

**Testimony of
RR Donnelley**

**John C. Campanelli
President
RR Donnelley Logistics**

Before

**The President's Commission
on the
United States Postal Service**

**Concerning
Partnership Opportunities for the Outsourcing
of Mail Processing Activities**

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R.R. Donnelley believes in the mission of the United States Postal Service and wants to promote and support changes necessary to ensure the continued health and viability of the USPS well into the 21st century. R.R. Donnelley's business relationship with the USPS goes back to at least 1895, when we started producing and mailing mail order catalogs for Montgomery Ward. This year, R.R. Donnelley will directly pay \$300 million in postage, and will tender \$3 billion of mail to the USPS on behalf of our customers.

You have already heard that the mailing industry is a \$900 billion industry employing 9 million US citizens. If we then think about the role the USPS plays in supporting the mailing public, these figures imply that the USPS makes up less than 10% of the mailing industry. That 10% share includes both upstream processing and transportation functions, which can be outsourced, and the Postal Service's unrivaled delivery capability ...which cannot.

It is evident that the real strength of the postal service, where they have developed significant economies, brand equity and public favor, is in the first and last miles of delivery – bringing hard copy communication and merchandise to and from the home, and small business. This is the competitive strength of the USPS, and any good business leverages their strengths and does not make them easy to replicate. There is a reason why no other service goes to over 100 million addresses 6 days a week. It is hard to do. Maintaining and extending this unique asset is paramount to the Postal Service and mailing industry's success in the future. Daily delivery to and from the home and small business – that's the USPS' strength.

Much of everything else the Postal Service does can be done more effectively by the private sector. Since I have only 10 minutes, I will focus on three areas:

- **Expanding worksharing:** Current worksharing programs are designed to selectively drive mail volume past some of the upstream postal processes and entry points with the mailer taking responsibility for more of the preparation, sortation and transportation activities – and absorbing the associated costs. This concept works because the Postal Service passes on a portion of their savings to the mailer via a worksharing discount. The mailer does the work at a cost below the postal savings earned, and usually, takes time out of the process as well.

- **Consolidating upstream processing operations** : No discussion of worksharing can be considered complete without going on to explore the impact on the postal system that worksharing enables. Once upstream processing work is successfully transitioned to the mailer, realizing the full Cost Saving Potential of worksharing means having the courage to make the hard business decisions necessary to keep the postal system healthy and viable...specifically, redesigning the network to reflect only the work it now actually needs to perform.
- **Upgrading the information infrastructure** : Regardless of the rate of electronic diversion of postal volumes in the future, better utilization of information technology by the USPS is critical to keeping pace with the changing world.

To set the stage for a discussion on worksharing, it helps to take a look at the magnitude of costs we are talking about. Mr. Robert H. Cohen, Director, Office of Rates, Analysis and Planning for the Postal Rate Commission, has provided testimony that, the total cost savings associated with all worksharing activities in 1999 was \$15.3 billion – or nearly one quarter of the USPS total costs of \$62.2 billion. [See Robert H. Cohen, Testimony Before the President’s Commission on the Postal Service, February 20, 2003]. Further, if the Postal Service had had to perform all worksharing functions performed by the private sector during the 1999 time period, the USPS’ mail processing labor costs alone would have increased from \$14.7 to \$22.7 billion in 1999 with a workforce increase of 187,000 or 22%.

Updating these figures as a percent of today’s USPS cost brings the present value of worksharing to approximately \$17 billion. Since additional programs have been successfully implemented since 1999, the current value is likely even higher. For example, since implementing the Parcel Select work sharing rates, delivery unit entry of qualifying packages has increased from 6% in 1999 to 58% Y-T-D, shifting volume away from the costly Bulk Mail Centers.

Cohen goes on to outline the secondary effects that deeper discounts would have on upstream worksharing. Greater pass through of cost savings would allow mailers to recoup their costs in the worksharing effort, and encourage them to move a higher percentage of their mail in this manner. This would in turn decrease mail processing costs and decreasing the need for further capital investments for the Postal Service in the upstream processing network. Ultimately, it would also increase the Postal Service mail volume because the cost for delivery of each mail piece would be lower, allowing the mailing industry to increase its mail volume, overall.

Clearly, these are all highly desirable outcomes...but before these dynamics can be realized, the USPS must begin to do everything they can to take advantage of worksharing opportunities -- specifically:

- Taking systematic steps to fully realize all the cost savings
- Extending worksharing opportunities to more classes of mail
- Tracking & reporting cost savings for worksharing programs
- Passing through up to 100% of the savings

Why 100% of savings? Because one of the most significant benefits to moving mail volume downstream is the opportunity to consolidate underutilized upstream processing operations and facilities and the transportation between them. The USPS Network Integration Alignment Plan (NIA) attempts to do just that, by optimizing the processing and ground transportation network and consolidating facilities within the network, thereby reducing overhead and processing costs – while maintaining service standards. According to figures published in the USPS Transformation Plan, the Network Integration Alignment Plan (NIA) affects \$5.5 billion in transportation costs and approximately \$20 billion in processing and distribution costs. This is the expense associated with approximately 500 upstream processing facilities, a part of the USPS less visible to the public.

More specifically, according to the Summary of Attributable Costs; R2001-1 PRC Distribution of Attributable Cost to Classes and Services Test Year/PRC Recommended Rates, attributable upstream costs in FY 2001 still exceeded \$23.7 billion – nearly 35% of the Postal Service's total cost for FY 2001, and 52% of total attributable cost.

In a previously submitted document, I presented a high level analysis of how these operating expenses could be reduced by an estimated 25% (\$6 billion) through focused productivity initiatives, network optimization and strategic facility consolidation. What I did not say in that paper, was that in 2000, R.R. Donnelley was faced with competitive and market challenges that dictated we commence initiatives to reduce our cost structure 25% by 2005. We are well over halfway to our goal at this time.

However, I do not think it is the mission of the Commission to detail how to get specific operating costs out. Rather, I believe your mission is to help create the vision and strategic direction for how the Postal Service should operate in the future. Further, I believe the USPS already has a roadmap of how to get this level of cost out of upstream processing via its NIA initiative. I encourage the commission to request a full report on the NIA initiative.

There is a paradigm shift that the USPS, the mailing industry, Congress and labor must undergo with respect to the design of the postal network. In a dynamic marketplace such as we have in the United States, the postal network cannot be fixed or static, but rather must be fluid and flexible, in order to meet the changing needs of a shifting population with changing mail volumes, mail mix, and technological capabilities. It should not require a Presidential Commission, or an Act of Congress, to realign and optimize the upstream processing network of the USPS; rather, this should be done routinely, as part of the normal course of business.

So what stands in the way of completing this mission? Certainly the USPS has labor contracts in place that we fully realize must be dealt with, and we believe employees should be treated equitably. In the most recent APWU contract, provisions were made to provide more early retirement opportunities, and the USPS is working with the Office of Personnel Management (OPM) to determine how to enable these retirements.

In industry, we would have a restructuring plan that addresses the human side of network realignment, covering severance cost as well as facility shutdown costs. If reform occasions a displacement of employment, the restructuring plan must include measures to mitigate the impact that such changes may have upon the organization and its employees. By engaging the labor unions and addressing these issues, an equitable plan could be brought to Congress. A well executed restructuring will dramatically reduce operating cost, help standardize remaining facilities and reduce future capital investment, just as it does in private industry.

One of the most significant actions the Commission can undertake is to establish a more traditional governance structure for the USPS that follows the "Best Practices" private sector governance model currently being endorsed and promoted by the NYSE and Sarbanes-Oxley. A practical application of best business practices means holding leadership accountable for sound business strategies that will enhance and maximize the Postal Service's ability to serve the needs of their customers, both the mailing public and the mailing industry. To achieve this, the USPS Board of Directors must be composed of credentialed and experienced leaders that add strategic and operational value to fulfilling this mission. That means Directors who have meaningful experience in both the public and private sector, and understand the tensions between them. America is a dynamic country and the Postal Service's governing charter should enable, rather than constrain, the Service to be flexible and responsive to its customers' needs now and in the future.

The final area I will cover, where advantageous strategic partnerships could be developed, is in information systems and information technology. Today, logistics powerhouses are world class at moving physical product and information. Along with upgrading the physical infrastructure, the USPS should be upgrading the

information infrastructure. Better systems and information can have a significant impact on the efficiency and reliability of postal operations and achieve the data integrity necessary to drive better costing and measurement within the USPS. For example, one of the problems encountered by the NIA project team was securing accurate postal volume and flow information to use for modeling.

The USPS has generally lagged industry and competitors in tracking and serving up information for both internal productivity applications and external customer applications. The Postal Service behaves in a reactive manner – reactive to competitors and industry proddings. A complete outsourcing of the USPS information technology functions should be studied. The strategic impact of information technology will only continue to increase. Just as the USPS improved their patchwork airlift network by partnering with FedEx, the USPS could close the information gap much quicker via a strategic outsourcing relationship.

In summary, the Postal Service should be commended for the successful worksharing partnerships that have been created to date, and for saving billions of dollars of variable cost each year. However, to fully capture the benefits of worksharing and automation, it's time to attack structural costs to achieve the highest degree of combined operating efficiency possible.

R.R. Donnelley appreciates the opportunity to participate in the proceedings of this Commission.

About R.R. Donnelley

R.R. Donnelley (www.rrdonnelley.com) prepares, produces and delivers integrated communications across multiple channels for content owners such as publishers, merchandisers, and telecommunications companies as well as capital markets and diversified financial services companies. As a single source supplying services up and down the communications value chain, the company excels in digital photography, content management, printing, online services, and print and package logistics. With these integrated services, R.R. Donnelley provides effective solutions for its customers' targeted communications and delivery needs. Headquartered in Chicago, Ill., R.R. Donnelley serves a global customer market and has 30,000 employees in more than 200 locations in North America, South America, Europe and the Asia/Pacific Basin.

About R.R. Donnelley Logistics

R.R. Donnelley Logistics, a business of R.R. Donnelley, provides logistics solutions for a wide range of industries, including leading catalogers, e-retailers, publishers, financial services firms and pharmaceutical companies. As a leader in postal logistics, the company annually directs more than 19 billion print and mail pieces and 160 million packages to homes across the nation. R.R. Donnelley Logistics delivers predictable, on-time, cost saving business solutions leveraging its nationwide network of sortation facilities, expedited delivery capabilities and advanced technology systems. For more information about R.R. Donnelley Logistics, contact the company at www.donnelleylogistics.com.