

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Dan G. Blair, Chairman;
Mark Acton, Vice Chairman;
Ruth Y. Goldway;
and Tony Hammond

Report on Universal Postal
Service and the Postal Monopoly

Docket No. PI2008-3

**TESTIMONY OF LIZ ROBERT
ON BEHALF
OF THE VERMONT TEDDY BEAR COMPANY®
(June 19, 2008)**

Mr. Chairman and Commissioners, on behalf of the employees and customers of The Vermont Teddy Bear Company® (VTBC), thank you for the opportunity to appear before you today in Portsmouth, New Hampshire to discuss mail, the Universal Service Obligation, and how a strong US Postal Service is critical to our success both as a company and as an entrepreneurial nation. In your deliberations, we understand you are balancing many diverse and sometimes competing priorities or needs. As you contemplate changes to our national mail system, it may be useful to consider the role the US Postal Service plays in enabling commerce, particularly for smaller US based companies and its greater benefits to rural America in providing higher paying employment than might be available in a local fast food restaurant or convenience store. VTBC represents a segment of commerce some believe is increasingly vanishing in America, domestic manufacturing, but one that remains critically important to thousands of small companies like ours and the millions of Americans it employs. We are also a small cataloger. As VTBC demonstrates, a properly managed postal system enables future growth for thousands of small marketers who use the USPS to connect to consumers, producing in turn increasing mail and package volume that helps cover the costs of maintaining universal service to all Americans.

Summary:

Vermont Teddy Bear uses the mail to market and differentiate its teddy bear products from imported mass market substitutes, and to distribute or exchange products. The USPS has been

an integral part of our company's rapid growth and success. While some see domestic manufacturing as an increasingly vanishing craft, "made in America" is still alive and flourishing in places such as nearby Vermont. We hope you will take our story as one small example of how businesses today use the mail to level the playing field in an increasingly competitive global supply chain. The USPS allows small businesses such as ours to compete effectively by achieving national reach without a national infrastructure. It helps us sell and deliver value added products in a market dominated by large multi-national concerns. We represent the success and innovation of small business, including a significant number of well paying jobs. When considered with the many other companies you will not hear from, we are in total a sizeable engine of commerce, employment, consumer product diversity as well as an important source of tax paying wealth creation for thousands of entrepreneurs across America.

The story of our beginning is one of a struggling start up, unable to secure a market or distribution for its products through conventional retail distribution, that only achieved real success when it turned to direct marketing methods. This lesson was reinforced once again when our documented growth of the early 90's diminished in a brief attempt at retail expansion mid-decade. VTBC only returned to rapid expansion in 1998 when it re-focused its efforts on direct response marketing, returning to the successful formula combining radio and catalog advertising, this time including the development of an e-commerce Internet presence.

We are an example of American manufacturer successfully competing against lower wage imports using, among other things, the nation's mail. VTBC's success with all of its brands is largely dependent on efficient, effective and widespread if not universal access to the mail. Since universal service is today paid for by mailers, we also represent a growing segment of hungry direct marketers who, given the right management and economic stimulus by the USPS, will increase the volume of catalogs and parcels put into the mail to support whatever level of public access and essential service we care to adopt as a nation in the future.

Introduction:

The history of the Vermont Teddy Bear Company is the story of how a tiny U.S. manufacturer, unable to compete on the thin margins of wholesale or with the expensive infrastructure of brick and mortar retail, is able to access a national marketplace at a sustainable cost structure to grow and prosper as a direct marketer of its own manufactured product using direct response, predominantly radio and catalog. In addition to selling and distributing product, the US Mail's

delivery of our catalogs has facilitated VTBC's efforts to differentiate its products from low cost imported plush toys by delivering our brand message directly to consumers that our product is not just a teddy bear. It is a BearGram® combining a customized Vermont Teddy Bear with the value add of a relevant personalized message and a candy treat, delivered in colorful gift packaging (with "airhole" so the bear can breathe on its journey) to help people of all ages celebrate special occasions and milestones in their lives.

Company History:

The Vermont Teddy Bear Company was founded by John Sortino in 1981 and incorporated in 1984 on the premise that teddy bears, with their legendary beginnings dating back to the presidency of Theodore Roosevelt, should continue to be made in America. From a pushcart on Church Street, an open marketplace in Burlington, Vermont, John struggled to establish his teddy bear business in retail outlets across northern Vermont and New York. It was not until the company turned to direct response in 1990 that it was able to make the transition from a struggling start up to an expanding success story. The company growth and success in direct response ultimately led to its being listed by Inc. Magazine as one of the fastest growing private companies several years in a row in the early 1990s.

Today, the Company is one of the largest Vermont employers with about 300 high skill jobs including 52 engaged in all aspects of teddy bear manufacturing. We believe we are the only manufacturer of teddy bears in North America with virtually all plush toys and gifts being made in China. We are convinced the Vermont Teddy Bear identity as an American manufacturer reinforced by our mission to design, make and market the best teddy bears anywhere, is a key element of our brand positioning and reputation. Our Shelburne and Newport, Vermont factories demonstrate our commitment to preserving and growing Vermont-based manufacturing. Newport is an economically depressed area with one of the highest unemployment rates in the State of Vermont. Our factory in this city, one of the smallest cities in America, provides high paying manufacturing jobs not generally available elsewhere. To be a successful American manufacturer, we have become an innovative and continuously improving manufacturer. We adopted "lean" and other advanced manufacturing techniques such as "modular manufacturing" where teams of employees rotate within modules performing all of the tasks required to produce a teddy bear from cut fabric to finished bear, allowing us to successfully improve quality, reduce repetitive motion injuries and reduce the unit cost of producing a finished teddy bear.

In its fiscal year 2007, VTBC mailed over 20 million catalogs that generated approximately 43% of its annual sales. Catalog remains extremely important to the future of our business, as we continue to expand on a national and even international level. The recent postal rate increases applicable to catalogs have a material impact on the profitability of our company.

Growth Driven by the US Mail

Our growth has been historically driven by the US Mail in two important ways. First, mail has been an important part of our direct response marketing that allows us to access the consumer across the country in a cost efficient manner, expanding our footprint virtually without having to sell to or operate in traditional brick and mortar retail outlets. We are clear that without direct response, our company would not be a success. The USPS has supported this growth as a channel through which consumers can conveniently select, purchase, return or exchange goods received from our Company.

The USPS also provides us the ability to differentiate our products from low cost imports. Each BearGram carries a personalized message from purchaser to recipient. Americans love the mail and can readily understand receiving a greeting via the mail. We provide both a greeting and a gift, wrapped on one expressive package. Our ability to deliver a “me-to-you” message on a customized bear is a key differentiating factor to cheaper imported teddy bears available at mass retail. Without American’s love for and understanding of the mail and its tradition of delivering greetings, a BearGram delivery service that involves sending personalized teddy bears directly to recipients for special occasions such as birthdays, anniversaries, weddings, and new babies, as well as holidays such as Valentine’s Day, Christmas, and Mother’s Day would not be possible.

Primarily through the BearGram delivery service, our company increased its net revenues from approximately \$351,000 in 1989 to just under \$39 million in 2002.

Universal Service for VTBC:

From VTBC’s perspective, changes to the definition of universal service may include a reduction in the number of days mail is delivered to consumers. However, it remains important that mail reach all of those Americans who may wish to purchase and send our products. The potential to reduce service frequency with respect to delivery of catalogs brings up some other considerations. Since orders we receive are closely tied to when customers receive catalogs, fewer delivery days, if

selected uniformly across the system, could concentrate responses making it difficult for our internal operations – particularly the call and fulfillment centers – to provide high levels of customer service. Any material impact on production and preparation of catalogs for mailing is also important to understand; changes should consider plant loading and efficiency implications on printers and bulk mail consolidators. On the outbound side, purchasers want their products as soon as possible after placing orders so intermittent package delivery would make the USPS less attractive than common carriers for delivering orders. Finally, there is the seasonality of volume to consider. Since many of the BearGrams we sell are holiday related, our business has a significant seasonal component. This is a factor for both our catalog and package shipments, requiring additional capacity to support significant spikes in volume in advance of certain major gift giving holidays such as Valentine's Day.

The Universal Service debate is largely driven by changes in USPS volumes that make it increasingly difficult for remaining mail volume to cover the cost of frequent delivery to every address in America. For a relevant lesson in adapting to changing consumption patterns, one might consider the experience of the common carriers (for example, UPS and FedEx, among others). In recent years, their bread and butter business on which they had long depended to maintain an efficient delivery platform was disappearing. The development of electronic word processing documents, email, pdf files, and even electronic signatures, all reduced demand for overnight document delivery. At the same time, another market shift was occurring. Internet driven e-commerce dramatically exploded the growth of parcel delivery volume. Because so much parcel delivery occurs at major holidays, these common carriers became capacity constrained on certain days of the year as their consistent daily base document business supporting the existing infrastructure was shrinking. FedEx, unwilling to invest in additional capacity presumably because the seasonal variability made such investment uneconomical, established “caps” on its largest holiday shippers (including VTBC) limiting the volume of VTBC packages it would carry at Valentine's Day and Mother's Day. UPS, on the other hand, was innovative and aggressive. It leveraged more broadly its integrated ground and air systems to handle the added seasonal parcel volume and won over a number of larger shippers (including VTBC) as a consequence. Struggling to recapture lost business, more recently FedEx eliminated these seasonal “caps.” The experience demonstrates two distinct approaches in adjusting to societal shifts in demand such as electronic distribution of printed material. One is to try to govern the demand and re-price current services in an attempt to cover the cost of existing infrastructure as contribution margins change. The second, and the premise for a healthy free-market economy, is to innovate and adapt to societal changes in

demand. We see a parallel for the USPS as it adapts to the loss of its bread and butter, the first class letter. E-commerce is the catalyst for an increase in direct marketing and the USPS as a long standing business partner to a plethora of direct marketers and virtually all catalog direct marketers is perfectly positioned to benefit both in delivering the incremental volumes of advertising and parcels. By leveraging its existing infrastructure with improved efficiencies and advanced relevant methods, it seems there is an opportunity to compete profitably in a developing market place that could then in turn support some responsible level of Universal Service Obligation tailored to the electronic age. On the other hand, it seems futile to focus on the reverse approach of meeting an outdated standard by raising prices on services for which there is a competitive market thereby reducing demand for those services and creating a negative spiral while trying to support an outdated and likely over extensive obligation or infrastructure.

Monopoly versus the Availability of Substitutes:

Some consider the USPS to be a full monopoly in every market segment outside of packages and overnight delivery. The experience of VTBC does not bear this out. As outlined in my letter of March 6, 2007 to then USPS Chairman James Miller (incorporated herein by reference), we have a variety of alternatives in how we allocate our marketing dollar. Our behavior is driven largely by economics. We compare the cost of each medium to the return that media delivers. In competing for our catalog volume, the USPS is not a monopoly. Since it appears that the current status quo is to have the effect of driving large numbers of catalogs out of the mail and completely missing a sizeable growth opportunity for the future, we urge an immediate review and reconsideration of the decisions made over the past few years as it relates to catalog postage.

Some tell us that catalog postage went up significantly because flats are not profitable to send through the mail. However, we understand that catalog companies were not engaged in this discussion and were the only major mailer group not involved in the debate of how to allocate the high fixed costs of running our national postal system. In making cost and pricing decisions, no one was available to challenge the claims of some that flats were not profitable or given a chance to explore ways to tailor catalogs or automate catalog processing methods more specifically to reduce cost impacts on the postal system. It is not surprising catalogers ended up where we are given the forces at work but now we face a structural migration out of the mail because it has become uneconomical.

Moreover, as we wrote to Chairman Miller, the magnitude of the increase and the short notice was disruptive and had a material impact on our profitability in our current fiscal year. While we have since worked hard to counter the postage increases with lower paper weights, reduced page counts and more sophisticated co-mail programs, VTBC is mailing significantly fewer catalogs in the coming year and is committed to reducing its mail dependency in the future. We intend to shift more of our marketing dollars as a percentage of total dollars spent to other direct response channels, including radio, TV and web advertising as we seek an improved return on each advertising dollar spent. We do not have a choice. However, we will take with us a legacy of growth and contribution to supporting universal service to all Americans.

Even without the benefit of automation investment, we have heard of studies that indicate flats mail prior to the rates imposed last year provided a materially positive contribution over their direct or variable costs to deliver catalogs. If this is the case, and applying the lessons of the common carrier industry, should not the current rate structure be reviewed in light of the availability of substitutes, the need for volume to fund the USO and the clear migration of catalogs out of the mail on economic grounds? The present circumstances do not appear to serve the interests of anyone.

The Cost of Universal Service:

With the USPS infrastructure currently in place, particularly at the local level, it seems hard to imagine that there is not room for substantial streamlining and consolidation that could reduce the cost of service. For example, in Vermont while there are far fewer schools than there are post offices, there is much political consideration being given to further consolidation as class sizes shrink and the cost of redundant administration rises. Before any broad changes to the Universal Service mandate are put in place, should we not review and address the cost of the system first?

How we work with the USPS:

Today, we do not send as much package volume through the USPS system as we might. VTBC over the years has repeatedly attempted to work with USPS on package delivery of its BearGram gifts but has consistently run into roadblocks. First, USPS pricing of its parcel delivery services is not competitive, except in certain localized situations (i.e. in the case of VTBC, ground service to certain locations east of Illinois). Second, trackability en route (not just delivery confirmation), critical to our gift delivery product, is not available when shipping via USPS. And third, the local post office and even the local distribution unit have not been able to provide adequate support for

the injection of significant package volume into the mail stream at the holidays. As we have tested the USPS on a number of occasions, we sincerely believe that with investment in management, systems and technology, the USPS can become a viable competitor to UPS and FedEx in the package delivery industry.

In addition, noted above, we do not feel postal policy makers fully understand our business model and the choices we have in allocating our marketing and promotional dollars or package delivery dollars. While ordinary letter mailings such as bill statements and payments are likely to become extinct over time as they are replaced by electronic means of delivery, advertising is a segment with a good potential to increase over time. The USPS has an opportunity to become a more efficient competitor with other direct response mediums as an advertising channel competing in essence with other direct response media such as TV and radio that are increasingly fragmented and blocked by electronic means such as TiVo. By investing in cheaper, faster, greater impact delivery of advertising mail, the USPS would likely enjoy a material increase in volume.

Standardizing and investing in the equipment and processes to handle catalogs on a cost reduced basis may be the most opportune use of a system that needs to support the principles of the Universal Service Obligation funded by growing volume. Since cataloging is complicated, to do this effectively, we think, requires experts within the USPS on our industry segment who can partner with catalogers to increase the value of mail via the impact and response it generates while reducing the cost of handling our mail through such initiatives as flats automation. In the present environment, it will take concerted and immediate action to prevent the wholesale migration out of mail of an industry segment that historically has been dependent on mail, losing with it an important commercial contributor that can help sustain some level of its Universal Service Obligation.

Conclusion:

Vermont Teddy Bear Company represents the story of a company that could not compete at wholesale or traditional retail with an American manufactured teddy bear against other teddy bears sold at the lower price points afforded by Chinese manufacturing. However, it could compete when positioning its more expensive teddy bears as BearGram gifts, a “creative alternative to flowers”, leveraging the convenience to consumers of direct marketing, including catalog, and timely delivery via common carrier or the USPS. Mail helps us differentiate our products, add value that supports higher wage US jobs, as well as allowing us to sell and deliver our products to millions of customers across the country. Given that we expect to continue our

historic growth rates, we hope the USPS will be in a position to capture the additional dollars we have to spend, and with this, be in a better position to fund a USO benefiting all Americans.

Thank you for your time. I would be happy to answer any questions you have.