



MAIL GATHERING
Postmaster General John Potter mulls postal reform with Michael Critelli of Pitney Bowes and Time Inc.'s Ann Moore

The Future of Mail

CEOs discuss how to head off postage hikes.

BY JENNIFER PELLET

Neither snow nor rain nor heat nor gloom of night—nor even outdated regulations nor economic woes — will stray postal couriers from their rounds. The latter two additions to the oft-quoted postal service homily, however, threaten to bring a hefty rate increase that CEOs across industries, and particularly those in the media, say would endanger the health of their companies.

“It would be a killer,” Cathleen Black, president of Hearst Magazines, told participants in a roundtable on postal reform held in partnership with Pitney Bowes. “A 15 percent increase would mean a \$300 million negative hit to the magazine industry, and represent a \$15 million cost increase for my company alone. That’s a very big nut.”

“Our whole supply chain is in jeopardy,” agreed Ann Moore, chairman and CEO of Time Inc. “We actually spend more on postage than we do on paper. Mail is our single largest line item expense, so this real-

ly threatens our business.”

Magazine publishing is just one sector that would feel a significant impact. From financial institutions and health care providers to retailers and advertisers, a wide array of businesses rely heavily on the U.S. Postal Service (USPS) for marketing, promotion, product distribution and other essential services. For JPMorgan Chase, postage for its credit card arm alone already tops \$750 million annually, while advertising company ADVO spends approximately \$600 million a year on mail. In fact, 650 million pieces of mail are processed and delivered daily.

But the critical role that reliable, timely and affordable postal service plays in American business is just one of several factors driving the issue of postal reform. Already, electronic alternatives to business correspondence and transactions have taken a toll on First-Class Mail volumes, as has the growth of private package and mail delivery services.

PHOTOS BY NAUHAITENNY FIKOS

“As consumer demand, use of the mail system and the competitive picture change, we have to be ready, willing and able to change with it,” said John Potter, Postmaster General. “In the past, we had a monopoly on First-Class Mail. Today, the competition is very real. As it becomes easier to pay bills by telephone and over the Internet, we are starting to see people migrate away from the mail.”

Surprising Resilience

In operation for more than 225 years, the post office has proved surprisingly resilient in previous decades, weathering the advent of the telephone and fax machine, among other changes. In fact, the USPS has swelled into an organization with more than \$69 billion in revenues, 38,000 retail outlets and more than 700,000 employees who deliver to 148 million-plus addresses.

Even today, the overwhelming majority of Americans remain attached to daily mail delivery despite the availability of alternatives. “We give our consumers the option of choosing how they want to receive bills, and they still largely prefer hard copies by mail,” said William Ellis, senior vice president of JPMorgan Chase Card Services, which mails 40 million card statements a month. “People are getting more comfortable with electronic delivery, but for the most part they’re not there yet.”

Yet a gradual decline in mail volume indicates this may be changing. First Class and Priority Mail volumes have been shrinking steadily over the past four years, with First-Class Mail dropping from 103.5 billion pieces in 2001 to 97.9 billion in 2004 (see charts, page 57). A rate increase would drop volumes further. That

volume decline in turn threatens the efficacy of a system that relies at least partly on sheer size.

During the past five years, the post office has done its part to address the issue by adapting its operations. Aggressive cost-cutting, management policy changes including pay-for-performance, technological improvements and new products, pricing policies and services introduced since Potter took the helm in 2001 have fundamentally reshaped the USPS. Over three years, the transformation effort cut costs by a total of \$4.3 billion. In 2004 alone, the Postal Service reduced total work hours by 21 million and delivered positive earnings for the first time since 1971, reporting a net income of \$3.1 billion.

“We wanted to move away from what had been a militaristic, autocratic style of management to one where we embrace the notion that every employee can make a contribution,” reported Potter, a 27-year veteran of the USPS, who noted that the transformation effort continues. “Today, we’re reaching out to understand what our customers want and trying to fulfill that.”

Thanks to the restructuring efforts led by Potter, the USPS is now in its sixth straight year of productivity improvement. Yet, the cost savings will soon be offset by the rising costs of postal operations. In 2005, the USPS forecasts a net loss of \$200 million, a drop attributed to increasing personnel compensation costs as a result of rising health benefit expenses, continued erosion of First-Class Mail volume, a growing retiree population and structural cost pressures.

Put simply, averting a significant rate hike requires further reform—and fast. But the implementation of

WHO'S WHO

► **Cathleen Black** is president of Hearst Magazines, a \$4 billion publishing company in New York.

► **Michael J. Critelli** is chairman and CEO of Pitney Bowes, a \$4.5 billion provider of integrated mail and document management services based in Stamford, Conn.

► **Jim Davis** is president of Chevron Energy Solutions, a San Francisco-based energy services company and subsidiary of \$113 billion Chevron Texaco.

► **Howard Draft** is chairman and CEO of Draft, a \$350 million direct and promotional marketing agency in Chicago.

► **William Ellis** is senior vice president of JPMorgan Chase Card Services based in Wilmington, Del.

► **S. Scott Harding** is CEO of ADVO, a \$1 billion direct mail company in Windsor, Conn.

► **William J. Holstein** is editor-in-chief of *Chief Executive* magazine.

► **Edward M. Kopko** is CEO of Butler International, a \$263 million strategic outsourcing firm in Montvale, N.J., and chairman and CEO of Chief Executive Group.

► **Judy Marks** is president of Distribution Technologies for Lockheed Martin, a \$31 billion defense contractor in Owego, N.Y.

► **Ann S. Moore** is chairman and CEO of Time Inc., a \$5.5 billion magazine publisher based in New York.

► **John E. Potter** is Postmaster General and CEO of the United States Postal Service in Washington, D.C.

► **Michael I. Roth** is chairman and CEO of the Interpublic Group of Companies, a \$6 billion communications firm based in New York.

► **John J. Shalam** is chairman, president and CEO of Audiovox, a \$1.3 billion electronic equipment maker in Hauppauge, N.Y.

Targeting Technology

Plenty goes on behind the post office counter.

From automating consumer mail to streamlining processing, technology has been at the forefront of the USPS's efforts to reduce costs and improve services. Customers can now go online (www.usps.com) to calculate postage, request pickups at home, forward mail, buy stamps, prepare prepaid labels, and track and confirm delivery.

Automated kiosks available in 2,500 post offices, accessible 24-7, enable customers to print labels and postage using a credit or debit card.



Judy Marks of Lockheed Martin

While many technology-related enhancements are visible, plenty more goes on behind the scenes, notes Judy Marks, president of distribution technologies at Lockheed Martin, which has a 40-year history of working with the Postal Service. "There are two types of technology advances that are aligning and integrating to drive capability for the Postal Service: mail processing equipment advances and advances in information technology," says Marks, who sits on the Mailing Industry CEO Council and serves on the Steering Group of the Mail Industry Task Force. "Advances in the recognition technology that reads addresses on the fly and in physical sortation are aligning with advances in the data and voice networks."

The deployment of 9,000 wide-field-of-

view cameras with enhanced optical-character recognition in postal plants nationwide, for example, is increasing sorting efficiency and paving the way for more "intelligent" mail. The cameras support new bar codes that combine zip code information and tracking information into a single code. "It becomes an intelligent tag that lets multiple people use it for different reasons," says Marks, who explains that in addition to USPS routing capabilities, bar codes allow mailers to serialize mail pieces or encode identifying information about the recipient. "It remains a code, so there are no privacy concerns."

Implementing technology advancements in the post office also presents unique challenges. "In an enterprise with 38,000 locations and one of the largest work forces in the country, ease of use is one of the first guidelines to introducing technology," says Marks. Some 300,000 people deliver mail, and the same numbers work in processing centers. "Consider the cost of training those types of work forces and how effective and efficient that needs to be," she says.

For an entity with more than 200,000 vehicles—one of the biggest fleets in the nation—maintenance concerns are also key. "In light of the unique environment, USPS distribution technology needs to be rugged and reliable to work indoors and outdoors, in the hottest and coldest of ranges," Marks explains.

But, ultimately, overcoming those barriers is worth it. "The more that can be known about a mail piece and how it can be moved efficiently, the more the mail itself will have value and contribute to the industry as a whole."

new initiatives is complicated by the need to work within the confines of the outdated Postal Reorganization Act and restrictions governing pricing and management.

Reined in by Rules

We're not allowed to close a post office—essentially a retail outlet—for economic reasons," explained Potter, citing the inability to respond to a decline in an area's population as an example of restrictions that hamper USPS efficiency. "Picture yourself as a retailer stuck with whatever stores were in place back in the 1970s."

A "universal service" mandate requires the post office to charge the same price for picking up, sorting, transporting and delivery mail regardless of variables such as location or mail quantity. For example, while it costs the USPS \$1 million a year to transport mail to and from the 600 or so people living at the bottom of the Grand Canyon using a mule train, postal rates there are the same as those for urban areas.

While that mandate ensures equal pricing among consumers, it also precludes competitive bidding. "Some pricing freedom is one of the things that would really help the business," explained Potter. "Right now, we can't even compete for delivery of packages within the federal government because our prices are the same whether you mail one piece or a million pieces. So when the federal government does solicitation for package services, our competitors beat us. We need a little more freedom to manage the Postal Service as a business."

The USPS also must provide wages and benefits on par with the private sector, yet it is locked into federal government benefit programs. "If you look at our wages, we're very competitive with the marketplace, but our benefit growth has been significantly above that of the private sector," explained Potter, who said that the USPS already runs as a business because it is not subsidized by the government. "I'd like to be able to put

everything on the table and negotiate.”

Flexibility for the USPS to adjust processes and systems requires legislation on an issue that has been particularly unpopular with Congress and the Bush Administration. “It’s not an issue that any congressman or senator historically has ever wanted to deal with,” said Hearst’s Black, who serves on the Mailing Industry CEO Council, a nonprofit organization aimed at supporting postal reforms, and providing senior executive input into it. She noted that the issue is as thorny as Social Security reform. “Those of us who have spent time in Washington have tried to make it an important issue on both sides of the House and at the administration level and we’ve come along way. But if we don’t keep pounding away collectively and individually, [legislators] will move on to something else.”

Instilling a sense of urgency is crucial to the reform effort, added Michael Critelli, chairman and CEO of Pitney Bowes. “We wouldn’t wait for the roof to leak to do maintenance on the roof,” said Critelli, who co-chairs the Mailing Industry Task Force and is chairman of the Mailing Industry CEO Council. “But in Congress and the administration right now there’s a very big bias toward dealing only with those issues where there’s a crisis. So we have a dilemma—how do we push this reform now so there won’t be a crisis next year down the road or beyond? How do we

create that sense of urgency without having a negative effect on the industry, which is doing quite well?”

“My concern is that we do something that hurts the momentum,” agreed Scott Harding, CEO of direct mail advertising powerhouse ADVO. “We’ve got a lot of things in this industry working right now. You’re surpassing expenses with revenues, and we run the risk of breaking a machine when it’s not broken.”

Beyond legislative reform, what else can be done to deliver greater efficiency—and escape a rate hike? “Having the post office be a knowledge center for small businesses in local markets could be interesting,” noted Howard Draft, chairman and CEO of Draft Inc. “You’re stuck with these 38,000 locations, and I think we have to figure out how to help them be helpful to the small business market. Because if we can teach small businesses to use databases, online services or the postal kiosks and they become better marketers, that will grow volume. And that volume growth will help keep costs down.”

Some CEOs wondered if competition for the Postal Service was the answer. But bringing in private players has a checkered history. “Germany is 38 percent privatized,” noted Critelli. “They have very efficient service, but 70-cent mail. And in Europe, where competition is supposed to be authorized, the politicians put in constraints. You can’t have competition where

all but one competitor is permitted to act commercially.” The problem today is not a lack of competition, he added, “but rather that this is not an independent agency. It’s an agency under a high degree of political regulation.”

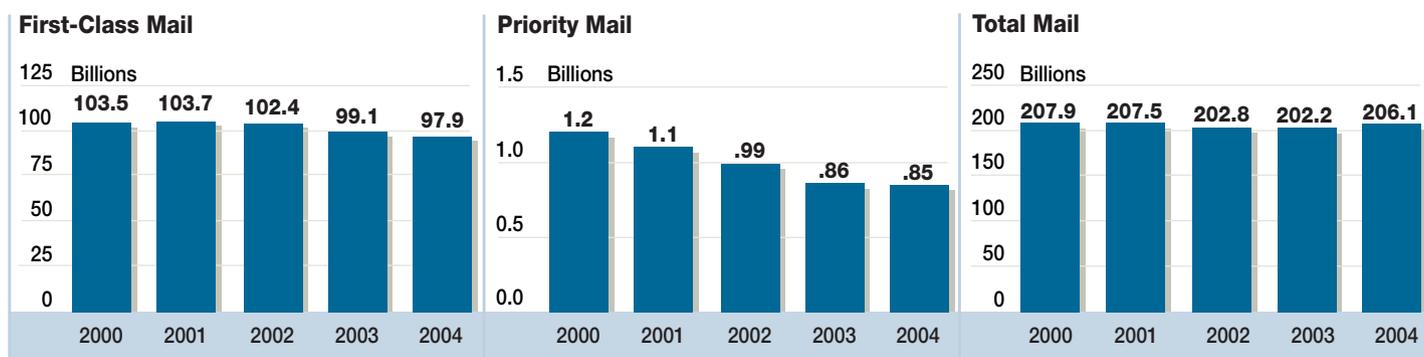
Jim Davis, president of Chevron Energy Solutions, agreed that only a partial leveling of the playing field hasn’t had much success in the past. “I personally felt the impact of rolling blackouts and problems that occurred after the California electricity deregulation crisis,” he recalled. “So I would put in a real word of caution that it sounds like a good idea in some cases—utilities being a good example—but on the whole attempting to open a traditional monopoly to competition without doing it all the way has not gone particularly well.”

Interim Improvements

Even as CEOs and the USPS band together in urging Congress to address regulatory reform, efforts to work within the current restrictions to improve efficiency continue. Partnerships with players in the private sector already have served to boost efficiency. Large-scale mailers can save on costs by bringing letters, magazines and catalogs to a destination plant, where the USPS takes on “last mile” delivery. “Mailers get a more reduced rate for bringing mail to that unit than they would if their mail entered the system at its origin site for delivery any-

Making It Up In Bulk

Although volume of some mail classes has declined, overall the mail remains steady.



Source: U.S. Postal Service

ROUNDTABLE

where in the country,” explained Potter. “And we also outsource much of our network, from ground transportation to mail sortation to private companies.”

“Some limited pricing flexibility does exist in the 30-year-old legislation,” added Judy Marks, president of distribution technologies at Lockheed Martin. “Last year, the USPS in association with the Postal Rate Commission authorized negotiated service agreements (NSAs), which essentially give incentives to mailers to hit certain volume thresholds.”

Contractual agreements between the Postal Service and individual companies, NSAs offer a rate reduction to a company on each piece of mail over its forecasted annual mail volume. A test NSA in September 2003, for example, provided financial company Capital One a rate reduction on all First-Class Mail over the 1.225 bil-

lion pieces it had forecasted sending annually. “We incented them to migrate advertising funds from other media to First-Class Mail,” explained Potter, who reports that the USPS has 10-plus additional NSA proposals pending and dozens more companies have shown interest. “As a result of the combination of cost reductions and increased margins, after the first year, we are \$21 million to the good in terms of the bottom line.”

Technology also plays a critical role in the evolution of the post office: Improvements to information networks are enabling near real-time mail tracking; wide-field-of-view cameras with enhanced optical-character recognition capabilities have been deployed in postal plants nationwide; and 2,500 automated kiosks were installed in postal branches in 2004 (see sidebar, page 56).

But despite great strides, CEOs see postal reform as an essential next step. “None of us here could run a Fortune 500 business with 30-year-old work rules,” Time Inc.’s

Moore noted. “Think of what the business world was like in 1970 when this legislation was passed. We didn’t even have personal computers. We were probably using carbon paper. So we have got to get reform through in order to allow the progress we’ve seen today continue.”

Cathleen Black agreed. “Reform would help the USPS to operate more like a business, enabling improvements in governance and a more sophisticated management structure,” she said. “Reform would also help the USPS control labor costs, which account for about 80 percent of costs. The Postal Service wants to be able to negotiate benefits, a rising expense that is a killer for many industries but particularly for the postal system.

“Finally, reform would also enable improvements in products and pricing by giving the USPS the freedom to offer new products and to adjust prices as long as the overall level of prices doesn’t go up more than inflation in each class of mail,”

TOP William Ellis of JPMorgan Chase Card Services

BOTTOM Scott Harding of ADVO



LEFT TO RIGHT
Howard Draft of Draft Inc.
and Michael Roth of The
Interpublic Group of
Companies

Black noted. "Everyone says postal reform is important and then, all of a sudden, it comes down to a congressman's backyard and he or she loses interest. But this administration needs wins, so by working closely with them by helping them understand how critical it is and that lowering rate increases will come as a result of reform, we hope to engage the House, Senate and White House. An awful lot of stars have to be in alignment. But so many disparate companies have come together on this. We need to keep going down the path we are on or risk losing the momentum that has been building."

A large bump in the postal rate remains possible. "We had a 24 percent increase in rates a few years ago," said Black. "Getting huge spikes like that make it very difficult to run any business."

If significant, a rate increase could further scuttle mail volume as heavy mailers seek other distribution methods, noted Draft. "Direct mail is a financial business," he said, pointing to reward programs' shift from mailings to email and online statements. "As long as people are making money, they will mail. When it stops being efficient, they look at alternative media."

"There is \$18 billion at risk when it comes to diversion of bills and payments from hard copy to electronic medium," agreed Potter. "That is at the crux of why we need reform. We've already seen that migration affect our volume of First-Class Mail. We want the flexibility to adjust our processes and systems—to manage our way into that new environment—so we don't become a burden to the very businesses we rely upon."

Added Black: "We all need to understand the postal system is not an anachronism. A viable, accessible and affordable Postal Service is an essential business tool for as far as anyone can see down the road. We all have a stake in the outcome of the reform effort." ▲

Going Postal?

"We need a healthy USPS . . . for the future."

Cathleen Black, president of Hearst Magazines and a member of the Mailing Industry CEO Council, discusses the private sector's role in keeping mail costs down.

How real is the danger of a significant postal rate increase?

The danger is very real. A rate hike will impact a huge number of people. The \$900 billion mailing industry encompasses 9 million jobs. About 85 percent of magazine circulation is via mail, so increases have an acute impact on my company's bottom line. A double-digit increase would be especially hard on any kind of struggling company or startup. A big increase also has a downward impact on volume, which will hurt the overall stability of the postal system.

[A rate increase] is a tax on every single American. Every American business relies on the postal system. We need a healthy USPS, not just for the next few years but for the future.

How do private sector partnerships benefit the Postal Service and its business partners?

Private sector partnerships let businesses do the parts of postal distribution that they can do more efficiently than USPS. The USPS will continue to do what they do best, which is deliver to every home in America. No one is talking about changing that. But as you go upstream in operations, private sector entities consolidate magazines at printers or at centralized consolidation centers and then drop-ship full truckloads close to the final destination for final processing by the USPS. That is a perfect scenario, where private sector entities

become the consolidators and the Postal Service does the final delivery.

Will making private sector partnerships and volume discounts available to large-scale mailers, such as major publishers, be a disadvantage for their small competitors?

As in all legislative efforts and lobbying, we will have to work through this. Small publications are niche magazines by and large. Some are business publications, some are special interest. They provide a service to readers as much as any one else. There are things they will have to do, probably put six magazines in a sack instead of 24. We will not benefit at their expense.

What modifications to pricing and services do you see in the future?

The USPS faces intense competition in its package business, and they need to be able to respond in a timely manner to compete. Reform would allow innovation by giving the USPS the ability to negotiate more negotiated service agreements. We would get a lower price for doing some of the work ourselves, and that will add value for USPS and for the mailers by keeping volume strong and prices affordable.



Cathleen Black of Hearst Magazines