Dr. Michael J. Riley's Testimony Before the Committee on Oversight and Government Reform

June 14, 2010

Mr. Chairman and members of the Committee, thank you for inviting me to testify, and thank you for holding these hearings on the future of the United States Postal Service.

From 1993 to 1998, I served as Senior Vice President and Chief Financial Officer (CFO) of the Postal Service. Those five years of service gave me knowledge and insight that I hope will be useful to you as you consider the future of the Postal Service. I am a Professor of Business and Executive Programs at the University of Maryland University College, and I also have my own consulting company. In addition, I serve on the board of directors of Church Mutual Insurance Company and as chairman of its audit committee. I served as chairman of the audit committee of the Architect of the Capitol from 2003 to March 2010. My experience also includes service as CFO of Lee Enterprises, CFO of United Airlines, and Treasurer of Michigan Bell Telephone Company. I have appended my resume to this testimony for your reference.

I am providing this testimony because I care about the Postal Service as an institution, I care about postal employees, and I care about postal customers. We are here because the current strategy of the Postal Service has failed. Put another way, the changed business model has not served the Postal Service well.

In 2003, I provided testimony to the President's Commission on the United States Postal Service and described the strategy adopted by the Board of Governors of the Postal Service under Postmaster General Marvin Runyon in the early 1990s. There were nine successful strategies and tactics that worked. They can work again. Adopting these or similar strategies can allow the Postal Service to achieve long-term success. A copy of this testimony is attached as an appendix.

Questions:

What will the mail market look like over the next five, 10, and 20 years? If significant changes are expected, what is the appropriate response to these changes?

The mail market will not change significantly. However, the Postal Service needs to capture more of the available market. Therefore, Postal strategy will largely determine if volume declines substantially or recovers and grows. In my opinion, the Postal Service should become the deliverer of choice for parcels, letter mail and advertising mail sent to residences. This will require improvements in parcel service and Priority Mail, as well as certified, registered, and Express Mail.

The future has many possibilities and no one forecast can be accurate. I would much prefer that the Postal Service make plans to succeed rather than to issue dire forecasts. Confucius, Henry Ford, and Will Smith have all said: "If you think you can, you are right. If you think you can't you are right." I would like to see a Postal Service that thinks it can.

Over the course of my career, I have seen many grossly inaccurate forecasts of the future from major consulting firms. In 1980 one such forecast was that the price of oil would be $200 per barrel in 1990. At the Postal Service, another firm forecasted $10 billion in international revenue within 5 years. Both were far from the mark. I think of the forecast of the $238 billion loss over ten years as a similar grossly inaccurate prediction.

Is the current postal regulatory regime suitable to the needs and challenges of the Postal Service and its customers? Is the price cap appropriate for the Postal Service, and is CPI-U the appropriate standard to use in constructing the cap.

Yes, the current postal regulatory regime is suitable, the price cap is appropriate, and CPI-U is acceptable. It would be better to structure the postal Service along the lines of a mutual savings and loan institution or a mutual insurance company, but the current regulatory regime can work in this environment.

As long as the Postal Service has the ability to raise prices through a rate case in addition to the price cap, I see no harm in maintaining the cap. CPI-U is a widely used measure of inflation and easily understood. I would favor continuing this measure and have used it myself on numerous occasions. In a related concept, the Postal Service would be better served with explicit requirements to earn a surplus much like a mutual savings and loan institution or mutual insurance company.

It may be useful to review history in this regard. The price of a first class stamp has risen slightly less than inflation during the period from 1972 to the present. In 1972, Postal revenue was $9.4 billion and this consisted of $1.4 billion in appropriations and $7.9 billion in mail revenue. Approximately 15% of the budget came from taxpayers. Since then the Postal Service has been able to eliminate any meaningful subsidy and keep price increases below inflation. Mail volume grew from 89 billion pieces to 213 billion at the peak and 177 billion today.

There has been significant electronic diversion over the same period with the fax, e-mail, cell phones, text messaging and internet bill paying. Keeping the price increase at or below inflation has not protected mail volume. Mail volume depends upon the health of the economy and is a leading indicator of economic activity. Recent volume declines are unrelated to the prices. Only an end to the recession promises to restore volume. Despite the very large increases in productivity of the past decade, there is no significant change in the inflation-adjusted price of the first class postage stamp.

If the cuts in service recently proposed by the Postal Service are not accepted by policy makers, what is the proper approach to dealing with revenue shortfalls? What happens if rates are increased to make up for the shortfalls? Is it time to consider an explicit subsidy for postal universal service?

Cuts in service should not be accepted by policy makers. Instead, Congress should permanently repeal the requirement to fund retiree health care costs in advance. The Postal Service should be treated the same as all businesses. This will reduce the amount of the needed price increase and should eliminate the need for a direct subsidy for universal service.

Rates should be increased. If rates are increased and all else is equal, then volume will decline slightly. The improving U. S. economy will increase mail volume and I would expect this will offset the effects of a price increase.

I do not recommend a subsidy. In past, Congress has not fully funded subsidies and I would prefer that the Postal Service obtain its funding from its customers.

It appears that the Postal Service is considering a rate increase. I will hope that it does implement such an increase. This would be an ideal time to begin to reduce discounts. To the extent possible, large rate increases over 10% should be avoided or phased in over time. Long term, the Postal Service needs to attract more profitable revenue utilizing some of its competitive advantages. It has the advantage of mail fraud laws, the Postal Inspection Service, Saturday delivery, Express Mail Sunday delivery, and a work force that has personal relationships with many of its customers. It is widely respected and trusted. U. S. Mail is safe.

What is the proper size and scope of the Postal Service?

I would suggest that the appropriate size and shape of the Postal Service be determined by customers and their choices.

The size and scope are not the problem, the strategy is. The Postal Service has had the mission to bind the country together and provide universal service. For over 200 years it has been the largest postal service in the world with wide spread admiration. It is an American treasure that belongs to the people of the country. I would like to see this continue and for the Postal Service to prosper.

Who are the appropriate bodies to make decisions on the scope and shape of the Postal Service? Should Congress seek outside expertise, such as a commission? If so, how should the commission be composed and what is the appropriate mandate for the commission?

Congress is the proper body to make decisions on the scope and shape of the Postal Service. Congress should not appoint a commission. In 2003, the President's Commission on the Postal Service brought together experts and studied the situation. The Commission made its recommendation and Congress held hearings. In 2006, the Postal Accountability and Enhancement Act was signed into law. The result has not been a dramatic change for the better.

Recommendations:

In addition to the questions raised by the Committee, I have four recommendations:

1. Congress should stick to the requirement, already in law, that postal work-share discounts may not exceed the costs that the work-sharing activity saves the Postal Service. Indeed, the recent actions by the Postal Service that violate the standard are misguided and are damaging the institution by depriving it of much needed revenue and, more importantly, money needed to cover fixed costs. Efforts by the Postal Service and large mailers to separate work-shared mail from other First Class letter mail in order to increase their work-share discounts should be rejected. Further, I recommend that the Postal Service move toward a situation in which cost savings are shared between the mailer and the Postal Service.

2. Congress should retain the requirement to provide universal service six days per week. The Postal Service's proposal to largely eliminate Saturday delivery is a strategic blunder. It is a miscalculation of the likely adverse reaction by the ultimate customer, the individual receiving the mail.   This proposal will exacerbate the trend toward electronic substitution for the mail. The

Postal Service should be increasing and improving the services it, not reducing them. The Postal Service is, quite literally, selling itself short. That strategy could prove to be the blow that may destroy any hope for future financial viability.

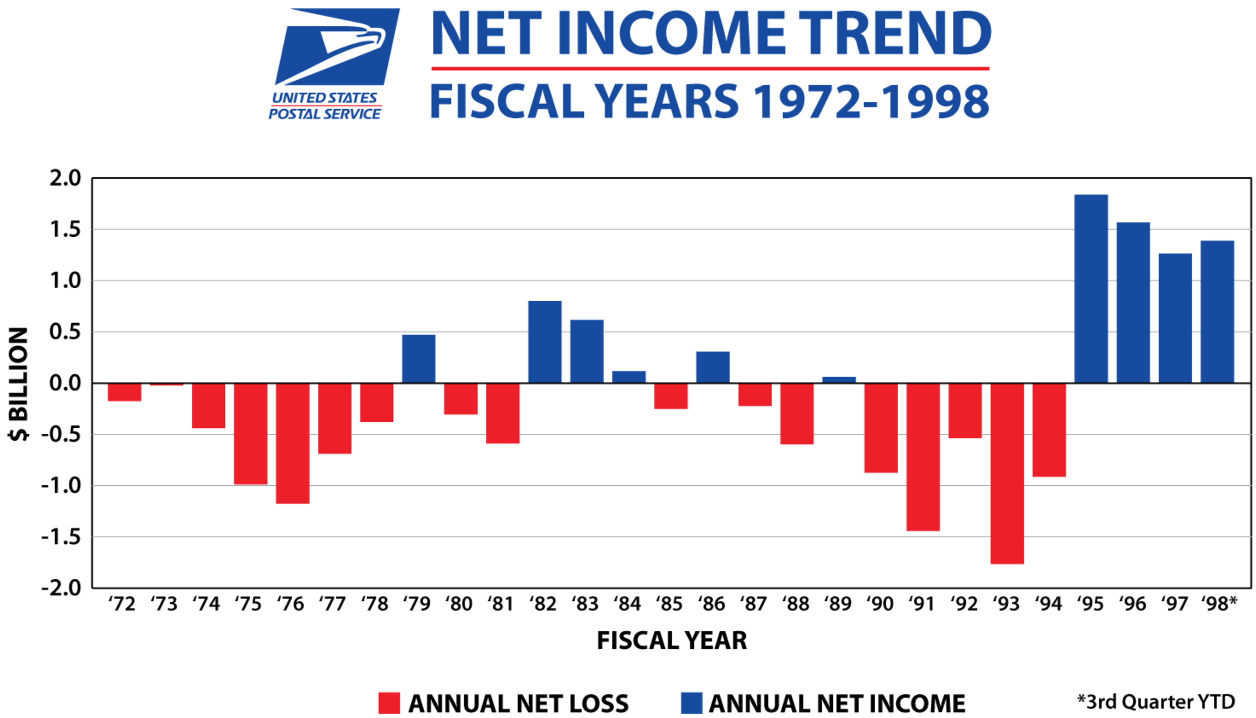
3. Congress should permanently repeal the requirement for advance funding of retiree health benefits. In my opinion, that Postal Accountability and Enhancement Act of 2006 came during an unjustified euphoria over the profits of the Postal Service during the mid-2000s. This net income was largely due to the result of adjusting the charges for retiree pensions to a sound accrual basis and as a result of the increase in mail volume to 213 billion pieces, partially due to the real estate bubble. Many thought that the Postal Accountability and Enhancement Act of 2006 would solve postal problems for 100 years.

The Postal Service should operate in the same way as other large employers in providing retiree health benefits. Typically, companies pay for retiree health benefits as the costs are incurred, rather than paying them in advance as the Postal Service is required to do.

4. It is my recommendation that the Postal Service should be structured similar to a mutual savings and loan institution or mutual insurance company. This would allow the Postal Service to accumulate profits as surplus to provide cash for new vehicles, equipment, buildings, new products and services, and to have a cushion to weather economic downturns. It would also provide the right signals and incentives to top management and the Board of Governors. Unfortunately, the "break-even requirement" has become part of the postal culture. The failure to appreciate the need for profits is, in my opinion, a major reason for the inability of senior management and the Board of Governors to recognize that the current strategy and tactics are bumbling at best. This "break-even" mindset has led to significantly increased costs for major mailers, a misguided incentive system, and an excessive focus on discounts instead of service improvements. It leaves the Postal Service vulnerable to a very severe recession, such as the one we're in.

Background

At the end of the 3rd quarter of fiscal year 1998, the Postal Service reported a year-to-date profit of $1.4 billion, along with improved customer satisfaction and higher employee morale. Four years of billion dollar profits had allowed the Postal Service to pay off $4 billion in debt as well as to triple capital spending. A graph showing the financial history of the Postal Service through the 3rd quarter of fiscal year 1998 is provided below.



As is shown above, the profits from financial year 1995 through 3rd quarter 1998 totaled $6 billion. These profits were used as capital to build post offices in new communities and to make major investments in equipment that improved accuracy and reduced costs. Despite a ten-year explosion of Internet use, mail volume rose nicely and the Postal Service was able to maintain the 32-cent price of stamps for four consecutive years.

The strategy was based on the Balanced Scorecard Model with equal emphasis on the customer, the employee, and the financial viability of the Postal Service. There was recognition that convenience, courtesy, safety, security of the mail, trust, consistency, and price were essential parts of the value mix. The primary customer was the individual. It was and is the preference and the response of the individual to mailings that drives mail volume. E-mail and electronic bill paying generally have no cost per use and, therefore, are the lowest cost choice for consumers and business. Nevertheless, people continue to send mail for a variety of reasons. It follows that the price of postage will not impede people and businesses from using the mail as they already have a free alternative.

New Management and Strategy

There was a management change at the end of the 3rd quarter of 1998. Many in the mailing community expressed their feelings that the Postal Service was earning too much money and that the profits were excessive. New management promised to solve that problem, and solve it they did. Billion dollar profits were replaced by billion dollar losses.

Instead of emphasizing the value of its products and prioritizing revenue protection, management focused on cost reduction—not just through further automation and streamlining of postal networks, but through cuts in service. This strategy seems to have hit rock bottom with the proposal to eliminate Saturday delivery and close facilities needed to provide universal service.

This counterproductive shift in strategy was, ironically, made possible by the financial success of the Postal Service in the 1990s. New management changed the business strategy to one that focused solely on productivity and discounts, rather than on the total value mix outlined above. Management began to view the primary customer as the representative of the large mailer instead of seeing the primary customer as the individual consumer. The representatives of large mailers focus on obtaining discounts for their clients and /or converting first class mail to less expensive categories of mail.

The apparent goal of the Postal Service was to grow volume and restrain or eliminate price increases. Neither goal was achieved.

Discounts

The Postal Service said that if prices were cut, volume would increase. This was generally true, but deceptive. Some of the services had price inelastic demand. As an example, if the Postal Service cut prices by 10% for a large mailer and achieved a 2% increase in volume, revenues would drop by 8%. Clearly, this was a financial problem.

Even if revenue increased slightly, as is the case with elastic demand, the effect would be negative on money to cover fixed costs and profits, and it would speed up the need for a rate increase. To illustrate, consider a $1 billion service with a 25% contribution margin. This means that direct costs would be $750 million and contribution, money to cover fixed costs, would be $250 million.

Now, consider what would happen if the Postal Service cut price by 10% and revenue dropped to $900 million. If volume increases 15%, revenue now becomes $1,035 million ($900 million x 1.15 = $1,035 million). The fact that revenue increases with a price cut does not mean that this price cut is beneficial.

A 15% increase in volume also means that costs go up 15% to $863 million. What appears to be a situation that leaves the Postal Service better off by the 3.5% increase in revenue actually hurts the financial condition dramatically. Contribution falls by 31% despite the revenue increase. Because costs rise to $863 million, the Postal Service has $78 million less cash to cover fixed costs. The table below shows this effect.

UNITED STATES POSTAL SERVICE

THE EFFECT OF PRICE CUTTING: FINANCIAL DISTRESS

	Original Case	10% Price Cut	15% Volume Increase	Difference
Revenue	$1, 000	$900	$1,035	+$35
Attributable Costs	$750	$750	$863	($113)
Contribution	$250	$150	$172	($78)

When a mailer can sort mail in the computer, the Postal Service saves costs. We should expect the Postal Service to share the benefit with the mailer through work-share discounts. But, rather than share the benefits equally between the Postal Service and the mailer, work-share discounts grew to give away all of the savings and more, too. The initial result was slightly more mail and substantially less contribution to cover fixed costs. Of course, with the recession, mail volume is now down by a very large amount.

Saturday Delivery

The Postal Service has projected great cost savings from the elimination of Saturday delivery. It assumes that this will have no effect on revenue and that is naïve. It is one strong signal to customers that the Postal Service is slowly going out of business. If only 10% of customers give up on the Postal Service and convert to electronic bill paying, that will offset any projected savings.

By far, the most important reason to retain Saturday delivery is strategic. The elimination of Saturday delivery is in direct opposition to the idea of the individual as the primary customer. Successful businesses find ways to appeal to various segments of their customer base. At best, many customers will not care about the elimination of Saturday delivery, while many will certainly be distressed. Customers who respond to a survey may well think differently when faced with the reality. I believe that marketing experts can find ways to leverage this competitive advantage to achieve large increases in profitable volume. It would be a shame to lose the advantage of Saturday delivery simply because current management is focused on cost cutting and discounts rather than on creating value for the customer. Anyone who has ever waited for a check or for medication by mail and had it arrive on Saturday before a long weekend can appreciate this benefit.

Elimination of Saturday delivery is a step that will not be easily reversed. And the following promise is one of failure. “Eliminate Saturday delivery and ‘only’ lose $115 billion over the next 10 years.” This is hardly a rallying cry for success.

Saturday delivery can be a major competitive advantage with the right strategy. Successful service businesses choose to retain and increase weekend service. The Postal Service should do the same.

Today

After 12 years, the price of a stamp is 12 cents higher than in 1998 and mail volume is lower. Instead of billion dollar profits, the Postal Service needed an emergency $4 billion bailout from Congress last September and still lost $3.8 billion in 2009. There is no money for capital and anecdotes abound about dissatisfied customers.

In June 1998, the Consumer Price Index stood at 163.0. It increased to 217.6 in March 2010, an increase of 33.5%. The price of a first class stamp is 37.5% higher than it was in June 1998. Despite increasing the price of the stamp to the public, the Postal Service has gone from a strong financial position to one of financial disaster.

There are 2 small positive innovations in an otherwise bleak outlook.

The Forever Stamp is a customer convenience and likely produces savings enough to cover the costs. It costs the Postal Service about 1 cent to create, print, and distribute a new 1-cent stamp.

This means that there is no net loss by allowing customers to use the forever stamp. Customers tend to misplace and lose some percentage of their stamps and the Postal service earns a return on their funds paid in advance of need. So, the Postal Service can provide a convenience that customers like and added value without cost.

The new advertising campaign, “If it fits, it ships,” focuses on value, not discounts. The customers like getting “free” boxes and enjoy the convenience of not having to weigh the package to figure out postage.

Surpluses allow Cash for Opportunity

There are numerous opportunities for improvement to delight customers and thereby increase mail volume. Unfortunately, the Postal Service lacks the money to implement these initiatives in its current state. The following is a short list of examples:

- Advertise 7 day-a-week delivery of Express Mail.
- Open a window at mail processing facilities for 24 hour, 7 day a week mailing similar to what used to be the case at National and Dulles airports.
- Use the Internet and password protected communications to allow retired individuals to direct their mail to multiple locations while away from home. This is a variation of the current “Snow Bird” mail service.
- Advertise the current “Snow Bird” mail service. The $15, once a week, Priority Mail Forwarding program, earns the Postal Service $60 in revenue per month for a service that costs less than the current free mail forwarding program. In fact, this service should be expanded to offer the service for 2 or 3 days each week if desired.
- Return to the 5-minute line wait policy. Last Christmas, I turned around from my local Post Office with an hour wait and mailed my presents at the UPS store. The wait there was 10 minutes.
- Open high-volume, high-service locations for the mailing public with very friendly employees. Merrifield, VA has such a location. It has been open 7 days a week and has been open as late as 10 PM.
- Use direct mail advertising to inform customers about such locations. Direct mail advertising works very well. The Postal Service should try it for its own advertising.
- Improve the speed and reliability of mail other than First Class. Certified mail is not reliable nor is it fast.
- Provide locked package lockers to individuals to allow secure package delivery while the customer is away from home during the work day.

It should be noted that this list is far from exhaustive and focuses on the individual as the primary customer.

Tomorrow

The Postal Service needs a business strategy that works. It needs to increase profitable revenue to provide capital for replacement equipment, vehicles, and new or improved services that will delight customers. With a different focus, long-term success is possible. Indeed, with the right focus, success is highly likely. In my 2003 testimony to the Presidential Commission on the Postal Service, I showed a strategy that has worked and can work again. I believe that within the Postal Service, there are dedicated employees who have other thoughts on how to make lasting improvement to bring long-term success. There are different roads that can lead to Postal Service prosperity. The current road is not one of them.

Summary

Congress can help. It can keep the requirement already in law that postal work-share discounts may not exceed the costs that the work-sharing activity saves the Postal Service. It can mandate the continuance of Saturday delivery. It can amend the Postal Accountability and Enhancement Act of 2006 to eliminate the pre-funding of health care costs and thus put the Postal Service on par with other large companies. It would be very helpful to also recognize the need for a surplus created by profits along the lines of a mutual company.

Thank you,

Michael J. Riley, DBA

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EDUCATION

Doctor of Business Administration, **HARVARD UNIVERSITY, Boston, MA.** **1977**
Special Field – Financial Institutions and Markets.
Thesis – A Study of Now Account Strategies.

MBA, UNIVERSITY of SOUTHERN CALIFORNIA, Los Angeles, CA. **1972**
Area of Emphasis – Finance.

BS, **UNITED STATES NAVAL ACADEMY, Annapolis, MD.** **1965**

PROFESSIONAL EXPERIENCE

UNIVERSITY OF MARYLAND UNIVERSITY COLLEGE **2003 - Present**
Professor MBA and Executive Program
Teach MBAs and Executive MBAs Finance, Accounting, Marketing, and Strategy
Assistant Dean, Business and Management
Managed all Undergraduate Business and Management Faculty.
Professor and Program Director, MBA and Executive Program
Managed Faculty and Taught MBAs and Executive MBAs Accounting and Finance.

RILEY ASSOCIATES, Venice, FL **2000 – Present**
Consulting areas of interest include strategy, tactics, incentives, prices, and control systems. Assignments have included acquisition, financial strategy, expert witnessing, interdepartmental partnering, and training. Clients included Auth-Florence Manufacturing Company; Systems and Electronics, Inc.; American Postal Workers Union, AFL-CIO; Federal Aviation Administration; Interbank Capital Partners; Northport Manufacturing Inc.; KPMG; Stern Stewart, Gerson Lehrman, and National Captioning Institute.

CUTLER MANUFACTURING CO., Lakeland, FL. **1999 – 2000**
In operation since 1883, it was the oldest manufacturer of mailboxes, mail chutes and related products.
CEO. 100 employees.

- Doubled labor productivity by cross training, job rotation, and employee involvement.
- Refocused engineering to reduce costs and improve security and appearance of products.
- Lowered breakeven by 1/3.
- Instituted marketing focus to solve customer problems.
- Increased market share in largest product line from 28% to 36%.

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UNITED STATES POSTAL SERVICE, Washington, DC. **1993 – 1998**

The eighth largest US Company with $62 billion in revenue and the largest business employer in the world with 823,000 employees.

Senior Vice President, Chief Financial Officer, Management Committee. 5700 on staff **.**

- Restored profitability: $6 billion from 1995 through the 3rd quarter of 1998. The 1995 increase in net income was the largest in the world. Previously, losses exceeded profits by $9 billion.
- Held expense growth under 4.7% for 4 years; saved approximately $1.5 billion per year.
- Freed $3 billion in idle cash to pay down debt.
- Negotiated with unions and presented economic case to arbitrators which resulted in contracts that saved over $ 4 billion compared to inflation and previous settlements.
- Cut interest expense from $765 to $328 million. Reduced debt from $9.9 to $5.9 billion.
- Won refunds from government of $500 million and reclaimed $500 million from vendors.
- Cut price increases from historical 15% - 33% to 10.3% in 1995 and 2.9% in 1999.
- Instituted an "EVA" incentive system that spurred breakthrough performance improvement.
- Expanded payment options to customers: credit and debit cards and ACH credits & debits.
- Instituted benchmarking for Finance and improved service with 37% fewer employees.
- Installed improved internal controls and saved $200 to $600 million per year.
- Led U. S. Postal Service delegation to the Universal Postal Union in Bern, Switzerland.
- Switched annual report to the "plain" language proposed as a requirement by the SEC.
- Improved morale significantly within the Finance Department.
- Began a Balanced Scorecard approach to performance evaluation.

LEE ENTERPRISES, Davenport, IA. **1987 – 1993**

An operator of newspapers, network television stations and a graphic arts manufacturing company. Lee had $300 million in revenue and was selected as one of "America's 100 Strongest Companies" by CFO Magazine. Lee is listed on the New York Stock Exchange and is in the top quarter in profitability.

Vice President – Finance, Treasurer and CFO. 10 on staff, reported to CEO.

- Saved $24 million in taxes through deductions of intangibles in acquisitions.
- Reduced state income and franchise taxes by $800,000 per year.
- Cut $500,000 per year in interest and $250,000 in fees by negotiation of $110 million debt issue.
- Purchased the daily newspaper in Rapid City, SD for $45 million.
- Negotiated a $100 million buy-out of Japanese partner's 50% share of a joint venture.
- Recommended and participated in strategic decision to offer weekly and free newspapers in cities with daily newspapers. The company started or acquired these businesses.
- Set up a program used by staff to acquire 26 small companies.
- Created an internal audit function.
- Began a program to hedge $20 million in foreign currency revenue.
- Funded the non-qualified retirement program using a Rabbi trust with five mutual funds.
- Assisted the CEO in the purchase of two television stations for $7 million.
- Started an investor relations program.
- Implemented new pricing for daily newspaper advertising, generating increased profit growth.
- Directed the redesign of bills to newspaper carriers, thereby improving controls, eliminating confusion, and decreasing write-offs.
- Raised morale in the department by largest amount as measured by company-wide climate surveys.

UNITED AIRLINES, Chicago, IL. **1985 – 1986**
A major international airline with revenue of $8 billion.
Senior Vice President - Finance and CFO, Senior Management Policy Committee.
Variously reported to UAL CFO, UAL CEO, and Airline CEO.

- Increased controls of ticket audits and saved $27 million per year.
- Used swaps to save $3 million per year in interest costs on debt.
- Saved $140 million in taxes through deductions of intangibles.
- Initiated the tracking, management and hedging of foreign currency exposure.
- Closed United's $750 million acquisition of Pan Am's Pacific routes.
- Negotiated the financial terms of a $6 billion airplane purchase.
- Priced and won an auction to buy Frontier Airlines for $150 million.
- Lowered fees by over 60% on an underwritten call of convertible preferred stock.

MICHIGAN BELL TELEPHONE COMPANY, Detroit, MI. **1983 – 1985**
A $4 billion telephone company serving most of Michigan with revenue of $2 billion. Return on equity rose from last to best among all 20 Bell Operating Companies in this period.
Treasurer. Reported to CFO.

- Raised profits by $25 million by reopening a popular wide-area calling rate.
- Added $25 million in profits by loosening credit standards for low-income consumers.
- Saved $13 million in interest per year and $7 million call premium by repurchases of debt. We were the first Bell Company and paid the lowest prices to buy back high coupon debt.
- Increased income by $2 million by using tax advantaged temporary cash investments.
- Set up a separate commercial paper issuance program.
- Justified company's 17% return on equity to regulators to retain profits for owners.
- Obtained credit rating upgrades from A3 to Aa2.
- Increased bank credit lines to $350 million without paying fees.

NORTHEAST UTILITIES, Berlin, CT. **1976 – 1983**
An electric and gas utility with revenue of $4 billion. Return on equity rose from 47th to 1st in profitability on the Fortune list of 50 largest electric utilities during this period.
Assistant Controller.

- Analyzed financing requirements and costs of two 1,150-megawatt nuclear power plants. Canceled both plants for economic reasons and limited write-off to $5 million.
- Led effort to improve rate cases to achieve needed price increases. Designed the initial "Attrition / Rate Year" concept used to generate additional cash and revenues of $14 million in '79, $36 million in '80 and $101 million in '81. Restored financial health.
- Initiated five additional rate case ideas that increased revenues, cash flows and profits by $5 to $40 million each.
- Initiated extensive use of charts, graphs and clearer footnotes in Annual Report. It was selected as "best" in the utility industry by Institutional Investor magazine.
- Installed an improved internal control system.
- Used time-sharing computer applications to reduce accounting department by 25%.
- Served as a member of the team that put together the company's first strategic plan.

TERADYNE, Boston, MA. **1972 – 1973**
A manufacturer of electronic test equipment.
Accountant.

- Performed all types of accounting and analytical tasks including tax returns, inventory, bad debt collections, currency exchange and international accounting.

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MILITARY

UNITED STATES NAVY. **1965 – 1970**
Naval Aviator, Survival School Instructor, Lieutenant

- Flew P - 2 aircraft in Vietnam and received the Air Medal.
- Supervised instructors and taught Survival, Evasion, Resistance and Escape (SERE) training in Rangeley, Maine to Naval and Marine Aviators and SEAL Teams.

AWARDS to U. S. Postal Service for Finance

- 1998 Alexander Hamilton Gold Award for Cash Management and Bronze Award for Corporate Finance.
- Selected as "Finalist" for 1996 Reach Award from CFO magazine for service improvement.
- 1996 Annual Report was chosen for Silver and Bronze awards by Financial World magazine.
- 1995 Alexander Hamilton Awards from Treasury and Risk Management magazine, Gold for Cash Management and Overall Best of all categories in February 1996. Personally featured on cover of March 1996 issue.

PUBLICATIONS

- "Centralized Mail Delivery" Web published on the official site of the Postal Regulatory Commission, February 2010.
- Chapter 7, "Global Finance", The Portable MBA in Finance and Accounting, 4th edition, John Wiley & Sons, Inc., New York, NY 2009
- Member Practitioner Demand Driven Academic Research Initiative (PDDARI) committee of the Financial Management Association. 2006- Present
- "Investing in Insurance Companies" Presentation to the Financial Planning and Analysis Corporate Roundtable at the Financial Management Association, Annual Meeting October, 2009.
- "The "Unimportance" of Productivity in a Service Company" Presentation to the Financial Planning and Analysis Corporate Roundtable at the Financial Management Association, Annual Meeting October, 2007
- "Restoring Value for MBA Students" Presentation to the Financial Planning and Analysis Corporate Roundtable at the Financial Management Association, Annual Meeting October, 2006
- "Pensions in Peril" The San Diego Union Tribune, February 19, 2006.
- "The Pension Problem" The Baltimore Sun, October 13, 2005.
- "The Challenge to the Presidential Commission" Web-published on the official web site of the President's Commission on the U. S. Postal Service, May 2003.
- "Audit Committee Red Flags" Director's Monthly April 2003.
- "The State of United" The Wall Street Journal, March 25, 2003.
- "Creative Destruction (Book Review)" Directors and Boards magazine, Summer 2001.
- "Report of the National Association of Corporate Directors Blue Ribbon Commission on Audit Committees: A practical Guide – 2000" sub-committee chairman.
- "Know your Customer" The Financial Executive magazine, January 1999.
- "Make Better Use of the CFO" Directors and Boards magazine, Winter (February) 1999.
- "The U. S. Postal Service's Dramatic Financial Overhaul – Using Private Sector Techniques" The Government Accountants Journal, Winter (December) 1998.
- "Profiles in Performance at the USPS" **EVA**ngelist, Autumn (November) 1998.
- "The Mail Man Cometh; Why you're no longer complaining about mail delivery" The Financial Executive magazine, June 1998.
- "Regulatory Lag: Everyone Loses" with R. Norgaard, Public Utilities Fortnightly, 1983.
- "The Connecticut Solution to Attrition" with H. K. Hobbs, Public Utilities Fortnightly, 1982.
- "Strategies for a NOW Account Environment" with D. B. Crane, The Bankers Magazine, 1979.
- NOW Accounts: Strategies for Financial Institutions with D. B. Crane, Lexington Books, 1978.

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TEACHING

UNIVERSITY OF MARYLAND UNIVERSITY COLLEGE **2003 – Present**
Professor: MBA and Executive Program
Taught Undergraduates, MBAs, and Executive MBAs Accounting, Finance, and Strategy.

GEORGE MASON UNIVERSITY, Fairfax, VA. **2001 – 2003**
Adjunct Professor
Taught Managerial Finance, Financial Management, Financial Policy, and Financial Institutions courses to MBAs and Undergraduates.

UNIVERSITY OF MICHIGAN, Dearborn, MI. **1984**
Adjunct Professor
Taught Introduction to Financial Management – one semester to evening MBAs.

UNIVERSITY OF CONNECTICUT, Hartford and Storrs, CT. **1977 – 1982**
Adjunct Professor
Introduction to Financial Management – taught 2 or 3 courses each year to MBAs.

BOSTON UNIVERSITY, Boston, MA. **1975 – 1976**
Lecturer
Introduction to Financial Management – taught 4 courses to Undergraduates and MBAs.

HARVARD UNIVERSITY, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, Boston, MA. **1973 – 1976**
Lecturer, Research Associate, Research Assistant
Taught Financial Cases Studies to small groups of Executives.

OTHER ACADEMIC

CAMBRIDGE REASERCH INSTITUTE, Cambridge, MA **1974 – 1976**
Research Assistant
Conducted research on Anti-Trust theory as applied to Cereal companies.

UNIVERSITY OF SOUTHERN CALIFORNIA, Los Angeles, CA. **1971 – 1972**
Office of Institutional Studies
Analyzed budgets for all Schools, recommended approach to eliminate deficits, and built consensus among Deans for funding guidelines that returned the University to a surplus.

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SERVICE

CHURCH MUTUAL INSURANCE COMPANY, Merrill WI **2003 – Present**
Member of Board of Directors, Chairman of Audit Committee

ARCHITECT OF THE CAPITAL, U. S. CONGRESS, Washington, DC **2003 – 2010**
Chairman, Audit Committee

GOVERNMENT PRINTING OFFICE, Washington, DC **2004 – 2007**
Member of Audit Committee

U. S. NAVAL ACADEMY ALUMNI ASSOCIATION, Annapolis, MD. **1999 – 2005**
Member of Joint Investment Committee

NATIONAL ASSOCIATION OF CORPORATE DIRCTORS **1998 - 2008**
NACD BLUE RIBBON COMMISION ON AUDIT COMMITTEES **1998 – 1999**
Member, Subcommittee Chairman

FINANCIAL EXECUTIVES INSTITUTE **1978 – Present**
Member of Committee on Government Liaison (1994 – 1999)
Director, Officer of Mississippi Valley Chapter (1987 – 1993)
Member of Membership Committee (1982-1989)
Director, Officer of Hartford Chapter (1980 – 1983)

INFRARED IDENTIFICATION, INC., Fairfax Station, VA **1999 - 2001**
Member, Board of Directors.

BRIVO, INC., Arlington, VA **2000 – 2001**
Member, Board of Directors

INTERGRATED TECHNOLOGIES INC. , Charleston, SC **1999 – 2003**
Board Member, Member of Advisory Committee

PUTNAM MUSEUM, Davenport, IA. **1978 – 1993**
Trustee, Chairman of Endowment Committee and Treasurer

FINANCIAL MANAGEMENT ASSOCIATION **1977 – Present**
Director (1983 – 1988)

GROUP HEALTH PLAN OF SOUTHEAST MICHIGAN, Detroit, MI **1983 – 1985**
Director, Member of Negotiating Committee
Assisted in the conversion to “For Profit” and sale of the organization to two large Detroit hospitals as the method of resolving numerous disputes between the three organizations.

MICHIGAN 4 H FOUNDATION. Lansing MI **1983 – 1985**
Trustee

The Challenge for the Presidential Commission

By

Michael J. Riley[1]

"The Commission's objective is to advise the President on the state of the United States Postal Service, prepare a report articulating a vision for the future of the United States Postal Service, and recommend the legislative and administrative steps necessary to enact reform needed to ensure the viability of postal services."

In fulfilling its mission the Commission should examine what happened to the U S Postal Service during the period 1993 through 1998. This was a period during which the Postal Service thrived financially and accomplished many of the objectives that now seem to be articulated for the future. It made sizeable profits. The Service reduced its debt significantly, and thereby was able to achieve debt levels well below its borrowing ceiling. Measures of customer satisfaction grew and were extremely high. Investment in plant and equipment rose while the accumulated deficit since postal reorganization declined significantly. Actions were taken to improve employee morale by eliminating problems.

The lesson should be learned that a change in the law is not required to permit the Postal Service to thrive and prosper.

Perhaps as the Commission explores this successful time period it can learn from it and recommend changes that will allow the same success to occur in the future. It can also take note that this success occurred with the existing legislation but with a significant departure in the mindset of the management team and eventually with the Board of Governors. Perhaps the Commission will also take note of some other key measures that currently fascinate many people and realize that these are the measures that caused significant harm to the Postal Service and resulted in poor service, inadequate facilities, and financial distress.

This paper is divided into 5 sections: I. Run it Like a Business, II. Good Results in the Mid-1990s, III. Nine Successful Strategies and Tactics, IV. Successful Strategies and Tactics Abandoned, V. Failed Policies and Counterproductive Claims, and VI. Recommendations. I believe that this Commission can confine its recommendations to merely administrative changes as legislative changes often become enmeshed in areas that change more than originally desired.

I offer these observations for the Commission's consideration so that it can fulfill its mission and ***"recommend the legislative and administrative steps necessary to enact reform needed to ensure the viability of postal services".*** That is the challenge.

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I. Run it Like a Business

The management of the Postal Service in the mid to late 1990's not only claimed to run it like a business -- the Postal Service, in fact, did run like a business. Financial business decisions were made with the longer term in mind and ultimately the Board of Governors adopted a policy that virtually assured financial health. Unfortunately, by the late 1990's those policies were abandoned and with them went the profits, the low level of debt, and the high customer satisfaction ratings. Interestingly at the same time that the Postal Service headed downhill, measures which had been erroneously used to measure progress such as Total Factor Productivity (TFP) once again began to rise, output per work hour again began to increase and the total number of employees began to decrease. Perhaps conventional wisdom regarding these measures as control objectives are WRONG and prudent planning for the future should learn from what has worked at the Postal Service in the past.

Because TFP measures only inputs and outputs, it does not deal with changes in service levels. In 1993, the gain in TFP was very high as service deteriorated dramatically. TFP does not reasonably allow for the time lag and learning curve of capital investments that require system changes. TFP is simply one measure out of many possible measures. A good business plan, not TFP, should drive business decisions.

There is no impediment in the current law to producing good results. The Postal Service can have profits, debt reduction, very high customer satisfaction among the people who receive mail, and strong and improving employee morale.

II. Good Results in the Mid-1990s

Commenting from the prospective of the Chief Financial Officer during most of Marvin Runyon's term as Postmaster General, I can attest to what is and was important. The record of the Postal Service under Mr. Runyon was outstanding: He turned losses into strong net incomes after just two years. The Postal Service reduced debt and undertook initiatives to improve productivity (not necessarily total factor productivity) through automation, to improve customer satisfaction, and to better manage employees.

The table below shows the results of these actions upon net income through the end of the third quarter of 1998 when Mr. Runyon stepped down as Postmaster General. Also, the full year 1998 is included. The difference of just one quarter indicates how quickly poor financial performance can drag down net income and adversely affect other key areas such as the level of debt:

Dollars in Billions

Year	Profit or (Loss)
1993	(1.8)
1994	(0.9)
1995	1.8
1996	1.6
1997	1.3
1998 YTD Q-3	1.4
1998	0.6

At the same time, debt was reduced dramatically:

Dollars in Billions

Year	Total Debt
1992	9.9
1993	9.7
1994	9.0
1995	7.3
1996	5.9
1997	5.9
1998	6.4

It should be noted that if the Postal Service had ended the year in 1998 with earnings of $1.4 billion, it would have further reduced debt to $5.6 billion.

The Postal Service accomplished this with a price increase of ten percent in January 1995, just 3 months into its fiscal year. It had been four years since the last price increase, which had been delayed too long. And, despite the size of the increase, it was well below inflation. One of the lessons learned is that delaying rate increases to gain mailer approval typically only causes later increases to be larger and less predictable. It also results in an increase in the size of accumulated losses and can often cause increased pressure for debt to be increased as well.

Mr. Runyon's objective was to run the Postal Service like a business. His recovery plan included an incentive system, debt reduction and restructuring, measuring and rewarding customer satisfaction, employee evaluation of their management, and strong controls. His overall first priority was profits.

III. Nine Successful Tactics & Strategies

The strategies that brought success were innovative and creative, but well known. In general they were the following: Cost Controls rather than cost reduction, Incentives rather than intimidation, Profits rather than break even, Debt Reduction by increasing rates in a timely fashion, Wise Capital Spending rather than spending freezes, Boosting Employee Morale rather than employee bashing, Adding Experienced Business Executives where appropriate, Price Increases when needed, and Customer Satisfaction Initiatives rather than reducing lobby hours and attempting to go to five day delivery. Of these, the most important are and were a focus on **Profits, Customer Satisfaction, and Employee Morale.**

Cost Controls:

Mr. Runyon joined the Postal Service in May 1992 and studied the situation for a short period before taking action. He realigned management, reducing about 23,000 jobs and offered early retirement that was accepted by 48,000 people. He cut the number of Vice-Presidents in half and brought in a number of new Officers from the business community. He retained only 6 of 42 Vice-Presidents. The heads of Quality, Purchasing, Facilities, Strategic Planning, Marketing and Finance were hired from "outside." The goal was to take a reduction deep enough to eliminate all of the pain in one action and to learn from the results. There were continual evaluations and many positions were added back later.

The number of employees was capped not frozen. Hiring above the cap was possible but required specific approval from Headquarters. Major spending was similarly constrained, but each Postmaster and Plant Manager received credit cards allowing them to purchase up to $10,000 in capital equipment and $10,000 in expenses at any one purchase. Many supervisors were also issued cards. The floor for capitalizing equipment was raised from $1,000 to $5,000. In short the focus was shifted away from what one senior executive called “travel, training and toilet paper” as a way to save money. We allowed managers discretion in doing what was needed, but kept control of significant spending. We used smart incentives to guide managers’ behavior.

Each officer and executive was asked to sign two letters. One attested to the correctness of the accounting statements within their control and another acknowledged their fiduciary responsibilities for the future.

Unlike prior practices Area (Operating) Vice Presidents and executives at Districts and Headquarters were promised that if they under-spent their budgets they would get the money back the following year. The “use it or lose it” philosophy was abandoned.

Incentives:

Stern Stewart was engaged to customize and implement their trade marked Economic Value Incentive (EVA) System including a “banking’ provision to create long-term positive results in February of 1994. A scaled down version, hurriedly was prepared by 4 Postal executives and implemented in March of 1994 as a reaction to 6 months of poor financial results. The Postal Rate Commission (PRC) predicted that the Postal Service would lose $2.5 billion in fiscal 1994. Instead results turned to “better than budget” by April 1994 and the Postal Service lost “only” $913 million. It beat its budget by over $300 million and the PRC’s April estimate by $1.5 billion in fiscal 1994.

The incentives used EVA and positive change in EVA to set the amount of the immediately available payments and the addition to the long-term “bank.” There were 3 items that were measured: EVA, Employee evaluations of their managers and Customer Satisfaction as measured by surveys. There were provisions to deny payment to bad performers and after the first year, payments were contingent upon the Postal Service earning a net income.

Profits:

The Board of Governors were asked to approve a resolution requiring that the Postal Service plan to earn profits each year. These profits were to be used to pay down debt, recover prior years losses, provide a cushion against emergencies, and fund expanded capital spending for automation, replacing old facilities and building new Post Offices in new communities. The resolution required management to file a rate increase request with the Postal Rate Commission whenever Profits were likely to drop below the $900 million level, the level of prior years loss recovery from the 1994 rate case.

Survey results revealed that the majority of senior career Postal executives thought that profits were inappropriate for the Postal Service. We undertook an education campaign to explain the need for profits and the legal requirement for a contingency that could only be met by earning profits. Many were surprised to learn that the ratemaking process provided for prior years loss recovery, contingencies to cover emergencies and certain non-expense items such as paying off debt. The Board resolution was an important part of this program because it signified the Board's commitment.

Debt Reduction:

The Board of Governors was asked to pass another resolution calling for the continued reduction in total debt. At the same time the Postal Service, with Board approval, implemented a complete restructuring of debt and cash management.

The U. S. Treasury adopted dramatic change in the methods it used to fund the Postal Service's needs allowing the savings of hundreds of millions of dollars. This action eliminated the need for a Postal Service request to borrow from U. S. financial markets. It allowed the Postal Service to have a same day line of credit of $300 million and a $3 billion line of short-term debt with 48 hours notice. Previously, the Postal Service used long-term borrowings at high rates to meet short-term needs.

Employee Morale:

Management believed that it was important to pay market-based wages. In 1994, we determined that the Postal Service paid wages at rates above market especially in rural areas of the country. This was addressed in the 1994/1995 labor negotiations. The 1995 labor arbitration provided for lump sum payments and a combination of cost of living and base rate increases that increased wage levels by 4 percent over 4 years. By 1997, our internal data showed that wage levels were at or below market in urban environments. I personally helped Operations Vice Presidents get increases to starting wages when the Postal Service proved unable to attract and hire qualified people.

Surveys were taken regularly (roughly once each year) to determine employee evaluations of managers. Efforts were begun to address the two major complaints from employees: the lack of negative consequences for problem employees and the lack of reward for good results. Managers scoring poorly were counseled and given training and/or re-assignment. The Board of Governors received regular reports regarding these activities.

It was our belief that business success required good employee morale. This was especially true for the one arm of the U. S. Government that touches everyone in the country 6 days a week. The primary factor was the approach of management. Managers and national programs need to be attuned to listening to employees, solving their problems, and improving working conditions. Also, we began a program to replace and/or rehab older facilities, some of which were in horrible shape as a reaction to valid employee complaints.

Customer Satisfaction:

Customer Satisfaction surveys were conducted regularly and a number of initiatives started to make the Postal Service more convenient. Many of these actions **reduced productivity** as hours were extended and counter people were added to reduce line wait. The concept of the "Postal Store" was started to let the customer use self-service for purchasing commemorative stamps and other merchandise. Employees were added in operations to eliminate processing bottlenecks.

Finance implemented the deployment of 60,000 terminals that accepted credit, debit, and ATM cards as a convenience for customers. It proved to be a very popular program as it eliminated a source of annoyance for employees and customers alike although it required an increase in expenditures.

Research has shown that the key to the long-term success of the U. S. Postal Service has been over 200 years of strong customer satisfaction. In 1993 and 1994, Congress held hearings and numbers of its members called and visited the Postal Service to stress the importance of satisfying their constituents. Service declines in 1993 led to angry town hall meetings in Chicago and the suburbs of Washington.

Customer satisfaction involves dependable mail delivery. It also means having Post Offices available everywhere; having short line waits; as well as being open when people want to mail packages, certified mail, and letters; and providing secure reliable delivery. It means safeguarding the mail with the Postal Inspection Service. It means trust, safety, reliability, and secure mailboxes to prevent identity theft. It also means delivery six days each week and pick up of mail from businesses and public drop boxes at the end of the business day. Marketing surveys show that the Postal Service has one of the strongest brands in the country and that the U. S. population likes the service that it gets.

The U. S. Postal Service compares favorably with the Posts of most major countries in terms of service, safety, security, trust and efficiency. In annual negotiations at the Universal Postal Union in Bern, Switzerland, about fees for the exchange of mail, we had frequent, positive comments about the trust and the public support that the U. S. Postal System enjoyed. In another example, Mr. Runyon and I personally hosted a delegation of 8 representatives of Japan's Post when they visited to learn how the U. S. Postal Service could have such strong customer satisfaction and a stamp price of 32 cents compared to their 80-cent equivalent price for a First-class letter.

Wise Capital Spending:

The Postal Service had been scrimping on capital spending for its entire life. By focusing excessively on short term cost reductions while absorbing costs that Congress continued to legislate, it allowed facilities to deteriorate and the infrastructure to become outdated. We increased the Capital Budget and asked the Board of Governors to commit to earning profits to pay for the needed spending. Money was included to build Post Offices in new communities around the country, an upgrade of the computer network and communication system, and even the introduction of robotics.

Adding Key Business Executives:

One key element of success was recruiting and hiring experienced business executives and officers from the private sector. They brought a different prospective that added to the experience base and allowed the Postal Service to prosper.

Career Postal people are bright, hard working capable individuals. However, they frequently lack business experience in profit making enterprises. The Postal Service has had losses in more years than profits. The team that was created by combining the experience of career people with the new business perspectives had great success. Of course, the vast majority of executives were career employees and they were very strong.

Price Increases:

The Postal Service needs small regular price increases.

There were and are conflicting pressures about price. Many called for extending the rate cycle to 4 years. Others preferred small annual increases. Most wanted price increases less than inflation. A few demanded no price increases. The Postal Service had mistakenly committed to 4 years without a price increase in 1991. The 1995 increase of 10.3% was below the inflation rate by over 2%. The 1997 rate case designed for implementation in 1998 was for rate increase of 4.5%, roughly 1.5% per year in a 3% inflationary environment. The delay to implementation in 1999 and the reduction to only a 2.9% increase led to abandoning the key Board resolutions and a return to dire financial problems for the Postal Service.

The Postal Service is a service business. Like most service businesses, it is labor intensive and requires regular price increases. The people who work at the Postal Service need and expect increases in their pay that keep up with inflation. The government has committed to these increases as a policy for its military personnel and civilian workers. Suggestions that the Postal Service can never again increase its prices are utter nonsense. It would be similar to saying that Universities can never again raise tuition, that doctors and hospitals can never again increase fees, or that the price of a haircut can never rise.

There is no prohibition to annual rate cases, which would result in small yearly increases in the worst-case scenario. The only constraint to ensuring annual profits, continuing declines in the accumulated deficit, and the provision of good service is self-imposed by the Postal Service and its Board of Governors. Another reason for annual price increases is to quickly respond to changing costs and provide appropriate pricing signals. For example, the costs avoided by having mailers presort and/or put bar codes on mail have been declining. Annual adjustments serve to buffer what otherwise becomes a large change in price. Also, it prevents losses from this portion of the business from growing and harming the Postal Service.

During my time as CFO of the Postal Service, I did what I could to limit the size of discounts for presort and work-share mail equal to, or slightly below, the costs saved by the Postal Service. It seemed ridiculous that pre-sort shops claimed great cost advantages over the Postal Service and then complained about needing higher discounts than the costs avoided by the Postal Service. At the same time their representatives have testified before the Postal Rate Commission that they must give “the lion’s share” of the rate discount to the originator of the mail piece. This seems counter productive if the pre-sort shops were creating the cost savings. Excessive discounts are a major cause of the current financial problems of the Postal Service.

IV. Successful Strategies and Tactics Abandoned

The Postal Service has abandoned most of the key strategies and tactics that brought it prosperity. The Board of Governors effectively reversed its policies about earning profits, reducing debt and the need to timely file and implement rate cases in order to achieve these important objectives.

It drastically modified its incentive plan by reducing incentives for profit and allowing bonus payments in years with losses based on an indexing system. It dropped EVA as a measure and switched to Total Factor Productivity (TFP) with negative consequences. At the request of management, it changed goals from customer satisfaction to speed of mail delivery as measured by an outside firm. It abandoned surveys of employees and substituted numerous other measures thereby weakening the incentive program.

As a way to increase service scores, some Postal managers canceled late pick-up of business mail, and re-scheduled the last pick up from some boxes earlier in the afternoon. The Postal Service also reduced the distance that was promised overnight delivery. These actions clearly negatively impacted the quality of service provided but did not change the speed of delivery. However, it affected the speed-of-service measure (EXFC), positively.

Spending soared due to lack of control and many initiatives failed to produce monetary returns or increases in customer satisfaction. It is no wonder that the Postal Service has fared badly.

Saving the Postal Service from Disaster:

Of necessity, the Postal Service made major efforts to lower costs and it deserves praise for avoiding bankruptcy. The current management of the Postal Service has reversed a situation that nearly brought disaster after the triple shocks of 9/11, Anthrax and the Recession. Mr. Potter and Mr. Strasser deserve great credit for their action to save the Postal Service from its dire financial straits. Mr. Strasser and Mr. Tayman deserve even more credit for their persistence and success in convincing OPM and Congress to finally eliminate overcharges in the older pension plan, CSRS.

Yet it would be a great mistake to set a course for the future that does no more than continue the focus on exclusively cutting costs and unnecessarily delaying rate requests as many have suggested.

Needless Problems:

However, the Postal Service need not have gotten in financial trouble in the first place. By losing momentum and by letting costs get out of control due to Board decisions in 1998 and beyond, it has had to resort to 4 price increases in 4 years.

After making decisions that caused a financial reversal, the Postal Service has asked for legislation to solve a problem that it, itself, created. Sadly, the changes requested will have little positive effect and many have potentially disastrous consequences.

V. Failed Policies and Counterproductive Claims

There is a great deal of advice that has already been given to The Presidential Commission. Much of it is illogical and suggests new approaches to failed policies. Several common themes are listed below.

Contracting Out:
Numerous initiatives to contract out Postal Service work failed to achieve the anticipated savings and generally resulted in both reduced service and reduced customer satisfaction. After initially accepting claims of huge savings to be derived from pay rate differentials, the Postal Service reversed itself on most major initiatives. Promised savings never materialized. Careful analysis of the Priority Mail Processing Center proposal discovered that initial estimates of savings were false. The Postal Service and its Unions have achieved market based pay through the arbitration process and the claimed "lower wage employees" produced less output with less quality.

(NOT) Earning Too Much Profit:
In 1998, the lobbyists for many large mailing companies, hoping to delay implementation of the recently recommended rate increase, argued that the Postal Service was earning too much profit and that it was supposed to break even at best. Despite the fact that the recommended increase averaged only 1.2 percent per year, was far below inflation, and was designed to cover significant and needed increases in spending, the lobbyists prevailed and the increase was delayed. The Governors voted to delay the increase to 1999 and at the same time approved significant spending increases in both capital and current expenses.

Board policies to reduce debt and earn profits were effectively negated. The word went out to spend as much as possible in fiscal 1998 in order to prepare for a tough 1999. The Postal Service lost approximately $0.8 billion in its last fiscal quarter ending September 30, 1998. Total debt began what became a dramatic increase. The Postal Service's financial situation declined rapidly.

Selling Retail Items:
The Postal Service attempted to use its retail outlets as stores to sell merchandise and lost money. People were not anxious to buy merchandise from a service provider. Numerous initiatives promised much and delivered only problems and bad publicity. Suggestions that the Postal Service can enter new businesses to contribute profits are a triumph of hope over experience.

Price is (Not) All That Matters:
Uninformed people speculate that the recent price increases have hurt mail volume and are the reason for the decline of 2.5% in mail volume from 2000 to 2002. Nothing can be further from the truth. Perhaps the best example is Priority Mail and Express Mail. The table below shows one example of a calculation I performed for a friend using published prices from the web sites of Fed-EX, UPS and the Postal Service:

Costs of 10- Pound Package sent from
Fairfax, VA 22032 to Los Angeles, CA 90210[2]

	U. S. Postal Service	Fed-EX	United Parcel Service
2 or 3 day	Priority Mail $19.20	Express Saver (3 day) $28.09	3 Day Select $39.02
Overnight	Express Mail $37.50	Standard Overnight $51.51	Next Day Air Saver $63.14

While it is true that Priority Mail rates have increased over the last four years, there is still a significant saving compared to each of the major alternative carriers. Prices cannot explain the 18% decline in Priority volume from 2000 to 2002 or the 15% decline for the Quarter 2, 2003 compared to the same period of 2002.

It is worth noting that both Fed-Ex and UPS have seen overall volume decline from 2001 to 2002. It is a misstatement of the facts for the Postal Service to use the "boogeyman" of electronic diversion as a reason for a change in its law. Its decline in total volume of 2.5% is in line with that of Fed-Ex and UPS volumes which are not likely to have been affected by electronic diversion. In any case, electronic diversion has been a fact of life since the Telegraph was invented in the mid 1800s. Of course, there is no price low enough to convince the public to abandon E-mail for letters through the mail.

Productivity Conflicts with Customer Satisfaction:

In the 1990s, total Factor Productivity was continued as a measurement, but discarded as a management tool and/or goal. Management continued to brief the Board of Governors but management believed that other factors were more important. Service improvement initiatives and capital spending for new facilities served to lower the productivity measure while increasing the long-term health of the organization.

In a major move, outdated equipment was removed first in the Sun Coast district and then nationally. Prior standards about obtaining maximum throughput per machine were discarded in favor of increasing machine utilization. The new electronic sorting machines were faster and more accurate than older mechanical models. This required expanding the time in which they were used and increasing time when employees were waiting for mail to arrive. Despite improved finances and less miss-sent mail, it gave fuel to those who complained about "non-productive time."

The table below shows that when the Postal Service Earned Profits, productivity stagnated. When the Postal Service struggled to survive and cut expenditures to provide for its future, productivity grew steadily.

[2] Owner supplied packaging

Comparison of US Postal Service
Total Factor Productivity Growth
With
Net Income

Fiscal Year	Net Income (Millions)	TFP Growth Percent
1993	($1,765)	3.8
1994	($913)	(0.2)
1995	$1,770	(1.9)
1996	$1,567	(1.3)
1997	$1,264	1.3
1998	$550	(1.0)
1999	$363	(0.1)
2000	($199)	2.4
2001	($1,680)	1.3
2002	($676)	1.1

Wages Premium:

There are many estimates about the amount that could be saved if only the Postal Service were to pay market-based wages. Yet every initiative that promises to save money by contracting out work to take advantage of the purported wage differential has failed to achieve the promised savings. In every contract negotiation, both the Postal Service and its unions start with positions that say the Union workers are either under paid or over paid depending on which side makes the case. As the main Postal Service witness in the 1994 –1995 labor arbitration hearings, I can testify that the Postal Service pays market-based wages. Any excess was wrung out in that contract that provided the smallest increase in base pay for union workers in the history of the Postal Service. In fact, as the contract continued, a number of operations managers asked for and received supplemental budgets to increase pay for new hires because they could no longer attract capable and qualified candidates. It is possible to find less expensive labor, but the service problems of 1993 convinced me that these jobs required skill.

The current labor arbitration required in the law is a major benefit to the Postal Service. It ensures the payment of market-based wages. Earlier in my career, I was CFO of United Airlines and I believe that the airline-type law that the Postal Service has requested would be a grave mistake. The Postal Service is like any other large organization. Its wage rates are set by the market or in the Postal case by a prestigious panel of Arbitrators chosen jointly by unions and management.

To those who argue that the Postal Service needs to fight with its unions about lowering wage costs, I point to the comparison of United Airlines and Southwest Airlines. Both are unionized but only one has employees who are very productive and enjoy their work. I joined United Airlines just after it tried to force pilots into major wage concessions and failed in an attempt to replace all of its pilots. The business has been declining ever since. The Postal Service cannot afford the disruption that inevitably occurs from major efforts to reduce labor costs by either a strike or by contracting out large portions of its work.

Public-Private Partnership, an Unfulfilled promise:

The Public - Private Sector Partnership has been and continues to be all promise and almost no results as far as having new initiatives that actually help the Postal Service. Examples include: Call Centers, Remote Encoding Centers, Priority Mail Processing Centers, Remitco (a remittance processing venture that failed), the sale of Warner Brothers merchandise along with other merchandise, and the FED-EX "partnership" that was recently implemented.

The two that succeeded financially brought tiny profits and huge amounts of bad publicity. A partnership with Mexico's second largest bank wired funds from the U. S. to families in Mexico avoiding the theft rampant in the Mexican Post earned a modest contribution to profit. It was roundly criticized for the high cost of the transactions.

Selling phone cards in a joint partnership with American Express brought about $8 million per year in contribution and when the venture was sold a capital gain of about $30 million. The purchaser ultimately filed for bankruptcy protection.

Labor as a Percentage of Total Costs:

Another strange measure seems to be circulating. Some have commented that it is wrong to have a high percentage of labor costs compared to total costs. Of course, the percentage of labor costs is a function of the service provided. In universities and barbershops the percentage is high. In fact, when Fed-Ex implemented its contract with the Postal Service, it was able to use some of its airplanes that had been idle during the day. It hired more pilots, crewmembers and ground people and its percentage of labor costs compared to total costs increased. I teach students that higher capital utilization is good, not bad.

Customers are the People, Not the Mailers

This Commission has not heard from the true customers of the Postal Service. Because the mail is as much a part of life as clean water from the tap, people do not get excited about the Postal Service until something changes. One member of Congress told me that closing small Post Offices generates more mail than anything else.

The companies and associations who have generated comments are valued clients of the Postal Service and need to be treated with care and consideration. However, they have an economic interest in switching costs to other groups and an interest in cost minimization for themselves. Instead customers want service, convenience, safety, security from identity and mail theft, and pleasant experiences in retail establishments.

If customers did not want mail, business would abandon the mail in a heartbeat. Mailing agencies who print, sort and enter the mail of other businesses are simply intermediaries who make a large profit by convincing the Postal Service to hurt itself financially through excessive discounts. Large companies that mail bills, statements and advertisements are clients, but not the ultimate customer. To be sure, these companies need attention and service, but the choice to mail is driven by what individual customers want.

Pricing Flexibility:

I see little to be gained from the pricing flexibility that the Postal Service desires. If it keeps profits at a level sufficient to provide for the contingency for emergencies written in its current legislation, it can absorb short-term increases in oil prices or other expenses. If it reduces its debt, it will provide more of a contingency.

My worry is that pricing flexibility will become the means to offer larger discounts to current customers for current business because they lobby effectively. It will likely hurt the bottom line with no positive long-term benefit. It is the United Airlines approach to pricing. At the moment, the Postal Service has the Southwest Airlines approach to pricing. There is a business lesson in this comparison.

Electronic Diversion:

Diversion of mail to electronic transmission has been a fact of life since the telegraph. The telephone accelerated the diversion of letters. Fax machines have done more and most young people have been using E-mail for a decade. Diversion will continue and mail volume will continue to grow steadily. It would be a mistake to try to fix a perceived problem with a non-solution.

VI. Recommendations

I would ask that you NOT recommend a change in the law. Too many unintended consequences come from well-intentioned law changes. These changes could destroy the Postal Service. None of the proposals is likely to help the bottom line or the long-term business prospects. Pay heed to the lessons learned from the 1990s.

The Postal Service needs to be governed by individual board members that would meet the intent of Sarbanes-Oxley legislation. The Board needs to concern itself with its fiduciary responsibilities to the American people. They are entrusted with the oldest and most successful business. It is a business that is also the only U. S. government agency that touches the lives of the American people 6 days a week. The vast majority of people like their mail service and wish only that Post Offices would be made more convenient.

Administrative Action, Not a New Law:

I suggest that this commission recommend to the President that the Postal Service Board of Governors focus on running the Postal Service as a service based business. Also, you should recommend that they return to the practices of the mid 1990s and pay attention to earning profits, building customer satisfaction with the American people, re-installing an incentive system for creating Economic Value Added, and take measures to improve the morale of its work force. This approach worked before and I believe it will work again.