

Postal Worksharing: A Partnership with Our Customers

Overview

Partnering with customers through worksharing has been one of the major success stories of the Postal Service over the past thirty years. This \$15 billion a year partnership has provided affordable mailing alternatives for customers, cost reductions for the Postal Service, and has been a primary source of growth for the mail. Worksharing has also been an engine of change for the Postal Service. It has helped usher in the age of automation by encouraging customers to prepare machine-readable mail and has remained an important tool for aligning the mail with the operating environment.

Today, the mailing industry is a major driver of the United States economy generating approximately \$900 billion in commerce annually, and employing about 9 million workers. This growth has been fueled, in part, by the advent of the Postal Service worksharing programs that have provided opportunities for customers and third-party service providers to grow their businesses by partnering with the Postal Service.

The USPS has been the world's leading postal administration in implementing worksharing. Many of the "unbundling" debates going on within European posts echo the worksharing debates that the United States postal industry resolved over a decade ago. The need for "postal reform" as discussed in foreign posts has been leapfrogged in the United States by the USPS worksharing partnerships. Today, the Postal Service handles 46 percent of the world's mail volume and the pervasive use of the mail for commerce and

communication in the United States is a testament to this quiet evolution in American postal policy.

At the same time, challenges remain. There is still considerable debate about the future direction of worksharing. As you have heard, opinions exist on all sides of the issue; however, all parties support a well-designed worksharing program. While differences of opinion may exist on how the worksharing program should progress, the Postal Service believes that the current program reflects a balanced approach and establishes a baseline from which we can continue to serve our customers' needs into the future. We are constantly exploring new opportunities with our customers and, as these ideas are refined, we will move to incorporate new, perhaps customer-specific, worksharing into our product offerings. To do this, the Postal Service will need additional flexibility to work with our customers. The current ratemaking process is too cumbersome and will unreasonably delay potentially beneficial pricing and product enhancements, particularly as we move to more customer-specific, pricing and product innovations.

Introduction

The Postal Service's worksharing program offers customers opportunities to perform mail preparation, handling, and transportation that would otherwise be performed by the Postal Service itself. These activities include presorting, barcoding, and transporting the mail closer to the mailpiece's ultimate destination (dropshipping). In return for performing these tasks, customers receive a rate discount reflecting the costs avoided by the Postal Service.

The worksharing program began in 1976 with a discount for presorted First-Class Mail designed, in part, to reduce the impact of rate increases. From this modest beginning, the worksharing program has expanded to include most Postal Service product lines and now encompasses a broader range of cost-saving activities. An innovative approach when it was introduced, worksharing has effectively “liberalized” a significant portion of the Postal Service’s business by sharing it with the private sector. In FY 2002, the value of worksharing discounts was \$15.2 billion, representing about 20 percent of postal revenues.

In the almost thirty years since worksharing was introduced, it has become a key means of keeping mail affordable by lowering rates and leveraging the ability of our private sector partners to assist in the efficient processing of the mail stream. In general, discounts are based on the Postal Service’s costs avoided when a customer performs the worksharing task, although other ratemaking considerations also come into play. If a customer performs a worksharing activity when it can do so for less than the Postal Service, then the country’s mail is processed and handled at less cost than if the Postal Service did everything itself. This is sometimes referred to as the principle of least combined cost.

The Postal Service considers the worksharing program to be an unqualified success. The program has served as a *de facto* liberalization of the Postal Service that is unparalleled even in the most “liberalized” postal administrations around the world. Portions of the mail value chain have been opened to private sector businesses in a way not contemplated by other postal

administrations. The Postal Service believes that the worksharing program has demonstrated how it can work cooperatively with its customers to use the pricing flexibility available under current law, and is a strong indicator of the kind of innovation the organization would be capable of if given more pricing flexibility in the future.

What is Worksharing?

Worksharing allows customers to perform certain mail processing, handling and transportation activities instead of purchasing those functions from the Postal Service, effectively unbundling the postal value chain. Types of worksharing fall into three broad categories: (1) presorting, (2) making mail automation compatible , and (3) dropshipping.

History

The first presort discount, offered in 1976, was a one-cent discount for presorting bulk First-Class Mail. Presort discounts were expanded to include Periodicals and Standard Mail later in the 1970s. Barcode discounts were introduced in 1988 for First-Class Mail and Standard Mail, and then extended to Periodicals in 1991 and parcels in 1999. To qualify for barcode or automation discounts, mailpieces must meet certain design standards, including standards governing the placement of the barcode and ensuring that addresses are accurate so mail can be delivered correctly the first time. Automation-compatible mailpieces that are deliverable-as-addressed make effective use of the Postal Service's mail processing equipment and, as the use of automation equipment increases, service times improve for all our customers.

Lastly, dropshipping involves transporting the mail closer to its ultimate destination. By entering the mail more deeply into the Postal Service's network, the customer both shares in transportation costs and bypasses handling costs. The first dropship discount was a one penny discount offered in 1985 for Periodicals entered at destination processing facilities. These discounts were later extended to Standard Mail and parcels. For business reasons, the Postal Service has decided not to extend dropship discounts to First-Class Mail. First-Class Mail is fundamentally different from the other mail classes in that it typically weighs only one or two ounces and is relatively inexpensive to transport. As a result, we determined that we would be unable to offer a discount that would be attractive to mailers.

Impact of the Workshare Program

The workshare program has had several far-reaching and beneficial effects.

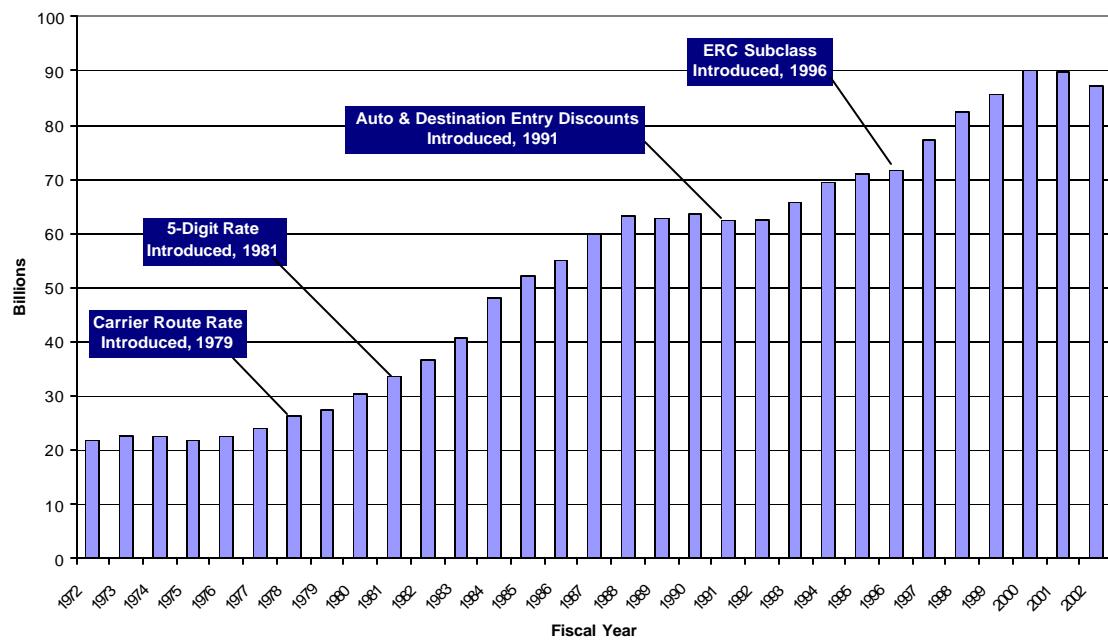
Worksharing has improved the implementation of the Postal Service's automation program and improved mail processing and handling generally: The Postal Service's customers have helped to control Postal Service costs through their participation in the worksharing program. In response to the incentives provided through the rate structure, the mailing community (both customers mailing on their own behalf and private service providers preparing mail for others) has made significant investments in equipment and processes enabling them to prepare, sort and transport mail in ways that reduce Postal Service costs. The address quality and mailpiece standardization requirements

associated with automation discounts have enabled the Postal Service to make more effective use of its automation equipment, thereby reducing Postal Service costs and improving service times. Moreover, a well-prepared and easy-to-process mail stream has furthered the cost-effective deployment of additional automation equipment.

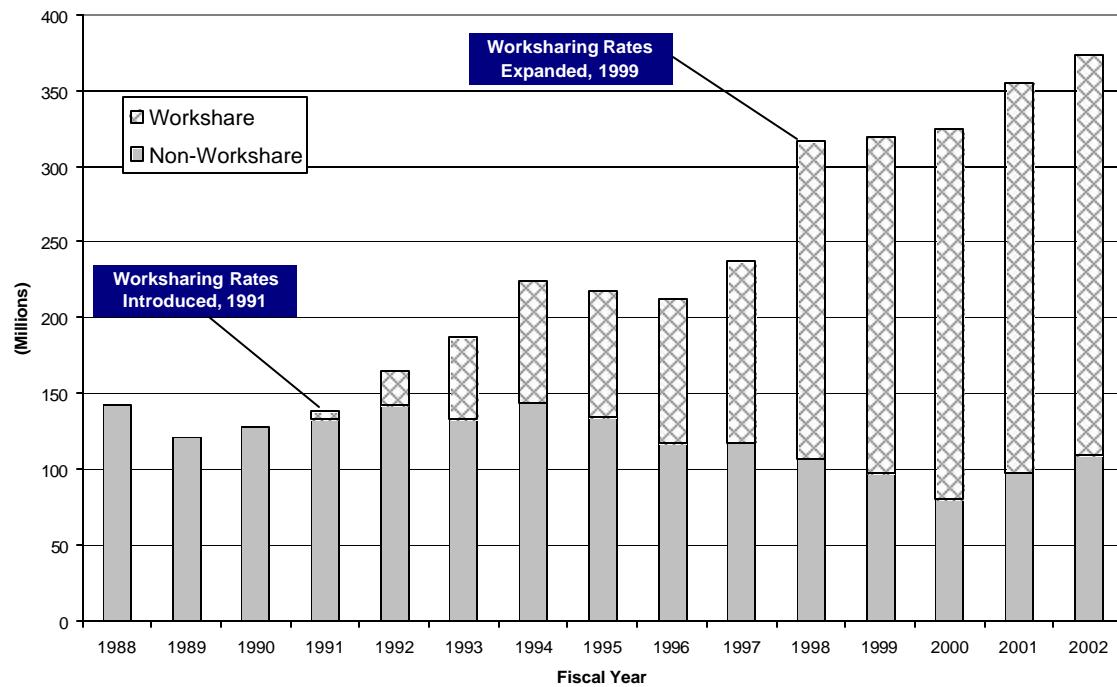
As a result, over the last fifteen years, overall mail stream quality has improved, mail pieces have become more standardized, and a substantial portion of the letter-shaped mail stream can now be processed through automated equipment.

Worksharing has stimulated growth in mail volume: Increases in volume have often followed the introduction of new worksharing discounts or changes in the discount structure. Statistical studies have also shown that workshare discounts result in volume growth, in part, because price increases are kept smaller than they otherwise would have been. As discussed below, worksharing has also enhanced volume growth by creating third-party consolidators who partner with the Postal Service in promoting the continued use of hard copy mail.

**Standard Mail (Third Class) Volume
1972 to 2002**



**Parcel Post Workshare and Non-WorkShare Volume Trends
1988 to 2002**



Worksharing has kept rate increases down and therefore benefits all mailers: Because the workshare program has facilitated the use and further installation of automation equipment, it has helped reduce Postal Service costs and the magnitude of rate increases. This in turn has enhanced the growth in mail volume. Because the worksharing program has facilitated the automation of the mail stream, it has reduced Postal Service costs and kept rate increases to a minimum for all mailers, including single-piece mailers like the proverbial “Aunt Minnie”. As discussed by CEO Pat Donahoe, worksharing has significantly reduced Postal Service labor costs and the size of the Postal Service complement needed to process and handle the mail.

Worksharing has created new private sector businesses: Perhaps one of the more surprising results of the worksharing program was how it encouraged the development of new businesses that consolidate mail for processing and transport. For example, presort houses emerged in many cities to sort and barcode mail for customers who either did not have the volume to qualify for discounts or preferred processing by a third party. The fact that smaller volume mailers can qualify for discounts through such consolidators mitigated concerns that the program was only accessible to large volume mailers.

Worksharing has provided customers with mailing options: By providing customers with the options to presort, to make mail automation compatible, or to transport mail closer to its ultimate destination – the worksharing program provides our customers the opportunity to use the postal

system in the way that makes the most economic sense for their business. For example, if a customer can presort mail less expensively than the Postal Service, then it can choose to do so if this option works within its business model.

Worksharing has leveraged our partners' strengths: Worksharing discounts are designed to meet our customers' needs while reducing overall Postal Service costs. Different organizations have differing strengths, and the organizations comprising the postal industry are no exception. While the Postal Service endeavors to provide mail service in the most economical and efficient way possible, the need to maintain a low-cost, nationwide network does not necessarily mean that we provide every individual component of this service at the lowest possible cost. Private sector firms who are able to specialize in particular service components or in handling, sorting and preparing specific segments of the mail stream may be able to provide these services at a lower cost than the Postal Service. For example, if a brokerage firm is able to sort a mailing list at a lower cost than the Postal Service could physically sort the resulting mail pieces, this does not imply that the Postal Service is inefficient. Rather, it implies that the two organizations have different strengths and that opportunities exist to leverage these strengths to the mutual benefit of the customer, the Postal Service, and the broader mailing public.

The worksharing program recognizes the potential for private sector provision of some services at a lower cost and has been developed to recognize these cost differences and provide our customers with choices that allow them to best meet their business needs. In setting a worksharing discount, the Postal

Service considers its cost of providing that service as well as numerous public policy goals. The discount signals the value to the Postal Service of not performing the specified task, i.e., the costs that the Postal Service would not incur if a customer did the work. While some have suggested that this should be always be done in a very mechanistic manner – the discount should be set exactly equal to 5 cents if exactly 5 cents in Postal Service costs are avoided – we believe that other business and market-place realities may merit consideration in some instances. In setting any price, including workshare discounts, a business-like organization must consider the effect of the price changes on its customers, the implicit signals it sends the broader industry about the value of the underlying product or service, and the long-term commitments that the organization has made to other stakeholders.

Worksharing Within the Context of Postal Pricing

The Postal Service's pricing approach recognizes the financial impact of postal rates on our customers and the economy. Worksharing provides a very important mechanism to keep mail affordable for our customers. However, not all customers choose to participate in the worksharing program, and it would make little sense to require all customers to do so. Options must continue to exist for household and small-volume commercial mailers who need a comprehensive end-to-end service and for those mailers who would like to use less standard, mailpiece designs. While the worksharing program offers customers choices, allowing them to opt for more standardized, automation-compatible mail preparation if it is cost effective – we do not envision a mail

service which offers no alternatives to a rigidly specified or uniform mailpiece design. Hand-in-hand with offering incentives for worksharing is the need to recognize that some customers consider innovative, less uniform, mailpieces as a desirable alternative for their messages. Forcing customers to fit one mold will only serve to reduce the value of the mail and to encourage a movement to non-mail alternatives.

Therefore, in developing prices and products, we consider our customers' interests and have worked to maintain existing and to develop new opportunities for customers whose mail does not necessarily meet the criteria of the automation letter mail program. In pricing less automation-compatible mail pieces, the Postal Service recognizes both the costs of processing and handling those pieces as well as the value of providing these services. One example is the recent request for a Postal Rate Commission recommendation for a new Customized MarketMail™ classification allowing nonrectangular, Standard Mail pieces to be entered at the destination post office. This will provide a new opportunity for direct marketers to reach their customers. In developing new products and services, we use many of the business tools used by any service provider. For example, the Postal Service has a market research program that evaluates new product concepts and informs our decisions to proceed with new products and services.

Existing Process

While our pricing and product decisions must have a basis in the needs of our customers, unlike private sector businesses, the Postal Service must also incorporate public policy goals into the pricing of its products and services. Some of these goals are statutorily imposed; others have evolved through the regulatory process and statutory interpretation. All affect the pricing decisions that we make. The most fundamental restriction on the Postal Service's ability to price its products is the statutory review of pricing by the Postal Rate Commission. As has been described elsewhere, this process can take up to ten months of litigation before the Postal Rate Commission (as well as several months to prepare the filing) and must be used for any price or product change regardless of its magnitude. While the Postal Rate Commission does expedite review of smaller pricing and product requests, the statutory restrictions result in some very unbusiness-like restrictions on pricing.

Limitations

The current statutory regulations impose significant limitations on the Postal Service's pricing flexibility. First, even small changes in product pricing cannot be implemented without Postal Rate Commission review. For example, as Chief Marketing Officer, I cannot authorize a "sale" on a product without requesting a PRC recommended decision even if resources are idle and the resulting new mail would contribute to the institutional costs of the Postal Service. This is a decision that, in other organizations, could be routinely made by product

managers. In fact, before the Postal Service can make even the most trivial of changes in its products and services, the proposed changes are scrutinized by numerous parties including competitors, customers, and industry organizations. Second, the Postal Service cannot respond quickly and effectively if fundamental changes in market conditions occur, such as the recent increase in fuel prices. Third, the Postal Service cannot experiment with new product offerings without a Postal Rate Commission recommended decision. Test marketing, evaluating different pricing structures and reformulating product designs in response to customer reactions also cannot be undertaken without Postal Rate Commission review and recommendation of each proposed pricing or product structure. Lastly, the Postal Service cannot even discontinue offering a product without PRC review. In fact, it is often much easier to maintain a classification for a low-volume product and all the systems to support it than it is to litigate the elimination of the service. Because of this, the Postal Service kept a ZIP Plus 4 rate category and Special Delivery service well after they became obsolete. The financial break-even requirement forces an “all-or-nothing” approach to pricing making it difficult to fine-tune product lines. Any product change that may substantially affect the contribution of a single product – even if that effect is positive – is difficult to implement outside the parameters of an omnibus rate case. The ability to retain earnings would not only help the Postal Service address other financial goals (e.g., invest in infrastructure, reduce debt, fund unfunded liabilities), it will also give us the ability to develop smaller, beneficial product changes without having to re-examine the entire pricing structure.

While the Postal Rate Commission has been responsive to our need for expedited review of some minor product changes, these statutory restrictions impose significant rigidities on the evolution of new products and services and can stifle product innovation. One unique risk for the Postal Service is that we are unable to fine-tune new product offering as we learn more about the market place, thus failing to adjust to meet the market needs. The resources required to propose even the simplest product changes may result in decisions that potentially beneficial changes be delayed or not pursued.

“One-Size-Fits-All” Process

Fundamentally, the statutory pricing requirements do not distinguish between proposals that have a substantial impact on the Postal Service’s finances and proposals that have a much narrower scope. However, often narrower, targeted product offerings may serve as the tools to maintain the value of the mail. A re-evaluation of the necessity of regulatory review of every price or product change, no matter how minor, is long overdue. Provided the Postal Service continues to meet effectively its universal service mandate, price and product changes as necessary to meet business requirements should be permitted without prior review. This will not only permit us to better address our customers’ needs, it will also facilitate movement towards a longer term planning horizon both for the Postal Service and its customers. Today postal pricing is often an all-or-nothing proposition; small incremental changes in prices are not easily accomplished making it difficult to implement a gradual movement towards a desired objective. This, in turn, may result in the pricing policy of the Postal

Service lagging both the strategic and operational direction of the organization. The Postal Service can be most effectively managed if we are granted the pricing flexibility necessary to implement fully a comprehensive strategic direction.

Impediments for Customized Arrangements

Over time, the Postal Service has moved to be a more responsive, customer-service-oriented organization. This process has recognized that our customers' needs must be met if the Postal Service is to continue as a viable institution. Negotiated service agreements are one customer-responsive pricing tool that has been discussed for years within the Postal Service and the larger mailing community. However, one factor inhibiting the movement towards customer-specific contracts has been the exhaustive review necessary under the current statutory requirements. Months ago, the Postal Service requested that the Postal Rate Commission recommend the first negotiated service agreement (with Capital One, one of our largest customers). To date, our experience with this proposal has demonstrated that the length of the regulatory litigation process may hinder the significant implementation of mutually beneficial, customer-specific pricing initiatives. While other mutually beneficial opportunities for customer-specific pricing likely exist, each such potential agreement must be separately reviewed and this is likely to limit the Postal Service's ability to pursue many opportunities. Even if a potential agreement clearly provides benefits to the participating customer and the Postal Service, and reduces the contribution to overhead costs required from nonparticipating customers, the litigation burden imposed by the current pricing mechanism may well stifle future development of

negotiated service agreements. Several customers have indicated that they are unwilling to discuss potentially beneficial pricing innovations because, for example, of the time lags inherent in Postal Service's attaining approval to offer customer-specific rates and the intense scrutiny and litigation expenses that relatively minor improvements necessitate. Many customers are also unwilling to subject themselves and their plans to the Postal Rate Commission's wide-ranging discovery process. A customer-responsive organization needs to be able to address its customers' needs in real time; under the Postal Service current regulatory structure this is not possible. After-the-fact review of the terms and conditions of customer-specific agreements would enable the benefits of these agreements to be captured as quickly as possible while ensuring that appropriate safeguards exist.

Social Policy Considerations

The Postal Service faces other unique pricing and product restrictions that are not typically found in the private sector. For example, the law specifies pricing formulas for nonprofit mail; requires the Postal Service to recognize "educational, cultural, scientific and informational value" particularly as it pertains to magazines, newspapers, newsletters, and books; and mandates the provision of some services under specified pricing rules. These requirements are based on public policy goals and result in lower rates for specified mail classes which must be funded through the general rate structure. While the Postal Service does not dispute the contributions of these customers to society as a whole, the end result is that these rate preferences are not free.

Conclusion

Increased pricing flexibility is fundamental to ensuring a financially sound Postal Service capable of providing for the affordable transmission of the nation's correspondence, business communications, merchandise and financial transactions.

Simply stated the Postal Service needs flexibility, the ability to retain earnings and an after-the-fact review process.

Flexibility – The Postal Service needs the ability to fashion mutually beneficial arrangements that are customized to meet the individual needs of its customers without having a substantial regulatory proceeding for each and every arrangement.

Retained Earnings – The Postal Service needs to the ability to retain some earnings. These funds would used to invest in its infrastructure to insure that the needs of the mailing community and the general public are met in the future, to reduce debt, smooth price changes, and focus on the long-term in developing its pricing and product strategies.

After-the-Fact Review – The Postal Service needs a modern pricing system that permits it to respond the realities of the market place and its own operating environment. The Postal Service now faces a year and a half process and severe limits placed on the ability to manage its prices and product offerings.

This lengthy cumbersome process only serves to stand in the way of a pricing strategy that utilizes more customized approaches on a real-time basis.