. To be competitive, the Postal Service may need to rethink its interface with small non-households to ensure that the way it conducts business, including pricing of products, tendering of products, access to drop-off points, and payment methods, does not put it at a disadvantage in this market.

The biggest challenge in serving the retail market is what how to provide a physical retail interface for the customer. Currently the Postal Service uses corporate owned post offices that are limited to providing mail and parcel delivery related services almost exclusively. Current law sets specific requirements for eliminating any of those post offices and that restricts innovation in

[28] For a more detailed illustration of a simpler product designed for smaller mailings sent by non-households see: http://courierexpressandpostal.blogspot.com/2009/07/could-usps-turn-jobless-recovery-into.html

[29] Private sector firms could use shareholder equity to absorb the write off of stranded costs.

providing retail access. Both foreign posts and private sector parcel carriers have determined that convenient customer access at a reasonable cost requires using multiple retail models including franchises in established office supply, drug, and other retailers, corporate sponsored and independent franchises of parcel and mail services, a combination of a simplified tariff and self-service pricing, acceptance and retrieval of parcels, corporate franchised and corporate owned outlets that offer a full range of mailing, packing, and business services, and expansion of service offerings beyond mail and parcels to include a full range of financial services through either a wholly owned subsidiary or contracts with specific providers.

2.6. ADJUSTING OPERATING COSTS TO THE NEW COMPETITIVE REALITY

The new competitive reality requires a completely different understanding of the relationship between costs and prices and how costs need to be managed than has existed since the passage of the Postal Reorganization Act. Currently prices reflect the requirement that they cover costs that are determined through processes developed based on best practices of honest, efficient, and economical management. The new reality reflects the return orientation of postal customers which by its nature requires postal management to develop operating processes, networks and labor and other contractual agreements that can provide the services at costs that would allow the Postal Service to set competitive prices while still having an operating margin that generates sufficient levels of corporate cash and reasonable returns on capital investments.

The new reality must also reflect a number of market and technological changes that have occurred since the passage of the Postal Reorganization Act that change how costs can be managed.

- First, technological changes and decreasing volumes allow the creation of distribution networks with fewer, larger sortation nodes while still meeting existing or improved service standards. Automated sortation allows the sortation of mail further and faster and, with sufficient equipment, should allow the substitution of transportation time for sortation time. Currently the Postal Service is developing a streamlined network for sorting flats that reflects the impact of new sortation technology. There is no reason to believe that technology for sorting other shapes of mail would not support a similarly streamlined network.

- Second, both technology and changing volume mix have increased the challenge of managing a full time workforce within processing plants. Sortation and address recognition technology allows the sortation of mail in less time. The total amount of processing time for any level of volume then only becomes dependent on the machine capacity available. The reduction in single piece mail has significantly reduced origination mail sortation and the time it takes to sort originating mail. The expecting continued decline in single-piece mail should further reduce the time it takes to sort originating mail. The technological and market changes suggest that a more efficient operating network could handle existing and future processing needs with fewer work hours and a more flexible mix of full and part time employees. All of the Postal Service's competitors primarily use part time employees, and in some cases part-time employees with full-time benefits, to handle the sortation of mail and parcels putting the Postal Service at a cost disadvantage independent of compensation levels. .

- Third, total mail volume has become increasingly sensitive to economic cycles with the decline in single piece mail's share of total volume. While this affects all parts of the postal network used by wholesale mailers, the biggest challenge will involve managing capital and labor assets within processing plants that may need to add and subtract capacity quickly depending upon the strength of the economy.

- Fourth, meeting the needs of the vast majority of retail and wholesale customers may require accepting some modification in delivery time between certain origin-destination pairs in order to create a processing network that has operating costs that can generate rates that are both reasonable for today's customers and allows the Postal Service to be self sufficient.

- Fifth, providing postal services at costs that support competitive prices that allow customers to earn positive returns on their mail spend requires the ability to continually modify operating process and networks in order to reduce costs and improve service.

- Seventh, changes in single-piece mail volume has created significant levels of automation capacity that could allow the Postal Service to develop new products designed around innovate labor-management agreements that would compete for the business that small and mid-sized mailers tender to pre-sorters today.

Managing postal costs to keep mail competitive and allow customers to earn a reasonable return on their mail requires that the Postal Service take advantage of all of technological and market changes to develop a network that manages costs as close to optimal levels as possible.[30] While operating at such levels will not ensure that all existing customers will find that the Postal Service provides true value, it gives the Postal Service the best opportunity to satisfy the most customers and compete for communication and parcel delivery dollars on the table.

2.7. FUNDING MODERNIZATION AND RESTRUCTURING

The three previous sections focus on why the Postal Service's retail and mail processing networks require modernization and restructuring to meet needs of postal customers today and in the future. The sections on financial self sufficiency and the financial risks to the Federal Treasury indicate that existing operating processes and networks are not sufficiently efficient to ensure that all of the Postal Service's obligations will be paid or allow it to remain self sufficient. This section looks at the challenges associated with funding this modernization and restructuring effort.

Up until this year, the Postal Service has tried to use the cost-free method of attrition to reduce its workforce as technology and lower volumes reduced the need for employees. It has completed some limited restructuring of its sortation and transportation networks to reflect the changes in technology and volumes. Unfortunately attrition has not been enough to reduce the workforce to match the Postal Service's current employment needs or to complete the additional restructuring efforts that are now underway.

To cut costs right now and reduce the workforce to match the much lower volumes the Postal Service now handles, the Postal Service has offered early retirement incentives to its clerks and mailhandlers that allowed for a reduction in the workforce of up to 30,000 employees and a cost up

[30] The need for major network restructuring has been noted by the Government Accountability Office since at least 2002.

to $450 million over the next two years in incentives. As employees eligible to retire are not spread evenly across the network, it is unclear whether retirements in any facility will bring the workforce down to optimal levels for today's volumes. Therefore the Postal Service will have additional training, transfer and hiring expenses to right-size the workforce in each of its over 300 processing plants and 30,000 post offices. Once the Postal Service completes this early retirement program, it will likely to find that similar programs are required from first line supervisory to the higher management levels to reflect the appropriate management requirements of a smaller workforce.

The retirement incentives that the Postal Service offered are likely its least cost method of reducing the workforce. Under civil service rules, a layoff conducted through a reduction in force or RIF procedure would require payment of significant levels of severance pay that could exceed the voluntary retirement incentives that the Postal Service offered and would limit flexibility since layoffs would first require eliminating non-career employees.

The current financial and market challenges indicate that the Postal Service will likely need to undertake a more extensive modernization and restructuring effort to improve its service to customers, lower operating costs, and ensure its long term survival as a financially self sufficient entity.[31] The restructuring effort would include all plants that currently handle letter and flat shaped mail. And, if conducted in a timely fashion, the effort could be coordinated with the implementation of flats automation and build on the experience gained from the successful introduction of Network Distribution Centers.

Due to its financial challenges, the Postal Service should develop network restructure plans that include both 1) limited modifications of existing service standards and the use existing facility locations and capabilities as well as 2) alternatives that permit changes in the number of facilities and facility locations.[32] The plans should also include options that would not change delivery times for any mail and options that would increase delivery times for 5, 10, 15, and 20% of all First Class mail in order to identify the potential cost savings of relaxing the constraint that no mail takes longer than it does today. All of these network redesigns should also recognize the associated transition costs as the Postal Service would not have positions for all existing employees in a streamlined network.

Developing a network redesign that includes new facilities would illustrate how capital spending on new plants could streamline operations, cut costs and improve service. At a minimum this "green

[31] The Government Accountability Office has issued a call for a network restructuring numerous times reports and testimony to Congress since 2002.

[32] Current modeling constraints limit restructuring efforts to those that have no impact on delivery time. As the previous section noted, preserving a status-quo sortation network will not meet the need of most mailers: a better return than alternative methods of communication or package delivery. Also, maintaining a status-quo network will not allow the Postal Service to reduce its operating losses quickly enough to prevent significant financial harm to all postal customers, postal employees, and the Federal Treasury that holds the Postal Service's debt and unfunded liabilities.

The Postal Service's current network optimization approach focuses on finding consolidation opportunities that district-level management have identified. These consolidation opportunities reflect opportunities that save cost without changing the delivery time of a single piece of mail. The postal forms that provide collect information on changes in costs and delivery quality limit the cost analysis to a single year, even though, with declining volumes, savings should grow with time. Restructuring efforts by partners of the Postal Service often use a two to three year time horizon in evaluating payback of restructuring operations. The postal forms also do not include transition costs that occur when moving employees to new facilities or new jobs of options for localized incentives to reduce the workforce when a consolidation is planned.

field" network could identify the 20 capital projects that would have the greatest impact on reducing costs and improving service and would include an estimate of the costs and benefits of each project. The inclusion of a "green field" network redesign would provide guidance as to how a well-managed and well-capitalized Postal Service could improve its ability to meet its customer's needs by having a funded plan to improve service quality and reduce costs. The "green field" plan would also aid customer relations during this difficult period as the customers would see that the Postal Service has a plan to replace its initial network restructuring that has a limited degradation of service with investments that improve service and hold prices down.[33]

The success of any network restructuring, including the one currently underway, depends on the Postal Services ability to fund:

- The up-front transition costs associated with reducing the workforce and modifying existing agreements to accommodate both the current restructuring plan and the restructuring that would occur by implementing a more aggressive restructuring that the various network models would require in a timely fashion[34]; and

- The capital costs to both upgrade and modernize existing facilities for the existing plans to restructure networks, the networks that would exist using the existing facilities and the green field networks.

A similar effort is required for modernization of the retail interface. Retail modernization requires capital for a complete rethinking of how retail services are provided. Expanded use of franchises and contract stations would require the proper information system and franchise management infrastructure that the existing effort is insufficient to support. In addition, a more determined expansion of retail self-service, similar to what the airlines, supermarkets, and other retailers have completed, would require a more aggressive implementation of Automated Postal Centers or similar technology. Finally, retail modernization will require capital spending to improve the physical condition of Postal Service operated retail locations. As with network realignment, retail modernization would have both capital and transition costs.

2.8. CREATING A WORKFORCE FOR THE LONG TERM

The mail business is a people business. The challenges of serving wholesale and retail customers do not change that. In fact, these challenges require a workforce that is closely attuned to service requirements of postal customers. This is true in terms of employees that move the mail; sell mail services; maintain customer relationships; and perform all other technical and management responsibility necessary to meet the challenges of service postal customers.

Creating a workforce for the long term requires two distinct challenges. First, the Postal Service will need a new top-to-bottom employment paradigm to reflect the market changes and the operating and retail networks that can best service customer needs at competitive prices. In this new paradigm,

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[33] The modeling efforts looking at potential sites for new plants should at a minimum identify a list of the top twenty plant locations.

[34] As network realignment may require renegotiation of some provisions in labor agreements, the exact costs cannot be estimated. As a high-end substitute, the Postal Service could estimate the cost of handling the reduction in the workforce through a RIF process.

the Postal Service would offer the best job prospects to its employees only if it can hire the right mix of skills, offer the right mix of full and part time jobs, and set the size of the workforce to reflect demand, technology and best business practices. Second, the Postal Service must handle a transition from today's paradigm.

Much of the focus in this regard relates to unionized employees that physically handle or transport mail, and maintain the equipment, vehicles, and facilities employed in retail services and mail collection, processing and delivery. The union jobs that the Postal Service offers are good, primarily full-time jobs that have traditionally provided employees a secure job through retirement. The framework within which these employees work and their pay and benefits reflect a combination of elements of federal civil service and the outcome of negotiations that the Postal Service and its unionized employees have completed since the passage of the Postal Reorganization Act.

Equally important to serving the Postal Service customers are the employees and contractors that perform required administrative, information systems, industrial engineering, sales, and management functions. These functions are critical for: 1) managing the relationship between the Postal Service and its wholesale customers that generate 70% of revenue, 2) managing workforce, transportation and capital assets, 3) developing and successfully implementing information systems technology, and 4) developing and implementing operating plans that will improve service quality and manage costs.

The employees that perform these functions work under a variation of civil service employment rules and law granting associations of supervisors, postmasters, and management employees the right to "participate directly in the planning and development of pay policies and schedules, fringe benefit programs, and other programs relating to supervisory and other managerial employees."[35] Employee associations have existed since at least the passage of the Postal Reorganization Act that formalized a requirement that Postal Management consult with these associations and more explicit consultation rules were established in 1980.

In addition to its employees, the Postal Service makes extensive use of contractors that provide a significant portion of its technical and information systems support.[36] These technical and information systems contractors provide the Postal Service with a flexible workforce that can grow or shrink quickly with Postal Service needs and financial resources. This would be far more difficult to accomplish with employees hired under civil service rules. The use of contractors also allows the Postal Service to pay for high-value skills that it finds more difficult to attract within its normal pay schedule. The contracting costs, and contractor profits and overhead reflect additional costs that the Postal Service must bear to get needed flexibility.

Nearly the entire framework of postal labor law and requirements for consultation with management associations date back to the passage of the Postal Reorganization Act. At that time relations between senior postal management and rank and file employees and local management was acrimonious at best Civil Service rules and regulations for employees did not provide a means of dealing with the changes that were to be required to manage mechanization, automation, and rapidly

[35] U.S. Code 39, Title 39, Section 1004(b). Sections 1004(c) through 1004(g) were added in Pub. L. 96-326

[36] The Postal Service uses other contractors for transportation, building maintenance, and vehicle maintenance. The Postal Services use of contractors in these areas in a manner that is common in the private sector.

growing demand for mail from bulk senders. Nor did the Postal Service have effective employee communications and human capital planning processes in place.

The labor agreements that the Postal Service signed over the past 40 years have reflected growing mail markets composed of mailers with few options for sending correspondence, bills, payments, advertisements and parcels. This historic market environment, along with normal employee attrition allowed the Postal Service to accommodate agreements that significantly limited its ability to adjust the size of its workforce and the mix of full and part-time employees, even as new technology that reduced the need for employees within its processing plants. However, the decade-long decline in single piece mail, along with a more recent decline in demand from larger-volume wholesale customers potentially caused by competitive digital alternatives to postal communications have removed the cushion that accommodated job guarantees, full-time employment and other negotiated constraints.

Civil service employment law creates three challenges in dealing with the new market and operating environment. First, civil service employment law slows down the process and increases the cost of adjusting the workforce size and skill mix as demand changes. Civil service employment law reflects the assumption that the rate that skill mix and employee counts must change is no faster than the rate that civil service processes allow the change to occur. GAO has noted that similar problems now exist in those agencies seeing significant changes in demand or significant technological changes in how their services are provided.. Second, civil service employment law, along with restrictions on postal pay schedules does not accommodate labor markets well that have pay and benefit levels, and processes for setting compensation levels that differ significantly from those common in the federal workforce. While the pay differences of senior executives is most often noted, this difference creates challenges across all sales, information technology, finance, engineering and field management positions Third, civil service employment law creates a duplicative and in some cases conflicting set of grievance and workforce reduction procedures with those contained in labor agreements.

If a new paradigm is created, the transition will not be simple. The Postal Service will need to negotiate new labor contracts. Changing civil service based employment law will put non-union employees in an unfamiliar employment environment that will create challenges that the Federal Government has not dealt with on such a large scale.

3. HOW OTHER FIRMS HAVE DEALT WITH THESE CHALLENGES

In looking beyond the Postal Service, this paper drew upon the experience of three types of entities. First, it included the experience of foreign postal operators. When they last operated as government departments, these operators all had similar challenges to those that the Postal Service now. Second, it included the experience of Conrail. This experience illustrates the challenges of completing a successful adjustment to new marketing and technological realities during a period of severe financial stress. Conrail is unique in that it is one of the few examples of a wholly owned government corporation operating under private sector business and labor law that is owned by the federal government. Third, it included the experience of other government owned and operated enterprises. With these enterprises, the paper includes information about variations in business models employed to provide service to the enterprise's customers and how the Federal government handled changes in business models.

3.1. MAINTAINING A MAIL SERVICE THAT CONTINUES TO DRIVE ECONOMIC GROWTH

The new business models of foreign postal operators reflected policymakers' understanding that mail was sufficiently important to the economy to require change. The new business models reflect a separation of the policymaking role of government for ensuring both strong mail delivery service and a definition of universal service, the regulatory process regarding rates and competition, and corporate governance of the post.

The separation of the policymaking, regulatory, and operating roles had the effect of removing the postal operator from the regular legislative process. The policymaking responsibility fell within an executive ministerial department. The regulatory role became the responsibility of either a third party regulator or, in countries with limited postal regulation, entities responsible for enforcing general competition law. All operating decisions became the purview of postal management who were free of most parliamentary or regulatory scrutiny which would tend to slow or stop change in favor protecting the status-quo interest of one set of stakeholders or another.

During the early stages of the transition to a new business model, both Canada Post and Deutsche Post both faced significant financial challenges. In choosing a new model both the Canadian and German government chose models that allowed postal management to make significant changes to the status quo that would ensure a strong mail market. In doing so, policymakers accepted the need to make significant changes in service offerings, prices, and operating procedures to ensure that the new operating model would meet financial goals and the postal operator's commitment to universal service.[37]

The challenges facing Conrail illustrate how similar challenges were handled in the railroad industry. The creation of Conrail followed the bankruptcy of nearly all of the railroads in the Northeast and affected rail service throughout the Midwest and Northeast. In addition to freight, these railroads provided transportation to hundreds of thousands of commuters from Maine to Washington DC.

Liquidation of these railroads was not an option as the economic impact of liquidation on freight shippers and cities that depended on commuter rail service was too great to allow this to happen. Railroad bankruptcy law recognized the economic impact of the industry and required that creditors must seek a viable operating solution prior to requiring liquidation of assets to pay as much of the outstanding debts as possible. When creditors appeared unwilling to fund an operating solution, the Conrail was created with the US Railway Association (USRA) to exercise the Federal Government's interest as creditor providing the debtor in possession financing until Conrail was sold in a public stock offering.[38]

[37] The greatest changes were experienced at Canada Post which went from 6-day to 5-day delivery and adjusted its service standards downward to what the existing network was capable of meeting.

[38] It should be noted that during the period that Conrail was owned by the federal government, directors on its board were not presidential appointments requiring Senate Confirmation but were appointed in a manner similar to boards of other private sector firms. Also, the Federal Government, through USRA paid creditors a portion of what they were owed as payment for Conrail's assets.

Throughout this period, the USRA created a barrier between Conrail's management, its Board of Directors, and political forces from Congress or the executive branch.

The creation of USRA protected critical decisions from both Congress and the Interstate Commerce Commission that were inclined to protect the status quo. Most importantly, USRA removed Congress from the process of approving financing decisions once the overall level of financing was approved, and removed both Congress and the Interstate Commerce Commission from making significant modifications to the operating plan that the USRA approved as a condition for financing Conrail's transition to a profit-making railroad.

The history of Amtrak reflects an alternative, and less successful effort to remove political actors from the decision making process. Just like Conrail, Amtrak needed to reduce the passenger trains that it ran. However, unlike Conrail, Amtrak's funding needs required annual appropriations that allowed Congress to dictate that certain unprofitable trains remain running. Amtrak's Board also retains a political input with both the US Secretary of Transportation and Senator Thomas Carper as directors.[39]

3.2. MINIMIZING THE FINANCIAL RISKS TO THE FEDERAL TREASURY

Deutsche Post, Royal Mail, Canada Post and Conrail all began their transformation process with significant operating losses, debt, and operating plant and information systems that did not make sense if they were to provide the service required by the markets that they served. In addition, these entities faced the prospect of needing to downsize a workforce larger than operations required and in many ways mismatched to their business needs. Beyond these transition costs these enterprises entered the transformation process with either significant debt or unfunded obligations for civil service benefits.

As most of the postal operators started as government departments, their obligations were initially considered government obligations. As part of the transformation process, some of those obligations remained with the government. The decision to divide the obligation between government and the post reflected acceptance that 1) the postal operator was not in any financial shape to pay all of its civil service obligations and become financially self sustaining; 2) the government's best prospect of covering any of the costs of these obligations would come from a combination of dividends from the operator and taxes on its profits, 3) government faced the prospect of either funding the transition costs or funding unfunded civil service obligations, and 4) taking on the civil service obligations created the smallest immediate government budget impact.

Government policymakers have minimized government financial risks of postal operators by installing a rather light regulatory approach to regulating service quality prices, lines of business, investments and processes employed to meet the Universal Service Obligation. In general, those posts that have been most successful in insulating their government from further financial risks are those that have had the most commercial freedom.

Conrail's transition illustrates another example of how government minimized its financial risks by removing unfunded mandates and regulatory roadblocks to good management. The challenge of

[39] The Board of Directors of Amtrak is similar to the Board of Itella Corporation (Finland Post) which has mostly politicians on its board. However, the politicians do not interfere with the commercial objective of Itella.

Conrail's transition highlighted the failures of railroad regulatory policy and commuter transportation policy. Congress passed three significant pieces of legislation that adjusted this policy to give Conrail the opportunity to be profitable and therefore pay back the debt that Congress appropriated to cover its transition costs and payments to its pre-bankruptcy debt holders.[40] Congress removed commuter operations from the responsibility of freight railroads and made it the responsible of local commuter railroad corporations. Congress streamlined regulations that allowed Conrail to rationalize its network to reflect demand, price products with reduced minimal regulation, control operating costs and choose how and where it will interline with other railroads. Finally, Congress significantly reduced the authority of the Interstate Commerce Commission to regulate rail rates and slow or stop abandonments.

3.3. ENSURING SELF SUFFICIENCY

Self sufficiency has been the goal of all foreign posts. Most were not in that position prior to transition but are now. The experience of foreign posts in dealing with the recent economic downturn illustrates that the business models chosen allowed the operators to remain self sufficient during most difficult times. There is no evidence that foreign postal operators needed to change their universal service obligation or service quality to remain financially self sufficient.

One of the problems that foreign posts have had is the conflict between maintaining self-sufficiency, operating with government-like expectations of operating returns and cash reserves, limits on rate changes, and limits on access to capital. The current problems facing Canada Post illustrates the consequences of this conflict. To deal with this problem, a recent report on Canada Post recommended:

> That the Board of Directors draw up a long-term plan for financial sustainability, for discussion with and approval of the shareholding department of government. The plan should address the costs of the Service Charter and modernization plan investments, as well as the sources of finances that are available from the exclusive privilege and competitive markets.[41]

The report went further and developed a specific financial framework that it recommended that Canada Post use in this plan. The financial framework requires that Canada Post must generate:

- Sufficient cash flow to fund capital expenditures, working capital, and payment of dividends;

- An EBITDA (earnings before interest, taxes, depreciation and amortization) / interest expense ratio such that a government guarantee would not be required to raise capital in the debt markets; and

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[40] Regional Rail Reorganization Act of 1973, Pub. L. 93-236, Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210, and The Staggers Act, Public Law 96-448

[41] Robert Campbell, Nicole Beaudoin, Dan Bader, Strategic Review of the Canada Post Corporation: Report of the Advisory Panel to the Minister, December 2008, p. 95.

- A commercially acceptable return on equity rate.[42]

The report defined targets for required returns and dividend policies that are consistent for Canada Post's business and its cash needs for modernization. The report recommended an EBITDA of between 10 and 15%; a return on equity of between 12.5% and 17.5%; and a dividend policy of 50-60% payout once Canada Post's modernization efforts were completed.[43]

In addition to requiring a long-range financial plan, the report recommended that the government of Canada relax Canada Post's price-cap formula on the basic letter rate.[44]

> The two thirds of CPI price-cap formula for basic lettermail has resulted in basic lettermail prices that are low relative to other countries examined by the Advisory Panel and low compared to Canada Post's costs. The Advisory Panel recommends that the two-third of CPI rate-cap formula be replaced by a new formula that better reflects the factors that influence Canada Post's expenses, such as labour and transportation costs."[45]

3.4. MEETING THE CHALLENGE OF SERVING WHOLESALE CUSTOMERS

The business models employed by foreign posts give the post significant freedom in serving its largest customers. This can be seen in the parameters of the universal service obligation, the definition of the reserved area or monopoly, price regulation of bulk mail, regulation of prices and interchange options to competitors that only collect and sort mail, and restrictions on revenue diversification.

Universal Service Obligation – Foreign postal operators are less likely to have specific regulatory obligations to serve their largest customers. Instead, the obligation to deliver to every address, no matter how remote comes from the commercial imperative that they have. In that way, it is similar to the common carrier obligation that United Parcel Service and FedEx have to deliver to every address in every ZIP Code in their service directory. There are some exceptions to reliance on the commercial imperative and the common carrier obligation. In the Netherlands, bulk senders of correspondence up to 50 grams (mostly transaction mail) fall within the USO. Sweden includes all "bulk mail" within the USO. The United Kingdom has a limited list of bulk mail services geared to small customers within the USO.[46]

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[42] Robert Campbell, Nicole Beaudoin, Dan Bader, Strategic Review of the Canada Post Corporation: Report of the Advisory Panel to the Minister, December 2008, p. 66.

[43] Ibid, p. 68.

[44] Only single items weighing more than 500 grams are subject to the price cap. All other rates are not.

[45] Robert Campbell, Nicole Beaudoin, Dan Bader, Strategic Review of the Canada Post Corporation: Report of the Advisory Panel to the Minister, December 2008, p. 95.

[46] Accenture, International Postal Liberalization – Comparative Study of the US and Key Countries, report for the United States Postal Service, August 2008, pp. 35-36.

Reserved Area (Monopoly) – Wholesale mailers are less likely to find their products fall within the postal reserved area or monopoly which gives them the ability to choose alternatives for mail sortation, transportation, delivery or any combination. The European Postal Directive will remove the monopoly between 2011 and 2013 for all mail, but in many countries within Europe, as well as in Canada, New Zealand, and Australia, wholesale mailers already enjoy competitive markets for much of what they want to send.

The business model of all foreign postal operators place unaddressed advertising mail outside the scope of the monopoly, and periodicals fall outside of the monopoly except in Poland.[47] Bulk addressed advertising mail falls outside of the monopoly in nine of the 14 countries examined in a recent study and transaction mail currently is outside of the reserved area in six.[48]

By removing wholesale mail from the reserved area, postal operators are subject to the forces of the competitive market in setting prices, and within service quality requirements of the USO, the level of service quality. The removal of the reserved area has created competitive markets for delivery of saturation advertising, upstream sortation and transportation and in some cases the delivery of mail. Posts have remained competitive in these markets by carefully managing costs, restructuring and modernizing operating networks, and pricing services at competitive yet profitable levels.

Price Regulation – In general, wholesale customers at foreign postal administrations find the prices that they pay subject to less regulation than that of retail customers. In most cases price regulation, generally in the form of a price cap is limited to either the small number of products that fall within the reserved area or specified as falling within the USO.[49] Some if not all bulk wholesale products fall outside of either the reserved area or the USO and postal operators are granted commercial freedom in setting rates. In all instances, regulators have no oversight role in contracted rates.

The opening of the reserved area, and in particular competition for upstream sortation and transportation services, has created a thriving private sector mail business in the United Kingdom, Netherlands, Sweden and Germany. In all cases, the incumbent operator has been an aggressive competitor in fighting back this challenge and has succeeded within the limits set by regulators and anti-trust authorities. Regulators have power over access rules and prices for Deutsche Post and Royal Mail, in the case of Royal Mail, regulators have used that power to assist in the development of a competitive mail industry.

Revenue Diversification – Postal operators have taken a number of actions to diversify revenue from wholesale customers beyond basic mail services. First, many have expanded their mail operations up the mail creation value-chain to include mail preparation and hybrid mail services. Second, nearly all postal operators have extensive operations in parcel delivery and logistics serving wholesale customers including handling everything from freight weighing more than 70 pounds to clothing on racks. These services may include warehouse and fulfillment services as well as

[47] Ibid, p. 23.

[48] Ibid.

[49] Ibid. p. 39 and p. 61.

transportation and delivery. Third, some offer financial and trade financing services with banking partners or a postal bank. Fourth, some provide delivery services with an independent non-traditional workforce to deliver unaddressed advertising, newspapers, or other periodicals.

3.5. THE CHALLENGE OF SERVING RETAIL CUSTOMERS

Foreign postal operators face significant challenges in serving retail customers. These challenges differ from country to country due to per-capita mail volume and the urban and/or rural characteristics of the country's geography. While the United States Postal Service is significantly larger than other posts, the urban and suburban locations of retail customers are not much different than suburban and urban locations of other postal operators. Its most rural areas are no more rural than those in Sweden, Finland, Australia or Canada.[50]

Many of the business models for serving retail customers include a requirement that the post must provide a specific level of service as part of their universal service obligation or service charter. Canada Post's Service charter has three provisions regarding access to retail services:

- Canada Post will provide an extensive network for accessing postal services that includes retail postal outlets, stamp shops and street letterboxes, as well as access to information and customer service through the Canada Post's website and call centres.
- Canada Post will provide retail postal outlets, including both corporate post offices and private dealer operated outlets which are conveniently located and operated, so that:
    - 98 percent of consumers will have a postal outlet within 15 km;
    - 88 percent of consumers will have a postal outlet within 5 km; and
    - 78 percent of consumers will have a postal outlet within 2.5 km.
- The moratorium on the closure of rural post offices is maintained. Situations affecting Canada Post personnel (e.g., retirement, illness, death, etc.) or Canada Post infrastructure (e.g., fire or termination of lease, etc.) may, nevertheless, affect the ongoing operation of a post office.[51]

[50] In some ways providing service in Sweden or Finland is a bit like serving many of the states in the plains or mountain west. There is one or two large urban center, and a significant number of communities with very little population a long distance from the urban centers.

[51] Transport Canada, "Canadian Postal Service Charter," released September 12, 2009, http://www.tc.gc.ca/mediaroom/infosheets/canadapost.htm.

Australia requires that the country have 4,000 postal outlets to serve a country with one-tenth the population of the United States. Among members of the European Union, most countries have some requirement for access for retail customers based on either a total number of outlets, distance of households to an outlet or community size.[52] Some even have requirements for the number of mailboxes.[53]

In meeting these service obligations, foreign postal operators have significant freedom in how they provide retail service that meets their retail access requirements. These freedoms both reduce the cost of providing an extensive retail network through the use of franchises and agencies and expand the revenue possibilities from each outlet through the sale of non-postal services.

Agencies and Franchises – An extensive use of agencies and franchises have been common in foreign postal agencies for many years. Canada Post has used agencies in urban areas since at least the 1980s. Deutsche Post began expanding its use of agents in 1993.[54] By 2004, 40% of all postal outlets in the European Union were franchises or agents of the national post.[55] The franchises and agencies allow access to postal services in many more communities than the postal operator could provide with existing retail locations. Agencies also allowed expanded access by offering postal services during evening and weekend hours.

Corporate postal offices have been eliminated in two countries, Sweden and Germany. In 2008 Posten AB (Sweden) eliminated all corporate post offices and went to an all agency approach of providing retail services. While retail customers were uncomfortable with the change at the beginning, customer surveys indicated that once customers became familiar with the new way of accessing postal services, they are willing to adapt to the changes. In fact, surveys indicate that the change improved two important features of retail service, satisfaction with operating hours and waiting time for service.[56]

Germany closed its last corporate post office in 2009. Today it operates with 850 outlets in PostBank outlets and over 8,000 partner-run offices. Deutsche Post partners operate one of three types of outlets:[57] 1) Post Service Outlets provide service in rural areas within retail or other stores;[58] 2) Postpoints are placed in independent retailers in urban and suburban areas and provide a full range of postal services and mailing supplies;[59] and 3) Stamp shops sell letter, flat, small parcel, and parcel

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[52] Ecosys, "Main Developments in the Postal Sector (2006 – 2008)," Report prepared for the European commission, DG Internal Market and Services, September 11, 2008, p. 44.

[53] Ibid.

[54] http://www.tc.gc.ca/mediaroom/infosheets/canadapost.htm.

[55] WIK Consult, <u>Main Developments in the Postal Sector (2004-2006)</u>, study prepared for European Commission DG Internal Market, 2006 p. 224.

[56] Ibid, p. 228.

[57] http://www.deutschepost.de/dpag?tab=1&skin=lo&check=no&lang=de_EN&xmlFile=1016889

[58] Ibid.

[59] http://www.deutschepost.de/dpag?tab=1&skin=lo&check=no&lang=de_EN&xmlFile=link1014828_1014814

stamps and are located in retail outlets.[60] To accommodate this non-corporate retail infrastructure, Deutsche Post also greatly simplified its retail pricing structure and expanded the use of self-service stations for parcel drop-off and pick-up.

Expanded Service Offerings – The second approach to improving service to retail customers involves expanding services to these customers. In the European Union, postal operators have few limitations regarding the type of services they can offer to retail customers. They offer many of the same parcel and freight services to retail customers that they offer to wholesale customers. They may provide packing services in addition to boxes and other mailing supplies. They may offer services for travelers including shipping luggage.

In addition, Postal operators have expanded banking and insurance services that they offer in corporately owned post offices.[61] The range of services offered runs the gamut from full banking services for consumers and businesses to financial products designed to meet the needs that existing banking and insurance companies do not meet. For example, Poste Italiane focuses on offering low-value life insurance policies and savings accounts. Australia Post offers bill payment services at its retail counters and in many locations acts as a franchise of one or more Australian banks.

Finally, postal operators have offered some government services at their retail counter. These include payments for government forms, acceptance of government forms for services, and driver licensing and vehicle registration services.

3.6. ADJUSTING OPERATING COSTS TO THE NEW COMPETITIVE REALITY

By using a business model that frees management's operating decisions from the power of regulators, legislators, and government ministers, foreign postal operators have significant freedom in adjusting their operating network to meet the needs of their customers. To the extent that there are constraints in restructuring the operating network, they relate to financing the capital and transition costs involved.

Restructuring operations has involved both consolidating and streamlining operating networks, creating optimized and flexible transportation networks, and automating sortation and material handling. In nearly every country, new operating networks had fewer processing centers with sufficient automation equipment to sort mail in short time windows that allow for longer transportation runs between sortation centers. Both Denmark and Germany built nearly all new facilities that were located in places that minimized operating costs and were free to move the jobs from facilities within cities to locations near airports or highway interchanges. Canada Post is on its second major effort to restructure its sortation operations but due to the geographic dispersion of its population centers, it has fewer options for consolidating processing than postal operators in Europe where distances between population centers are less.

Postal operators have somewhat more constraints in modernizing their retail networks as their operating charter or USO may include a specific requirement regarding access to a postal retail outlet. But as the previous section notes, foreign postal operators have been aggressive in the use of

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[60] http://www.deutschepost.de/dpag?tab=1&skin=lo&check=no&lang=de_EN&xmlFile=link1014828_1014815

[61] Deutsche Post had traditionally offered postal and banking services in the same retail location when it owned PostBank. When it sold PostBank, it contracted with it to provide the postal retail services that it had provided prior to the separation.

contracted outlets in both urban and rural areas. The actions of Posten AB and Deutsche Post illustrate that a contractor model can work in rural and isolated communities. Canada Post's experience illustrates how political power of postal unions and rural communities, corporate insensitivity in adjusting retail service in rural community, and the lack of viable contract program to replace corporate offices in rural communities, can result in restrictions that preserve the status quo but do not necessarily provide better rural retail service.

Conrail provides an illustration as to the challenge of adjusting an operating network to new competitive reality within the American political complex. Conrail started with the rail networks of multiple railroads with duplicative parallel track, branch lines that served few customers, and a requirement that it accept interline traffic from other railroads at any point in its network where interline could occur. The cost of maintaining its extensive track network and signaling systems along the rail lines far outstripped the railroad's ability to pay and service consistently declined as deferred maintenance resulted in slow orders over much of the railroad's route network.

Political opposition to abandonment was strong from communities that railroad lines served, rail unions, and rail customers. In addition, the Interstate Commerce Commission had a relatively slow process for reviewing railroad abandonments that could tie up network changes for years.

To deal with these problems, Congress placed the responsibility for an initial network restructuring within the responsibility of the USRA in conjunction with its responsibility for funding the transition to a profitable railroad. Congress passed legislation that streamlined the abandonment process and created the opportunities for communities and "short-line" railroads to bid on routes proposed for abandonment.

The USRA in its approval of Conrail's operating plan permitted Conrail to determine locations where it would accept interline with each railroad without regulatory approval. This eliminated the process of gaming interchange charges that resulted in the use of circuitous routes to maximize the share of total origin-to-destination charges by the originating railroad.

The streamlining of Conrail's network allowed it to focus its maintenance and modernization budgets on a more limited track network. This allowed it to use the limited capital resources that it had during restructuring to improve service quality and introduce higher-speed corridors for the newly developed technologies for hauling truck trailers and containers by rail. By starting with a streamlined network, and improving services over that network, Conrail was able to generate sufficient revenue to put itself on the path to profitability and improve services for all of its customers.

Finally the methods used to deal with the cyclical nature of the mail business by the Postal Service's direct competitors as well as the firms printing and producing the mail pieces that the Postal Service delivers illustrate the challenge of managing the mail business in the current economic climate.[62] Harte Hanks experience is illustrative.

> Responding to the worsening economic environment, we have taken action to reduce costs in our Shoppers business. In 2008 and into the first quarter of 2009 we

[62] While the firms spending the money to buy the production and delivery of mail and parcels are also experiencing these trends this section focuses on the actions taken by firms that physically produce, transport, or deliver mail or parcels.

have curtailed over 1.4 million of unprofitable or marginal Shoppers circulation, representing $16.5 million of revenues and an operating loss of $2.3 million in 2008. The Florida circulation curtailment will allow us to consolidate two production facilities into one facility, which we expect to complete by the end of the first quarter of 2009. In addition, we implemented wage freezes in 2008 and wage reductions at the beginning of 2009. We anticipate recording approximately $2.3 million in additional costs related to these actions in the first quarter of 2009, primarily as a result of the Florida production consolidation.[63]

3.7. FUNDING MODERNIZATION AND RESTRUCTURING

Prior to the creation of their current business model, nearly all foreign postal administrations faced significant financial challenges that limited their ability to fund the capital improvements and transition costs of modernization and restructuring efforts. Postal operations were loss making with substantial obligations for civil service pensions. As a government department, the only funding option for modernization and restructuring efforts was direct appropriation and budgetary constraints eliminated that as an option.

To deal with this situation, governments focused on creating business models that would allow the postal operators to generate sufficient capital from retained earnings and private investors to fund modernization and restructuring. In general, governments created a business model that:

1. **Removed civil service liabilities –** The largest single liability on the books of foreign postal administrations was the unfunded historic civil service pension obligation. For most postal operators, these obligations were transferred to the state when the new business model was formed.[64] The one exception is Royal Mail. Although there has been serious discussion about relieving it of historic obligations, it must still continue to fund those costs out of current rates, while the measure is still being debated in Parliament.

   Postal operators retained the obligation for newly accrued liability for retirement benefits of employees on roll at the time of the creation of the new business model.

2. **Created a clean balance sheet** – In order to attract private capital, the postal operator had to have financial statements and financial controls that matched expectations of private investors. One of the first orders of business was restructuring the entire finance and accounting activity to meet modern private-sector standards.

3. **Permitted changes in rates and operations to generate acceptable levels of retained earnings** – By accepting the need for significant changes in operations and rates, governments allowed the new business models to generate sufficient levels of cash to self-finance. Some of the greatest changes occurred at Canada Post once the government decided that it would no longer fund operating deficits.[65]

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[63] Harte Hanks, 2008 10Q, p. 31, April 10, 2009.

[64] WIK, p 181

[65] Robert M. Campbell, The Politics of Postal Transformation, McGill-Queen's University Press, Montreal, Quebec, Canada, 2002, pp. 281-2821.

4. **Had access to government provided seed capital –** Foreign postal operators often began with a limited amount of seed capital to begin the process. Mostly, it represented the value of the physical assets of the enterprise. The postal operator was free to sell or develop these assets as it saw fit.
5. **Permitted the sale of non-core assets –** Deutsche Post generated significant cash from the sale of its Poste Bank subsidiary.

All of these steps are steps that are similar to what a firm going through bankruptcy restructuring would do. The one difference is the provision of financing during restructuring that may have been provided by the government in the case of postal operators where in the private sector such financing would be provided by private sector lenders. [66]

Once the business model was created, most foreign postal operators were limited to private debt financing due to roadblocks European competition law create to public financing of firms that compete with firms in the private sector like UPS and FedEx. Therefore, the steps listed above were required in order for the new postal business model to have access to any debt capital in the future.

In countries where privatization was politically palatable, corporatized postal operators sought access to private equity capital. To date, postal operators in Austria, Belgium, Germany, Malta, the Netherlands, and Singapore have all raised private capital. The merged postal operators of Sweden and Denmark are expected to seek private equity capital soon and a proposal exists for Royal Mail to sell shares as well.

Conrail had a challenge in finding sufficient capital similar to what foreign postal administrations experienced but with three key differences. First, Conrail's capital needs to cover operating losses and restructuring costs far exceeded what sale of assets, operating and pricing changes, and eliminating existing unfunded liabilities could generate. Second, private lenders were unwilling to provide the bankruptcy restructuring financing and existing creditors preferred liquidation to bankruptcy restructuring. Third, the federal government provided the funding in bankruptcy restructuring in order to preserve the rail service. It should be noted that many of the changes in railroad regulation occurred to remove operating impediments that either made earning a profit impossible or raised the financing needs that Congress would have to fund prior to returning Conrail to the private sector.

3.8. CREATING A WORKFORCE FOR THE LONG TERM

Nearly all of the entities either faced challenges similar to those that the Postal Service now faces or are dealing with them today. The postal operators all began with a business model that had all employees as civil servants with employment law reflecting that status. The postal operators, and Conrail all had significant levels of unionization and many had a contentious labor-relations environment. Finally, nearly all of the entities examined had a workforce significantly larger than what mail and rail freight volume or modern mail handling and rail transportation technology required.

[66] It is not clear how European postal operators may have funded their modernization and restructuring costs during the first few years of their transition to the corporate model that they now employ. During the initial years of Canada Post's restructuring, the government of Canada covered operating losses that included expenses for capital investments.

In creating an environment for creating a modern workforce environment, many business models used by foreign postal operators replaced the civil service employment law framework with a private sector employment law framework. But in doing so they allowed existing employees to retain many if not all of the parameters of the civil service employment contracts.[67] In doing so, the new business models in European post now have about half of their employees in this grandfathered status., having been as low as 41.4% in 2004.[68] In modernizing their operations, the proportion of employees with civil service contracts grew due to non-civil service employee head count shrinking faster than civil service head count. As time passes, retirement and attrition should eventually eliminate employees who still work under civil service contracts. [69]

There are some exceptions to the use of private sector employment law. For example, in Germany, Deutsche Post employees still work under civil service employment law even though it is privately owned. In other countries, such as Austria and Belgium, a unique postal employment law exists that retains many of the characteristics of civil service employment law.[70]

With the establishment of private sector employment contracts, postal operators set up compensation schedules, benefits plans, and pensions for employees working outside of the civil service. This applied to the administrative, technical, sales and management employees that the postal operators hired as well as the production employees that the postal operators hired following creation of the new business models.

Independent of the choice of business model or employment law, modernization, and in particular automation and network optimization efforts, changed the nature of work at all postal operators. Across nearly all posts, employment levels declined. Once the initial restructuring effort was completed, a new employment paradigm developed. A recent survey of European posts found three significant changes that were found in the new paradigm. [71]

- First, postal workforces became more flexible both in terms of job specificity and job scheduling. Walls between crafts were broken down to allow a more flexible use of the postal workforce.[72] Part-time and flexible schedule use increased to accommodate changing mail volume and the reduced time it automation required to sort mail. Today, part-time workers represent 20% or

[67] The difference between civil service and private sector employment contract reflects differences in the employment law and job protections that an employee may have. The difference do not relate to wage or benefit levels as postal wages and benefits, other than pensions, were not necessarily tied to pay of other civil servants.

[68] Ecorys, p. 209.

[69] This is similar to what has happened in the United States with the reduction in employees that participate in the Civil Service Retirement System.

[70] European Foundation for the Improvement of Living and Working Conditions, Industrial Relations in the Postal Sector, 2007, pp 15-16.

[71] European Foundation for the Improvement of Living and Working Conditions (EUROFOUND), Industrial Relations in the Postal Sector, 2007, p15.

[72] In some instances, breaking down the walls between crafts resulted in the merger of trade unions that represented the separate crafts. This occurred in Canada where unions for clerks, mailhandlers and letter carriers eventually merged.

more of the employees at most of the European posts. At Canada Post, part-time workers work 20% of all hours within mail processing plants.

- Second, postal operators introduced "continuing training schemes, and a tendency to hire workers with higher educational qualifications than previously." These training schemes and hiring practices were in direct response to the change in technology, service delivery methods, and competition. In particular, competition required that the postal operators have employees that have the communication and interpersonal skills to handle an increasingly demanding set of customers.
- Third, postal operators expanded the use of non-standard employment contracts. These workers include contractors of the postal operators, casual or short-term employees, and employees that are paid based on services delivered or products sold. The shift to contractors is most clearly visible in the provision of retail services but also exists in the provision of transportation between sortation centers.

Regardless of the type of employment contract, a high proportion of postal employees are members of labor unions. In Europe, unionization ranges between 76 and nearly 100 percent.[73] In Canada all clerks, mailhandlers, drivers and letter carriers are members of the Canadian Union of Postal Workers. Most employees who are members of trade unions have contracts negotiated through collective bargaining.[74] With few exceptions, laws do not prohibit the right to strike. However, in many countries, the law requires that parties complete cooling off periods or use alternative dispute resolution options prior to exercising that right.[75]

The shifts in employee counts and employment paradigms have created great conflict between postal employees and management wherever they have occurred. In countries where the changes occurred after employees were granted the right to strike, labor action often accompanies major restructuring efforts In particular, strikes in Europe have occurred in Belgium, France, Ireland, Luxembourg, the UK, Poland, Portugal and Romania. Canada Post had major labor actions in 1986, 1987 and 1991-1992 that when settled resulted in Canada Post Corporation receiving "some operational flexibility particularly, in contested areas such as contracting out, franchising, employment cuts and the use of part-time and casual labour."[76] Currently labor actions are occurring against Royal Mail.

The use of strikes has lessened in recent years as employees came to realize that governments would not stop the strike and impose a settlement. Both employees and management also learned that volumes lost after a work stoppage were difficult to regain and work stoppages gave new non-

[73] Ecorys, 223.

[74] The major except is Germany, where Deutsche Post employees are not permitted to strike. EUROFOUND, 2007, p. 27.

[75] EUROFOUND, 2007, p. 27.

[76] Campbell, 2002, p. 281.

union and electronic competitors openings that did not previously exist.[77] Management also developed new cooperative approaches to introducing change once they gained much of the flexibility that they required. Some of the cooperative approaches have even taken the form of local operating agreements that modified national work rules to meet the specific service and pricing needs of one group or a small group of customers.

Conrail, as a railroad operating under the Railway Labor Act (RLA), made its changes under an alternative labor relations framework. The RLA creates both significant impediments to strikes and lockouts and a negotiating process that maintains current contract provisions when parties cannot agree to modifications. Conrail's contracts with employees included job guarantees for all employees, guaranteed jobs within crafts that technological change made obsolete, and work rules that limited work to many hours less than eight hours a day. These were changed through over time as union resistance in negotiations weakened due to employee retirements and Congressional pressure.

Today, foreign postal operators face new workforce challenges relating to managing their workforce. In particular, these challenges relate to the fact that postal operators today find themselves with an older full time workforce than found in government or the rest of the private sector, with a significant portion of the workforce nearing retirement. Canada Post's situation is illustrative and it expects to see 50% of current employees to leave within the next ten years with 80% of this turnover coming via retirement.[78] Employee departures at Canada Post are disruptive as each departure ultimately causes five other employee changes, including new hires and internal movement by current employees.[79] The older workforce and changing market forces created greater demands on workforce planning, recruiting and hiring processes as Canada Post must compete for employee talent as it reshapes its workforce to meet the challenges of a modern postal operator.

While the workforce planning challenges affect all geographic regions and all levels of Canada Post, the problem is greatest in unionized technical positions and non-unionized skilled, administrative, sales, and management positions where employees may have external opportunities. The workforce planning model that Canada Post uses is unconstrained by civil service constraints. Therefore, Canada Post can solve its human capital challenges through solutions that include offering incentives to discourage retirement and encourage retention when alternatives are not readily available,, developing new talent from within to replace key individuals in time for their expected departure, and expanding the recruitment process within the appropriate competitive labor market.[80]

[77] The strike against United Parcel Service by the Teamsters had a similar effect. FedEx Ground gained a significant amount of business during the strike and kept enough of that business to experience both an immediate gain in market share and open doors to United Parcel Service customers that had never used their service before.

[78] Mary B. Young, Implementing Strategic Workforce Planning, The Conference Board, New York NY, 2009, p. 30.

[79] Ibid.

[80] For more detailed discussion of Canada Post's Workforce Planning approach, reads the case study contained in Young (2009), pp 30-34.

4. MAILING INDUSTRY POLICY FRAMEWORK

A new business model and regulatory framework for the Postal Service will affect the entire mail, courier, express, and parcel industry and the over eight million people that the industry employees. Creating this mailing industry policy framework requires understanding 1) all of the conflicting roles that the federal government now has and will have after any change occurs and 2) the federal entities that Congress designates to manage its day-to-day interest in each of these roles. These conflicting roles are as follows:

- **Policymaker** – A mail industrial policy is comprised of 1) all decisions affecting the how firms involved in the process of delivering mail, its electronic competitors, and parcels can make marketing, investment, and operating decisions and 2) how those decisions are regulated. These decisions determine winners and losers among all stakeholders and changes to these rules will affect the competitive landscape, the product and service choices available in the market, the prices and service qualify of those choices, and the demand for hard-copy communications or parcel delivery.[81]

- **Law Enforcer** – In this role the Federal Government enforces a set of laws that relate to the Postal Service and other market participants, what the Postal Service may deliver, and violations of the postal monopoly for delivery and mailbox access. These laws cover the range of actions relating to protection of federal employees and federal property, and employee actions that prevent the Postal Service from meeting its delivery commitments to its customers. [82] The Federal Government enforces laws relating to failure to pay for mail service. Finally, the Federal Government enforces a series of laws relating to what is prohibited for delivery or criminal activities that involve the use of the mail.

- **Service Guarantor** – This role comes from the constitutional responsibility of Congress to establish posts and post roads and the over two hundred years of postal history that has resulted in the modern definition of a "post." With this responsibility, Congress defines each competitor's obligations to its customers including the universal service obligation of the Postal Service and the common carrier obligation under which United Parcel Service, Federal Express and other transportation firms that serve the "mail" market operate.

- **Shareholder** – As the "owner" of the Postal Service, the federal government is the owner of the largest operator in the industry. Since passage of the Postal

[81] Industrial policy is a politically charged word. In this context, I only want to indicate that while we live in a capitalist country, all industries have "rules-of-the-road" and Congressional action since the creation of the Post Office has done the same for the mail industry. Any modification in these rules will change the existing balance among stakeholders.

[82] Private sector competitors of the Postal Service and those handling mail between the printing plant and tender to the Postal Service are covered under state criminal and civil code as it relates to crimes against the people who work for or the property of private sector carriers. Actions by private sector employees that cause a delay in a carrier's delivery are generally covered under internal company human resource processes unless they involve theft of goods to be delivered when they are covered under local laws relating to theft of property.

Reorganization Act, the federal government has acted as a hands-off shareholder, limiting its involvement in management decisions once the President appoints and the Senate approves the Postal Service Board of Governors. Rules relating to the selection and pay of the Board of Governors and the scope of their responsibility reflect the importance that Congress has placed on the shareholder role.

- **Creditor** – Three federal agencies act as Postal Service creditors. The Office of Personnel Management holds the liability for retiree pension and health benefits. The Department of Labor's Office of Workers Compensation Programs administers the Postal Service's workers compensation claims. The Treasury Department holds most of the Postal Service's debt. As a creditor, these departments have an interest in ensuring that the Postal Service can pay its obligations. The Postal Service's relationship with these creditors differs from its creditors in the private sector as changes in terms and conditions for repayment of obligations to government creditors require Congressional action. Furthermore, changes in payments schedules affect the Federal budget which then requires that every potential change receive budget scoring by the Congressional Budget Office.

- **Regulator** – In this role, the federal government performs tasks necessary to ensure that a well functioning national market exists for the delivery of mail and parcels, ensures that service obligations under both universal service and common carrier requirements are met, and protects consumers in this market from unfair trade practices and deceptive advertising by competitors in the market. In addition to economic regulation, the Federal Government is responsible for safety regulation as it applies to the vehicles that transport of mail and parcels by rail, truck, plane or ship.

All of these roles together shape the mail industry within which the Postal Service, its customers and its competitors operate. Responsibility for these roles is shared between Congress and the regulatory authorities, government departments, the Postal Service's Board of Governors and various congressionally designated entities that support congressional decision making.

Besides Congress, there is no specific executive or regulatory entity responsible for the industry as a whole. There is no single executive agency or department that Congress can ask about a President's position regarding policy changes that would affect the Postal Service, its business model, its regulatory framework or how such changes would affect the health of the $800 billion industry within which the Postal Service serves. Therefore when Congress deals with policy questions that affect the industry it must rely on multiple entities that have some jurisdiction: the Departments of Transportation and Justice, that has jurisdiction over transportation and competition policy issues affecting private sector carriers.[83] The Departments of Transportation and State handle issues relating transportation contracting and international postal affairs. The Department of Labor and Treasury and the Office of Personnel Management all have interests relating to Postal Service financial obligations. The Department of Commerce and the Federal Communications Commission set policy affecting the Postal Serivce's diugital competitors. Finally the Postal Regulatory Commission, and the Postal Service both have some policymaking authority relating to the provision of services by the Postal Service

[83] The Federal Trade Commission has no jurisdiction over the business practices of private sector express and parcel carriers.

Part of the problem is that the Postal Service falls into both the communication and transportation industries that have executive departments with responsibility for monitoring and evaluating industry policy. Communication policy is set within the Commerce Department with regulation of broadcast media handled by the Federal Communications Commission. Transportation policy is set by the Transportation Department.[84]

In general all private sector participants in the mail market are ignored by federal policy. To the extent that the federal government has an interest in other participants in the mail market, it comes when firms merge or advertisers produce deceptive material that is delivered by mail, private carriers, or via electronic media.

The next section looks at potential business models within the context of a Postal Service that is the core provider within the sizeable mail market. As the earlier section on the market for mail service indicates, the mail market is troubled and long ago lost its role as the primary means of personal communications to the telephone, and more recently the internet. However mail is and will remain a critical means of conducting commerce both in terms of delivery of advertising and parcels. The discussion below will assume that it is Congressional policy to ensure that the industry can effectively deliver the periodicals, messages and parcels necessary to conduct commerce as well as to serve those remaining communications needs that hard-copy communications can uniquely provide. The discussion below also assumes, that any decision relating to the business model or regulatory framework chosen for the Postal Service, will by default shape policy affecting all stakeholders with hard copy or parcel delivery interests.

5. POTENTIAL BUSINESS MODELS

Any change in the postal business model must deal with the federal government's role as policymaker, law enforcer, service guarantor, shareholder and creditor. The business models examined include those used by other competitors within the U.S. mail market, foreign postal operators, federal departments that receive some or all their revenue from user fees, U.S. government corporations, government-owned enterprises that have been privatized, commuter and inter-city passenger operators, and municipally owned utilities provided the basis for identifying a set of business models that warrant further examination. The organizations examined employ business models covering the full range of options from government department to private corporation with no ownership or investment ties to the Federal government.

The business models examined differ on how they deal with specific characteristics of an enterprise relating to corporate governance, financial management, operations and marketing management; and human resources and labor relations This paper looks at five models that illustrate options that postal administrations and government entities currently use to perform their services.

- **Government Department** – The Postal Service would return to its status as a department that existed prior to the Postal Reorganization Act.

[84] Railroad regulation is handled by the Surface Transportation Board, which is now part of the Department of Transportation. The interstate air and ground parcel operations of United Parcel Service, FedEx Ground, and other parcel carriers are no longer subject to price or service regulation.

- **Government Enterprise – status quo** – The Postal Service will continue to operate under the same governance, financial management, operations management, marketing management, human resources, and labor relations framework that now exists.

- **Government Enterprise – relaxed constraints** – The Postal Service will operate with some additional flexibility in many characteristics of a business model with the flexibility modeled on what other federal enterprises now have.

- **Government Corporation** – This is a corporation operating under private sector law that has all shares owned by the government. This is what is often called a crown corporation. Government corporations include Conrail, prior to privatization, the US Enrichment Corporation prior to privatization, and Amtrak. For the purpose of this paper, the government corporation model reflects Conrail prior to privatization.

- **Private Sector Corporation** – This is a corporation with private sector shareholders. The Federal Government could have shares in the corporation as is now the case with Fannie Mae, Freddie Mac, General Motors, Chrysler, and many banks, or all shares may be owned in the private sector. As a shareholder, the representative of the federal government has the ability to vote on the selection of the board of directors.

These models are divided between those that have primarily governmental characteristics and those that have a corporate orientation. The descriptions below illustrate the difference between the models on a limited set of the characteristics that distinguish each model.

5.1. CORPORATE GOVERNANCE CHARACTERISTCS

Corporate governance characteristics are those characteristics that relate to the overall governing structure of the enterprise. The five models break down into three groups based on these characteristics as the government department model is clearly different from the other two governmental options. The key differences between the corporate models and governmental enterprise models are 1) selection criteria for the board of directors (governors) and 2) independence of postal management from Congressional influence in operating, marketing, human resources, and labor relations decisions.

One of the challenges facing the Congress is how will it manage the financing that will likely be required through the Postal Service restructuring and modernization efforts. In both the government department and government enterprise – status quo models, Congress, in legislation, will determine the amount of federal financing and the conditions that the Postal Service would need to meet to receive the designated financing.

In the Government Enterprise – Relaxed Constraints and Corporate Models, a separate entity determines the amount of funding required for restructuring and modernization costs and the conditions for providing the necessary funding. This entity would be similar to the United States Railway Association, which was responsible for approving Conrail's business plan and the financing needs of the business plan. In essence, this entity would act as the investor that provides financing following bankruptcy. Most importantly, it removes the details of providing financing at particular points in time and determining conditions for financing from the regular legislative process where stakeholders have significant opportunities to protect the status quo from changes an investor might demand. This entity may also be required for the Government Department and Status quo models as well.

Table 4: Comparison of Corporate Governance Characteristics across Alternative Business Models

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Corporate Governance					
Executive Authority	Postmaster General appointed by the President and confirmed by the Senate	Board of Governors appointed by President and confirmed by the Senate	Board of Directors appointed by the President and confirmed by the Senate or a board composed of cabinet officers and presidential appointees	Board of Directors appointed by the designated Shareholder(s) that could include Cabinet officers, Congressional representatives and/or representatives of other Executive departments	Board of Directors selected by a vote of the shareholders and may have government representatives if it holds shares
Senior Management	Senior management are either executive appointments requiring Senate confirmation or senior level civil servants	Senior management selected by the board with limited civil service protections	Senior management selected by the board with no civil service protections	Senior management selected by the board of directors with no civil service protections	Senior management selected by the board of directors with no civil service protections

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Financial Objective	Budget Adherence and any other Congressional requirement	Self Sufficiency as defined by Congress, postal management and the postal regulatory commission, and any other Congressional requirement	Self sufficiency as defined by Congress, postal management and the postal regulatory Commission; May include a dividend payment to Federal Treasury based on board's discretion	Shareholder return limited by regulatory constraints; Share of profits paid to shareholder based on dividend policy	Shareholder returns limited by regulatory constraints; Share of profits paid to shareholders based on dividend policy
Restrictions on Business Activities	As determined by Congress in charter and legislation	As determined by Congress in charter and legislation	As determined by Congress in charter and legislation	No restrictions on business activities as long as requirements of charter are met; any other restrictions come from the fiduciary responsibility of the board. Federal, State, and local laws and regulations apply.	No restrictions on business activities as long as requirements of charter are met; any other restrictions come from the fiduciary responsibility of the board. Federal, State, and local laws and regulations apply.

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Congressional Oversight	Oversight over all financial, pricing, marketing and operating decisions; subject to review by GAO, CBO, CRS, and Inspector General; Congress can overturn any management decision	Oversight over all financial, pricing, marketing and operating decisions; subject to review by GAO, CBO, CRS, and Inspector General; Congress can overturn any management decision	Oversight over all financial, pricing, marketing and operating decisions; subject to review by GAO, CBO, CRS, and Inspector General; Congress can overturn any management decision	Limited to oversight of board and financing entity that provides governmental financing to Postal Service; financing entity subject to full scope of reviews by Congressional research arms (GAO, CBO, CRS), and an Inspector General	Limited to oversight of board if government shareholders; otherwise similar to scope of authority to conduct investigations relating to private sector corporations.

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Oversight of Financing Needs of Restructuring and Modernization	Congress with analytical support from the General Accounting Office, Congressional Budget Office, Congressional Research Service and the Postal Regulatory Commission	Congress with analytical support from the General Accounting Office, Congressional Budget Office, Congressional Research Service and the Postal Regulatory Commission	A designated entity, similar to the United States Railway Association that will represent the Federal Government's interest that is similar to that of a creditor providing loans to a firm working its way out of bankruptcy. The entity would provide funding necessary for restructuring, and modernization efforts necessary to meet long financial goals and service objectives	A designated entity, similar to the United States Railway Association that will represent the Federal Government's interest that is similar to that of a creditor providing loans to a firm working its way out of bankruptcy. The entity would provide funding necessary for restructuring, and modernization efforts necessary to meet long financial goals and service objectives	None unless the Federal Government offers loan guarantees

5.2. FINANCIAL MANAGEMENT CHARACTERISTCS

Financial management characteristics reflect all characteristics of the business model relating to the enterprise's use of money. The governmental and corporate models differ as to their independence from federal budget, the accounting conventions that they use, whether the entity pays taxes and requires a tax policy, what method is used to fund retirement health care liabilities, and what alternatives they have to fund capital investments and extraordinary expenses.

The governmental options all have links to the federal budget. The corporate models are independent of the budget.

The corporate models follow private sector generally accepted accounting principles (GAAP) and the government models use either government GAAP or a modification of private sector GAAP to reflect the enterprises existence as a government entity. Governmental options are not subject to taxation at all levels and corporate models are.

Retirement health care liabilities are funded based on a schedule determined by Congress in the governmental options. The corporate models use a funding method required by private sector GAAP.

The distinctions between the models as they relate to financing illustrate a continuum from how government departments fund capital spending and transition costs and how private sector enterprises do. The privately placed financing option listed for the Government Enterprise – Relaxed Constraints model follows the model used by the Tennessee Valley Authority. This option may not be available until the Postal Service gets on surer financial footing. The debt for the Private Sector Corporation may be either government guaranteed or non-guaranteed debt as both have been used in the past. Ideally, a privatized Postal Service could obtain all necessary funding without government guarantees.

Table 5: Comparison of Financial Management Characteristics across Alternative Business Models

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Financial Management					
Accounting Policies	Government GAAP	Private Sector GAAP as modified to reflect enterprise status	Private sector GAAP as modified to reflect enterprise status	Private sector GAAP	Private sector GAAP
Taxation	No taxation	No taxation	State and local payments in lieu of taxes	Full federal, state and local taxes and business fees	Full federal, state and local taxes and business fees
Sources of Investment Capital	Appropriations	Treasury issued debt, and retained earnings	Enterprise issued debt, and retained earnings	Enterprise issued debt, and retained earnings	Enterprise issued stock and debt, and retained earnings
Funding of Transition Costs	Annual appropriations, switch to government department practices for payment of retiree health liabilities, and transfer of debt from Postal Service to Treasury	Funded by a combination of appropriations, debt, and changes in retiree obligation payment schedules and deferral of debt payments	Funded by a combination of appropriations, debt, and changes in retiree obligation payment schedules and deferral of debt payments	Funded by government issued debt, shift of retiree health benefit obligation payments to what is required under private sector GAAP, and deferral of existing debt payments	Funded by government issued debt, shift of retiree health benefit obligation payments to what is required under private sector GAAP, and deferral of existing debt payments

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Financial Independence	Revenues and expenses part of the federal budget	Revenues and expenses part of unified federal budget; payments for benefits administered by OPM and appropriations for cost of certain preferential rates are part of budget	Revenues and expenses part of unified federal budget; payments for benefits administered by OPM and appropriations for cost of certain preferential rates are part of budget	Independent except for appropriations for contracted services; payments for benefits administered by OPM, taxes paid and dividends on stock and interest paid on debt are part of the budget of appropriate departments	Independent except for appropriations for contracted services; payments for benefits administered by OPM, taxes paid and dividends on stock and interest paid on debt are part of the budget of appropriate departments
Funding of Retiree Obligations and Workers Compensation	Funding method determined by Congress	Funding method determined by Congress	Funding method determined by Congress	Payment schedule governed by private sector GAAP	Payment schedule governed by private sector GAAP

5.3. OPERATIONS AND MARKETING MANAGEMENT CHARACTERISTICS

The operations and marketing management characteristics reflect different approaches to both long-term planning about operations, marketing and pricing and day-to-day decisions. The corporate models differ from the governmental models based on the level of control that Congress has on operating and marketing decisions.

The table illustrates the impact of the general tenor of governmental options to focus on process and fairness objectives in setting operating and marketing plans and corporate options that focus on customer needs and financial objectives. Governmental options are more likely force management choices that reduce service quality because of limitations that restrict operating flexibility and increase the time it takes to make operating changes. The impact of independence from governmental control is most evident in the ease that that each model can make changes in operating processing and the provision of retail services during periods of constrained revenue. The impact of independence is also evident in how service quality is determined, especially when constraints within the model prevent operating changes that could either maintain or improve quality of service to customers.

The relaxed constraint model would have less regulation of prices than the either of the other two governmental models. Price regulation would be limited to single-piece letter and flat mail. Pricing rules would also allow single-piece mail rates to rise in order to generate sufficient returns from today's customers to cover future costs that will be born for reducing capacity as single-piece mail volume declines.

The corporate models operate with greater pricing freedom, with restrictions on pricing products for wholesale customers as well as pricing parcel products used by retail customers removed. The corporate model would have pricing decisions subject to competition law provisions that apply within the express, parcel and courier industry.

Corporate models could be subject to price regulation but regulatory process should have an expectation of eventual elimination. Price regulation if maintained during a transition would be limited to single-piece letter and flat mail and must allow single-piece mail rates to rise in order to generate sufficient returns from today's customers to cover future costs that will be born for reducing capacity as single-piece mail volume declines.

Table 6: Comparison of Operations and Marketing Management Characteristics across Alternative Business Models

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Operations and Marketing Management					
Strategic Direction	Determined by Postmaster General as set by legislation	Determined by Board of Governors as set by legislation	Determined by Board of Directors as set by legislation	Determined by Board of Directors within limits set by charter	Determined by Board of Directors within limits set by charter
Operating and Marketing Objectives	Process and fairness objectives dominate operating and marketing decisions	Business objectives subject to significant restrictions due to process and fairness objectives	Business objectives subject to significant restrictions due to process and fairness objectives	Business objectives pre-eminent; private sector process objectives supplemented by charter or regulator	Business objectives pre-eminent; private sector process objectives supplemented by charter or regulator
Product Pricing	Set by Postal Service and may require approval by Congress	Set by Postal Service under rules set by the Postal Regulatory Commission	Set by Postal Service with price regulation limited to single-piece letter and flat mail	Market based; subject to application of competition law	Market based; subject to application of competition law
Determinants of Delivery and Retail Service Quality	Operating costs, budget, and legislative restrictions	Operating costs and budget, regulatory analysis and legislative restrictions with a limited focus on customer requirements	Customer requirements subject to financial constraints	Customer requirements subject to financial constraints	Customer requirements subject to financial constraints

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Distribution Network Design and Modification	Determined by Postal Service and subject to modification by Congressional action	Determined by Postal Service and subject to regulatory review and modification by Congressional action	Determined by Postal Service and subject to modification by Congressional action	Determined by Postal Service	Determined by Postal Service
Retail Network Modernization	Determined by Postal Service and subject to modification by Congressional action	Determined by Postal Service and subject to regulatory review and modification by Congressional action	Determined by Postal Service and subject to regulatory review and modification by Congressional action	Determined by Postal Service; requirements may be set for notice of changes	Determined by Postal Service requirements may be set for notice of changes
Procurement Rules	Government procurement rules	Modified government procurement rules	Modified government procurement rules	Private sector contract law	Private sector contract law

5.4. HUMAN RESOURCES AND LABOR RELATIONS CHARACTERISTICS

Given that labor costs represent 60% or more of total costs for even the most efficient postal operator, the importance of the characteristics described below is clear.[85] While most of the attention is focused on the Postal Service's unionized employees, the choice of model could have an even bigger impact on ensuring that it has the right quantity and quality of management, sales and technical employees.

The primary difference between the governmental and corporate sector model is civil service. While the current model modifies some civil service rules, it still sets significant constraints on pay and benefit levels that affect the hiring from the most senior management levels to computer, industrial engineering, quantitative analysis, sales, and other positions. A number of government enterprises including the Tennessee Valley Authority, the Pension Benefit Guarantee Corporation, and the Federal Deposit Insurance Corporation have developed alternative pay schemes that allow them to offer competitive salaries to exempt employees at all levels.

All of the governmental options fall under most if not all of the civil service protections relating to employee grievances and layoff procedures. Both of the corporate models have all of the flexibility that is found in the private sector. For exempt employees, this makes the governmental models less flexible for increasing or decreasing the number of non-union employees on the payroll during the various stages of the business cycle.[86]

The US Enrichment Corporation represents an illustration of an employment law approach that could occur during a transition from a governmental to a corporate model. During the initial period a government corporation, US Enrichment Corporation was exempted from civil service pay schedules and so that it could develop a private-sector like compensation and benefits schedule for employees of the government owned corporation.[87]

For unionized postal employees, the current model and the relaxed constraint model would likely retain civil service rules as a secondary process relating to grievances and efforts to increase or reduce the workforce. The government department model could remove the processes that have been negotiated under the union agreement as employees return to full civil service status. The corporate models would maintain the negotiated processes subject to changes required to make them consistent with private-sector employment law and replace civil service procedures with those common in the private sector.

The Government Department model differs from all other models in regard to labor relations as postal unions would lose significant bargaining power. Under the other two governmental models,

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[85] Postal operators use a mixture of employees and contactors to handle the process from the sale of services to delivery. The 60% figure represents the costs of employees and the labor component of contracted delivery. FedEx, with its significant business in air freight, represents an exception as its labor cost runs significantly less than 60%.

[86] The Postal Service has adapted to the reduced flexibility that it has for paying, hiring and firing non-union employees through the use of contracted services. As there is no restriction on maintaining service contracts in all economic weather, contractors bear impact of the boom and bust cycle and hire and fire employees as contract dollars wax and wane.

[87] General Accounting Office, Uranium Enrichment: Activities Leading to Establishment of the US Enrichment Corporation, June 1994, pp. 6-8.

bargaining processes could remain as they are. The relaxed constraint model could modify the existing negotiating process more in line to what is common in the private sector.

The two corporate models would see a change in the labor law under which postal unions and employee associations operate. Three potential changes could work under the corporate models.

1. The labor law provisions of the Postal Reorganization Act would be maintained with only modifications necessary to make these provisions consistent with private sector employment law.

2. The provisions the National Labor Relations Act (NLRA), including lockouts and the right to strike, would replace current labor provisions contained in the PRA as a framework for contract negotiations and all other issues between the Postal Service and its unionized employees.

3. The provisions the National Labor Relations Act (NLRA) would be employed with modifications that sets limited barriers to labor actions that requires fact-finding or binding-arbitration.

The Railway Labor Act is not a viable option for the corporate models because the contract negotiating provisions of the RLA make little sense as a framework for labor law as its provisions are unlikely to facilitate the negotiations necessary to develop an employment paradigm that reflects current and future market realities.[88]

[88] The experience of the railroad industry in the 1970's and 1980's illustrate why the RLA does not effectively deal with negotiating adjustments in labor agreements to reflect new technological or market realities.

Table 7: Comparison of Human Resources and Labor Relations Characteristics across Alternative Business Models

BUSINESS MODEL CHARACTERISTICS	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Human Resources and Labor Relations					
Employment Law	Civil service law	Modified civil service law in regard to labor relations but most other provisions remain	Modified civil service law in regards to labor relations and creation of a streamlined process for hiring and firing employees	Private sector employment law or specific employment law reflecting the government corporation status	Private sector employment law
Pay Schedules and benefits	Civil service pay schedule and government benefits	Postal pay schedule with limits set by Postal Accountability and Enhancement Act with benefit levels set by negotiation or management decision	Market based pay schedules and benefits for non-union employees, negotiated pay and benefit levels for unionized employees;	Market based pay schedules and benefits for non-union employees, negotiated pay and benefit levels for unionized employees.	Market based pay schedules and benefits for non-union employees, negotiated pay and benefit levels for unionized employees
Labor Law	Civil service rules regarding employee unions	Postal Reorganization Act labor provisions with civil service rules applying in cases of some employee disputes	Postal Reorganization Act labor provisions with civil service rules applying in cases of some employee disputes	Modified PRA labor law to fit with private sector employment law, NLRA or modified NLRA to reduce risk of labor actions	Modified PRA labor law to fit with private sector employment law, NLRA or modified NLRA to reduce risk of labor actions

6. EVALUATION OF THE BUSINESS MODELS

All of the business models can provide postal services. However, all of them cannot both provide postal services and handle the eight challenges facing the Postal Service today. This section reviews the issues that the various models have in dealing with these challenges.

6.1. MAINTAINING A MAIL SERVICE THAT CONTINUES TO DRIVE ECONOMIC GROWTH

The experience of foreign postal operators show that ensuring that mail continues to drive economic growth can occur when the national postal operator is 1) free from political influence in operating, pricing, financial, and human capital decisions; 2) has operating freedom to serve customer needs and maximize the use of existing assets; and 3) is strong enough financially to make investments necessary to continually reduce costs and improve service.

None of the governmental models remove the Postal Service from political influence, probably the most important step that foreign postal administrations took in creating their new business models. By retaining congressional power over the Postal Service the government models maintain the risk that stakeholders will use political processes in Congress and at the Postal Regulatory Commission to try to preserve the status quo.[89] By protecting the status-quo positions of stakeholders, political processes are less likely than market forces to allow the Postal Service to best meet the customer needs that will promote economic growth.

A modified government enterprise model may have fewer restrictions. Examples of entities that work under such a model include the Tennessee Valley Authority, the regional power authorities, the Pension Benefit Guarantee Corporation, and the Federal Deposit Insurance Corporation. These entities have somewhat more freedom in financing and employment practices. However, it is not clear whether modifications in the governmental framework would ensure that the Postal Service can maximize its role as an economic driver. The TVA and power authorities work within a less dynamic market environment than the Postal Service. Both the PBGC and the FDIC have significant employment challenges given the disparity in pay between civil service employees and employees in the financial community and the PBGC has significant challenges in managing contractors that constitute around half of its workforce.

6.2. MINIMIZING THE FINANCIAL RISKS TO THE FEDERAL TREASURY

The Postal Service currently does not have sufficient assets to cover its debt to the Federal Treasury and fund its unfunded liabilities. Even without counting its $53 billion in unfunded retiree health care liabilities, the Postal Service currently has a net capital deficiency of $6.361 billion.[90]. The Postal Service may have additional obligations in the form of debt to cover operating losses and transition costs as it adjusts to new market realities.

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[89] The Postal Regulatory Commission is described as a political process because it is a process within which groups of people generate a result. The alternative is a market process where economic forces generate the result

[90] United States Postal Service, 10Q for the Third Quarter of FY 2009, filed with Postal Regulatory Commission, p. 5. Adding in the unfunded retiree health care liability would raise the deficiency to nearly $60 billion.

The Treasury's greatest risk is that the Postal Service does not become truly financially self sufficient including returns sufficient to fund investment needs and pay its long term obligations. If it cannot, the Treasury faces the prospects of finding funds to cover postal operating costs as well as its existing long-term obligations. Therefore, the Treasury's risks would be minimized by models that give the Postal Service the best prospects for true financial self sufficiency.

The government models retain all risk with the government. The government department model operates under a standard budget model where retained earnings are treated like tax revenue and distributed to general government needs. The current model does not have a sufficiently robust understanding of financial self sufficiency. Since the passage of the Postal Reorganization Act, this lack of a clear understanding of what self sufficiency requires has allowed stakeholders to claim that the Postal Service's financial position was stronger than it was in arguing for lower rates or higher compensation. The modified government enterprise model could employ a more robust definition of self sufficiency, as TVA does, but still would have the issues of political interference and operating and human capital constraints that would limit financial prospects and increase risks to the Treasury.

The two corporate models are the only models that are likely to include a self sufficiency requirement sufficiently robust to give the Postal Service the chance to cover a reasonable calculation of its obligations to Treasury. These models would likely require that governmental obligations and onerous payment schedules imposed by past Congresses be fully removed before the Postal Service could generate sufficient cash to cover necessary restructuring and modernization costs or attract the interest of private debt or equity investors. The federal government could cover some or all of the removed governmental obligations through payments of dividends and taxes or tax equivalents. If the Postal Service is privatized, the governmental obligations could be reimbursed in the form of revenue from a stock sale.

6.3. ENSURING SELF SUFFICIENCY

The two previous efforts at postal reform did not adequately address the issues of self sufficiency. Both efforts implied a robust definition of self sufficiency. In practice, though, the Postal Service continued operating within a governmental budgetary model with one difference: when revenue exceeded expenses, the Postal Service could hold the surplus within its own accounts and did not need to turn it over to the general pool of government revenue.

The government department model returns the Postal Service to a full government budget model as the definition of self sufficiency. To the extent that capital investments or transitions costs exist, they must be come from annual appropriations which could limit expenditures to what is available from current postal revenue and special appropriations for these costs.

The current model has significant political, operating, financial and human capital roadblocks that prevent it from completing a transition to a truly financially self-sufficient enterprise. Most importantly, the current model slows down the process of change, and weakens management ability to make operating changes that would anger Congress or stakeholders even if they would improve financial self sufficiency and improve service to customers.

For the government enterprise model with relaxed constraints, self sufficiency depends on how willing Congress is to grant independence and relax operating, marketing, pricing, regulatory, and human capital constraints. The experience with the TVA suggests that it may be possible or relax constraints sufficiently to make the Postal Service self sufficient while still retaining government characteristics. However, it is not clear that Congress is prepared to have a government entity operate as a full competitor using its assets in both mail and non-mail markets. Also, the experience of both Amtrak and regional commuter rail authorities and public transit authorities illustrates that retaining links to the federal budgetary cycles create significant challenges regarding service quality and funding capital investments.

The experience of foreign postal administrations illustrates that corporate models are self sufficient. The experience in Europe during the current recession illustrates that these models are sufficiently flexible to allow the operators to maintain their self sufficiency during even difficult economic times.

6.4. MEETING THE CHALLENGE OF SERVING WHOLESALE CUSTOMERS

The effectiveness of the various models relative to their ability to serve wholesale customers depends on the model's ability to 1) price products at competitive levels that provide a reasonable return to customers, 2) manage operating costs to support those prices, and 3) manage the business by continually improving service and cost efficiency.

Both the government department and status quo models cannot do these three things. These models may be able to hold prices down, but because they lack necessary independence, they are both politically constrained from managing operating costs based on market prices and unlikely to have the cash available to make capital improvements necessary to improve service and cost efficiency.

The government enterprise – relaxed constraint model could provide some additional flexibility in managing operating costs. But, by being tied to civil service employment rules and continuing political pressures, the needed transition may slow sufficiently to prevent the Postal Service from making necessary changes to retain the business of current wholesale customers and identify new opportunities to serve them.

In addition, during tough economic times, all three of the governmental models will likely force significant cutbacks in service and/or deferment of capital investments that could result in service deterioration that could drive wholesale customers to alternative delivery modes. In many ways, the proposal by the Postal Service to eliminate Saturday delivery reflects a budget based response that could hurt its competitive position. In some ways, the governmental models would likely force the Postal Service to make choices similar to what commuter railroads and public transit agencies have chosen during tough economic times. These include deferred maintenance, deferred replacement of plant and equipment, slower service, and major increases in rates.[91]

The two corporate models have the best chance of serving wholesale customers needs. With limited restrictions on prices, the Postal Service could set rates and provide services and products based on its best understanding of what provides customer value. With limited restrictions on operating decisions, the Postal Service could restructure its distribution network to minimize costs with a goal of improving service levels to the vast majority of customers. By allowing the Postal Service to compete with private sector firms without concerns regarding government competition,

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[91] Commission on Metropolitan Transportation Authority Financing, Report to the Governor, December 2, 2008, p. 1

the Postal Service can offer complementary services enhance the value of delivery that mailers must now buy from multiple parties, both lowering costs and improving the value of delivery.

Three of the most important ways that a corporate model could improve serving wholesale customers are in the process of: 1) simplifying costly mail preparation requirements where possible, 2) offering competitive, market-based pricing on an array of products and services, and 3) streamlining physical acceptance. By disassociating the Postal Service from the government, the Postal Service would then be able to handle the business relationship with its customers in a manner similar to its private industry competitors. The current process of both reviewing individual contracts, and relationships among rates charged to various wholesale customers would no longer remain part of the pricing process. Price changes could be implemented more quickly and contracts with customers could go into effect as soon as they are negotiated, without any review. Removing this review process reduces the overhead costs of both the Postal Service and its customers and removes the influence of regulatory precedents that reflects different market conditions and limitations of data to generate "scientific" pricing relationships that a regulator can support.

Moving to a corporate model would also likely streamline the process through which the Postal Service accepts mail from its wholesale customers. Initially, a streamlined network would like likely have a more streamlined set of acceptance locations and regulations that allows the Postal Service to operate efficiently and without variations that increase operating complexity and costs. Over time, after the Postal Service adjusts to its new network, it should be capable of developing tailored services including specialized product characteristics and prices for specific customers.

6.5. MEETING THE CHALLENGE OF SERVING RETAIL CUSTOMERS

This is probably the greatest political challenge that all of the business models face. The retail network barely makes sense for today's mail volumes and will likely make less sense in the future. However, it is the part of the business most visible to the general public and therefore Congress. How the business model both determines the retail network needs and adjusts the current network to those needs is critical.

As adjusting the retail model requires new thinking about how retail customers access the network, there are real questions as to whether any of the governmental options would have the political independence to do that thinking. Expanding the use of franchises and contract operations, along the lines that UPS, FedEx, and nearly all foreign posts do would require significant changes in the current contract station program and would upset employees who work in postal offices. Simplifying parcel products sold to retail customers in order to reduce the complexity of mailing would require overturning long-standing regulatory precedent regarding both relationship among the prices of products charged to retail customers and other customers and traditional pricing that favors recognizing differences in costs over simplifying the buying experience for customers and the selling experience for the Postal Service.

The governmental models also face a challenge in their ability to meet retail customer needs due to financial goals with either explicit or implicit government budgetary characteristics. Recent decisions to close retail post office without an accompanying retail strategy including expanded non-corporate alternatives reflects actions driven by budget and not service considerations.[92]

Foreign postal operators illustrate examples of providing retail services within corporate models. In almost all cases, the postal operator has a specific retail access requirement within their charter. They are given extensive freedom in how they meet these requirements that reflect their corporate status. Surveys in Sweden suggest that this freedom has improved customer satisfaction with the retail services offered.

6.6. ADJUSTING OPERATING COSTS TO THE NEW COMPETITIVE REALITY

The current financial challenges require significant restructuring of the operating and retail network in a timely fashion to eliminate operating deficits allow the Postal Service to begin the process of managing its costs based on market-based prices rather than setting prices on a cost plus basis. This restructuring is required regardless of the choice of business model. The human capital and labor relations challenges will also exist regardless of model, although adjusting the non-unionized workforce within a restructuring might be easier with corporate models.

The GAO has recommended a major network restructuring since at least 2002. The political, financial, and human capital constraints that exist within the current model have resulted in a limited, locally-driven approach to restructuring. Nearly every proposed change has generated opposition from employees, local politicians and the affected plant's member of Congress. Many of the changes that are now underway could have happened before today but management required more severe financial distress to take action. The delay that has occurred in completing this restructuring illustrates why the status quo model is unlikely to accommodate the restructuring that is now required.

The government department model could face greater constraints as the entire postal budget would return to the standard appropriation process. The relaxed constraints model may have more limited political constraints but financial challenges for funding the restructuring remain.

The problems that the government models have with completing a major restructuring in a timely fashion raise significant concerns regarding four other the other challenges: minimizing risks to the Federal Treasury, ensuring financial self sufficiency, meeting the needs of wholesale customers, and meeting the needs of retail customers.

The corporate models are not without problems in meeting this challenge. While removing political, contracting, and some human capital constraints that slow restructuring efforts, these models may still have funding constraints to ensure that the restructuring is done in a timely fashion.
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6.7. FUNDING MODERNIZATION AND RESTRUCTURING

Restructuring and modernizing the Postal Service will not be a cost free process. Each of the models has to come up with cash to cover operating losses during the transition, capital for new and remodeled equipment and putting the proper automation equipment in the right location, costs of

[92] The current model has created a situation in many urban and suburban markets where there are more outlets offering UPS and FedEx services than there are post offices.

excessing unneeded employees, training employees to fill new roles, and paying penalties for ending unneeded or modified transportation contracts and facility/equipment leases.

All of the models will require government funding, whether it takes the form of restructuring payment of existing long-term liabilities or cash. All governmental models present significant impediments to finding a funding mechanism as any change in payment schedules or appropriations would affect the scoring of the federal budget. Only expanding the Postal Service's borrowing capabilities falls off budget. However, this option is not particularly attractive as it expands the risk to the Treasury without any assurance that future management will meet self-sufficiency goals that will allow the Postal Service to make needed investments in the business as well as pay its obligations. The government models create another problem in that funding decisions would be made as part of the legislative process within which there are numerous ways of delaying timely funding decisions that could weaken the prospective path to solvency and viability.

The budget issues create an additional challenge for governmental models once the Postal Service begins earning profits again. The Federal Government in the past has chosen to move the Postal Service back on budget during good times as a way to reduce reported deficit levels. In doing so, the Postal Service also found itself short of cash for needed investments.

The private sector models, as well as the relaxed constraint model provide an option for funding as they open up additional funding options. However, these three models all require a Postal Service that is financial self sufficient according to private sector standards prior to private investors being willing to provide debt or equity capital for restructuring. Given the current financial state of the Postal Service, the private corporation model is not an option any time soon.

The federal government has successfully turned around two enterprises to the point that they were attractive to private capital, TVA and Conrail. Conrail's success clearly reflected both 1) its ability to manage the railroad business independent of congressional interference, and 2) the USRA's approach in providing funding that kept specific funding decisions out of the hands of Congress but also required that Conrail management, creditors, its customers and employees all make sacrifices to pull the company through.

The federal government is the primary investor in the restructuring efforts of a number of large financial institutions and GM and Chrysler. It is too early to know whether this investment will pay off. However, the approach to restructuring follows the USRA model in which funding decisions are made without requiring direct Congressional action but subject to normal Congressional oversight.

6.8. CREATING A WORKFORCE FOR THE LONG TERM

Choosing among the five business models for an approach for the Postal Service's human capital and labor relations challenges requires determining how well these models can deal with 1) the transformation of the workforce from one accustomed to dealing with a stable market environment to one that works within a dynamic environment and 2) the immediate challenge of rightsizing the workforce to reflect current market demand and production technology.

The GAO has written extensively about the problems that civil service has in dealing with dynamic organizations that have to adjust complement quickly as demand for work rises and falls in a manner similar to how postal demand rises and falls with the business cycle. The GAO has also found that even entities that contract out much of their workforce have significant challenges in managing contracts and extra costs associated with contracting.

The government department model, which would work under standard civil service, would have the same problems that GAO has noted for other agencies. In many ways it would be a step backward from the current situation.

While the status quo model's employment law rules are not exactly the same as standard civil service, they retain sufficient similarities that the criticisms still apply. The status quo rules also retain significant conflicts with postal labor law that create duplicate processes for transferring employees between facilities and between crafts. The status quo model does not address the issues regarding creating strong long-term jobs for non-union postal employees either and the need of management's need for flexibility in staffing these jobs as market and economic conditions change.

The relaxed constraint model could choose among full range of options for employment law that TVA, PBGC, FDIC and other agencies have used to adjust to specific needs. However, these entities still have had difficulty in workforce management of high-skilled positions and employment flexibility. Also, none of these entities are in as dynamic a market as the postal market where the size and mix of employee skills change as customer needs change.

The two corporate models can deal with these issues. Private sector firms in the United States in dynamic industries, including parcel carriers, and firms that produce and sort the mail that the Postal Service delivers all work under private sector employment and labor law. These firms have all dealt with the significant challenges of the economic cycle and changing technology. These firms have significantly less challenge in hiring and developing the proper mix skills to manage their business profitably. To the extent that these firms are unionized, they have negotiated contracts that reflect the competitive nature of their business and have negotiated adjustments as market changes warrant.

The transition process will be difficult under all models. In particular adjusting the unionized workforce size and mix to reflect current market demand and required flexibility in the use of full and part time workers will require serious negotiations. Under the current model, arbitration creates uncertainty about what changes will occur and may color negotiations. Under private sector models, working under the NLRA, postal strikes could occur as they did in other countries where management tried to make changes or in the United States when UPS tried to modify the Teamster pension. The corporate models could retain the existing PRA labor law to prevent these strikes.

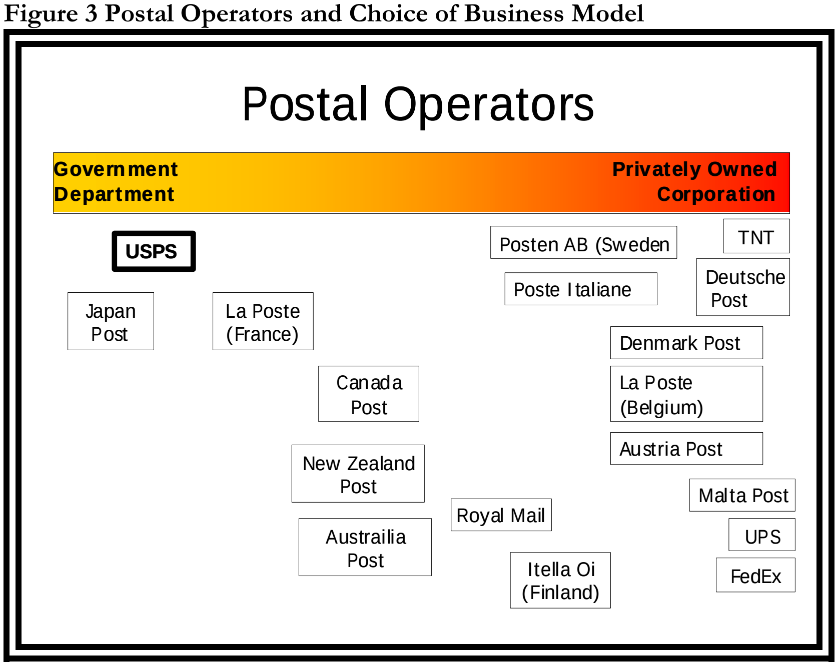
The corporate models would have a significant advantage in trying to adjust the non-union workforce. Having greater flexibility to adjust the mix of skills among non-union employees, and a pay schedule that reflects the labor market could speed the process of upgrading management and technical talent at the Postal Service at all levels.

7. CONCLUSION

In choosing a business model for the Postal Service, policy makers are choosing an industrial policy for the mail industry. As with nearly all industries, the federal government uses a range of tools from tax and regulatory policy to loan guarantees, to direct investments, to running a major competitor as a public enterprise to influence industry direction. Since the beginning of this Republic, the Postal Service has run as a public enterprise, first as a government department and later as a quasi-independent public enterprise. But, its current financial challenges raise questions about the viability of its current public enterprise model. This paper explored five potential options including maintaining the existing model.

Foreign governments were faced with severe financial challenge with their approach to mail industry policy over a decade ago. At that time, most posts were government departments requiring significant tax revenue to cover costs and were in need of significant operating and product restructuring to control costs and meet customer needs. Over the past two decades, most of these governments chose different business models for their national postal operator. Figure 3 illustrates the current status of many of these operators on a continuum from government department to private sector firm. UPS and FedEx are included on this chart to clearly illustrate that certain posts have chosen a business model no different than other investor owned enterprises.

Figure 3 Postal Operators and Choice of Business Model



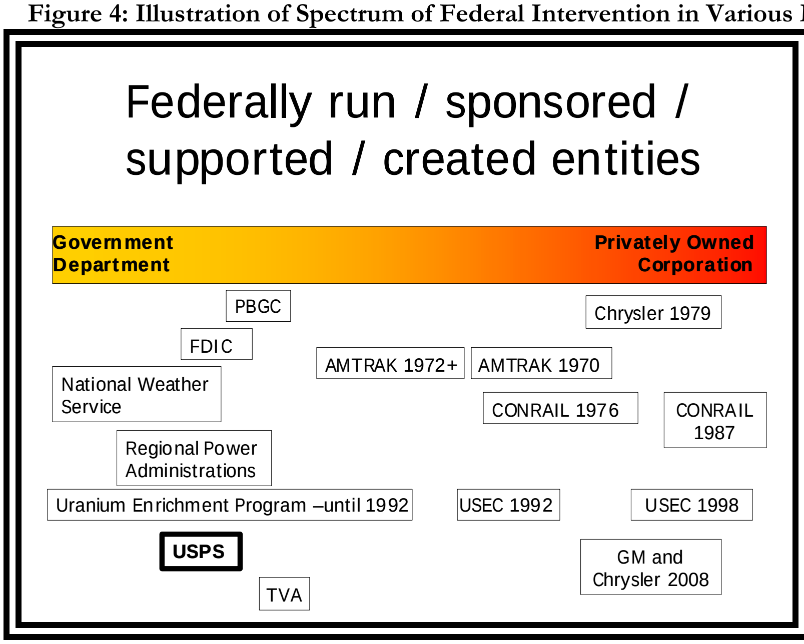
The figure illustrates that the Postal Service's current business model leaves it in a unique position as compared to its peers. Nearly all of its peers have chosen business models that remove the governmental characteristics of the enterprise. The difference between posts that fall in the middle of the spectrum and those that are on the privately owned corporation side is that the national governments for the former have chosen to retain ownership of the post as a crown corporation and may set certain public-service goals for the post in remote areas.

The federal government has numerous entities that have business like characteristics and at times have taken over, made investments in or guaranteed loans for troubled private sector firms. Figure 4 illustrates the spectrum of federal involvement.

This figure illustrates that the federal government has very limited experience running a government corporation in a manner that is common overseas. Conrail, GM and Chrysler all reflect instances in which the private sector would not finance the business through a bankruptcy process. Amtrak represents the attempt to remove the money losing passenger business from freight railroads as a means to ensure freight rail service. US Enrichment Corporation (USEC) was a transition phase for the privatization of the uranium enrichment program.

In nearly all other instances, the federal government runs its business-like enterprises, either as an agency within a cabinet department, as is the case of the Weather Service, or as a quasi-independent entity like the Postal Service. The differences among the various quasi-independent entities reflect how federal employment law and civil service compensation schedules apply as well as some differences in financial and accounting practices.

Figure 4: Illustration of Spectrum of Federal Intervention in Various Markets



The three governmental models reflect the general approach that the federal government has taken with business-oriented services. The corporate models reflect what foreign posts have chosen. All of the Postal Service's competitors, including those providing sortation, transportation, and physical or electronic delivery, also use corporate models.

Table 8 summarizes how well each of the models handles the challenges facing the Postal Service and policymakers. Examination of how well each of these models would handle the challenges facing the Postal Service finds all of the governmental models wanting. While relaxing the some of the constraints of the current model would be a reasonably safe choice, it would not be sufficient to serve the mailing industry, retail and wholesale customers, and ensure that the Postal Service's obligations to the Treasury are paid. Instead, the best solutions would involve preparing the Postal Service to operate as a government corporation, working under private sector law.

Making this transition will not be easy. The Federal Government has done this only twice with the US Enrichment Corporation and ICAAN. Neither organization was as large as the Postal Service. In particular, neither the US Enrichment Corporation nor ICAAN had the challenge of transferring more than a few hundred employees from civil service to private sector employment, nor did the have significant financial needs to cover modernization, debt and unfunded. However, the experiences of foreign posts, many which employ tens of thousands of employees and had similar financial woes illustrates how this can be done, and how it can be done with minimal disruption of the careers of postal employees.

Table 8 Summary of the Evaluation of the Alternative Business Models

CHALLENGES FACING BUSINESS MODEL	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Impact on the Economy	Retards economic growth	Retards economic growth	Could either retard or promote growth	Promotes economic growth	Promotes economic growth
Financial Risks to the Federal Treasury	Significant default risk	Significant default risk	Significant default risk	Reduced default risk	Minimal default risk
Self Sufficiency	Appropriations required in long run	Appropriations required for transition and in long run	Appropriations may be required for transition and in the long run	Federal loans required for transition	Federal loans required for transition
Challenge of Serving Wholesale Customers	Unlikely to sufficiently control costs or gain pricing flexibility to prevent rapid exit of customers	Unlikely to sufficiently control costs or gain pricing flexibility to prevent rapid exit of customers	Possibly capable to sufficiently control costs and gain pricing flexibility to prevent rapid exit of customers	Likely capable to sufficiently control costs and gain pricing flexibility to prevent rapid exit of customers	Likely capable to sufficiently control costs and gain pricing flexibility to prevent rapid exit of customers

CHALLENGES FACING BUSINESS MODEL	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Challenge of Serving Retail Customers	Unlikely to modernize due to funding constraints and congressional interference	Unlikely to modernize due to funding constraints and congressional interference	Could modernize but funding constraints and congressional interference would delay	Would likely modernize to reflect customer needs and USO obligations	Would likely modernize to reflect customer needs and USO obligations
Adjusting Operating Costs to the New Competitive Reality	Unlikely in a timely fashion due to funding constraints and congressional interference	Unlikely in a timely fashion due to funding constraints and congressional interference	Possible in a timely fashion but could be delayed without appropriate transition funding	Likely in a timely fashion with appropriate transition funding	Likely in a timely fashion with appropriate transition funding
Funding Modernization and Restructuring	Unlikely to provide funding in a timely fashion	Unlikely to provide funding in a timely fashion	Could provide funding in a timely fashion with creation of appropriate funding entity	Should provide funding in a timely fashion with creation of appropriate funding entity	Should provide funding in a timely fashion for modernization required private sector funding sources

CHALLENGES FACING BUSINESS MODEL	ALTERNATIVE BUSINESS MODELS				
	GOVERNMENTAL OPTIONS			CORPORATE MODELS	
	GOVERNMENT DEPARTMENT	GOVERNMENT ENTERPRISE – STATUS QUO	GOVERNMENT ENTERPRISE – RELAXED CONSTRAINTS	GOVERNMENT CORPORATION	PRIVATE SECTOR CORPORATION
Creating a Workforce for the Long Term	Unlikely to provide sufficient flexibility for required transition and	Unlikely to provide sufficient flexibility for required transition	Somewhat likely to provide sufficient flexibility for required transition depending upon which civil service restrictions are removed	Likely to provide sufficient flexibility for required transition and beyond	Likely to provide sufficient flexibility for required transition and beyond

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