

**NALC-T-5**

**BEFORE THE  
POSTAL REGULATORY COMMISSION**

**SIX-DAY TO FIVE-DAY STREET DELIVERY  
AND RELATED SERVICE CHANGES, 2010**

Docket No. N2010-1

**DIRECT TESTIMONY  
OF  
DR. MICHAEL J. RILEY  
ON BEHALF OF  
THE NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL-CIO**

## **I. AUTOBIOGRAPHICAL SKETCH**

My name is Michael J. Riley, DBA. I am a Professor in the Business and Executive Programs of the Graduate School of Management and Technology at the University of Maryland University College.

From August 1993 to July 1998, I held the position of Chief Financial Officer (CFO) and Senior Vice President of the U.S. Postal Service. While I was CFO, the Postal Service overcame the biggest deficit in its history and posted billions in profits. During my tenure, the Postal Service's Finance Department received the first Alexander Hamilton Award given by *Treasury and Risk Management* magazine. Also during my tenure as CFO, then Vice President Al Gore touted our successful efforts to turn around the Postal Service in publications about reinventing government.

In addition to having served as the Postal Service's CFO, I have also served as CFO of United Airlines -- one of the largest airlines in the world -- and as CFO of Lee Enterprises, a newspaper and television company. I have also served as Treasurer of Michigan Bell Telephone Company and as Assistant Controller of Northeast Utilities. I began my business career as an accountant at Teradyne, Inc.

I earned a Bachelor of Science degree from the U.S. Naval Academy in 1965, a Master of Business Administration degree from the University of Southern California in 1972, and a Doctor of Business Administration degree from Harvard University in 1977. At Harvard, I completed all of the required course work for a PhD in Economics. My "Special Field of Study" was Financial Institutions and Markets and my sub-field was Corporate Finance.

At the University of Maryland University College, I teach students in the Master of Business Administration program as well as Executive MBAs. Previously, I was the Assistant Dean of the School of Undergraduate Studies at the University of Maryland University College.

Prior to that, I held positions on the faculty of Harvard Business School, Boston University, University of Connecticut, University of Michigan, and George Mason University.

In addition to my position at the University of Maryland University College, I currently serve as a Director and Chairman of the Audit Committee of Church Mutual Insurance Company. I also consult through my firm Riley Associates for businesses, non-profits, and other organizations. My publications have appeared in numerous magazines and newspapers including *The Wall Street Journal*.

I have testified before Committees of the U.S. Congress; the Postal Rate Commission (the predecessor of the Postal Regulatory Commission); the President's Commission on the Postal Service; and, while I was employed by the Postal Service, in labor arbitration.

## **II. PURPOSE OF TESTIMONY**

The purpose of my testimony is evaluate whether the Postal Service's proposal to eliminate Saturday delivery is necessary and whether it is consistent with good management practices. I conclude, for the reasons explained below, that it is neither. In my view, the Postal Service's long-term financial health depends not on reducing the frequency of delivery but on its making its services *more* available to consumers.

## **III. ELIMINATING SATURDAY DELIVERY IS NOT NECESSARY**

In support of its proposal to eliminate Saturday delivery, the Postal Service's current CFO, Joseph Corbett, asserts that a change to five-day delivery is "necessary and unavoidable." (USPS-T-2, at p.2). He asserts that the Postal Service is now in "dire financial condition," (*id.* at p.3) and that eliminating Saturday street delivery is needed to help "close the gap" between the Postal Service's costs and revenues (*id.* at p.14). In fact, the Postal Service's

costs and revenues are not fundamentally misaligned and no radical change like ending Saturday delivery is necessary.

The financial challenge now facing the Postal Service stems from two principal sources. First is the requirement in the Postal Accountability and Enhancement Act of 2006 (“PAEA”), P.L. 109-435, that the Postal Service spend billions to pre-fund its retiree health care obligations -- an unfair requirement that Congress can and should change. Second is the most severe economic downturn since the Great Depression, which continues to depress mail volume.

The statutory obligation to pre-fund retiree health obligations -- which no other business or government agency bears -- added \$12.4 billion in costs to the Postal Service’s balance sheet from FY2007 to FY2009. *See* NALC-LR-N2010-1/6 (USPS Annual Report), at p. 48. During those same three years, the Postal Service had a cumulative net operating loss of approximately \$11.8 billion. *See id.* at 2. Thus, without the unique burden imposed by the PAEA’s pre-funding requirement, everything else equal, the Postal Service would have enjoyed a cumulative *profit* during those years. And such profit would undoubtedly have been even greater had the recession not dragged down economic activity and mail volume with it.

The Postal Service’s present financial situation is also a result of its having been unfairly overcharged \$75 billion in retiree pension costs, as explained in the January 10, 2010 report of the Postal Service’s Inspector General (IG). *See* NALC-LR-N2010-1/10. Were the Postal Service credited with the amount by which it was overcharged, that would be enough to pre-fund *all* of the Postal Service’s retiree health obligations and have more than enough left over to pay off the Postal Service’s debt.

Moreover, I would argue, the Postal Service’s current financial situation is in part self-inflicted, to the extent that postal management failed until just recently to seek rate increases

that would generate additional revenue. Successful service businesses raise prices as needed to maintain financial health.

The Postal Service acknowledges in its latest annual report that its current prices are a comparative “bargain”: in 2009, first-class mail in the US was 44 cents, but was 47 cents in Canada, 64 cents in Great Britain, 77 cents in Germany, 78 cents in France, 83 cents in Japan and \$1.25 in Norway. (*See* NALC-LR-N2010-1/6, at p.1) That American mail is now relatively cheap means that even with a rate increase it would remain reasonably priced.

The PAEA allows for reasonable price increases beyond the inflation cap when made necessary due to “extraordinary or exceptional circumstances.” *See* PAEA Section 201. I believe that faced with the worst economic downturn since the Great Depression, the Postal Service could make a credible case that these are “extraordinary or exceptional circumstances.” Indeed, I understand that on July 6, 2010, the Postal Service filed with the Commission a request for an exigent rate increase in which it argues that such “extraordinary or exceptional circumstances” now exist. *See* Docket # R2010-4.

A reasonable rate increase would undoubtedly help close the current gap between the Postal Service’s revenues and costs. Commission Chairman Goldway correctly noted in her April 22, 2010 testimony before the U.S. Senate that the demand for mailing services is largely price inelastic. This means that there would most likely be a substantial increase in revenue and in added profit from a reasonable price increase. Large mailers provide the majority of postal revenue and their behavior is such that they adopt to price increases with minor changes in volume. Even for those services that are slightly demand price elastic, there is a significant positive contribution.

As a rule of thumb during my time as CFO of the Postal Service, we assumed that a 10% price increase for market-dominated products (also known as “mailing services”) would yield a net revenue gain of about 9%, since it would reduce volume by about 2% and costs by about 1%. So a 10% increase on FY 2009’s \$56.9 billion in market-dominated products, *see* NALC-LR-N2010-1/6, at p.82, would likely have produced approximately \$5.1 billion in additional revenue. It would have improved the Postal Service’s bottom line by more than the \$3.1 billion in net annual savings that the Postal Service says it would achieve by eliminating Saturday delivery. *See* USPS-T-2, at 16. It would also have made FY 2009 a profitable year for the Postal Service even with the PAEA pre-funding payment made that year and despite the recessionary drop off in economic activity.

I understand that in its recently filed exigent rate case, the Postal Service is seeking an aggregate rate increase of approximately 5.6%, which it estimates would yield a net increase in annual contribution of \$3 billion. *See* Statement of Joseph Corbett, Docket No. R2010-4 (July 6, 2010), at p.19. Such an increase in annual contribution would be about what the Postal Service says it would save from eliminating Saturday delivery.

#### **IV. ELIMINATING SATURDAY DELIVERY WOULD HURT THE POSTAL SERVICE IN THE LONG-RUN**

Eliminating Saturday delivery is not only unnecessary, but would be a grave error that would hurt the Postal Service in the long-run.

The proposal to eliminate Saturday delivery reflects Postal management’s view that it must react to financial challenges with relentless cost-cutting. But no service business achieves success by a single-minded focus on cost. Of course, constraining costs is important and the Postal Service should continue to explore ways to further automate or streamline its

operations, so as to maintain productivity growth. But it should not engage in cost-cutting that eliminates valuable services to its customers.

The CEO of Coca-Cola once said that his company's goal was that no one in the world should be more than five minutes away from a cold Coke. To achieve success as a consumer-oriented business, the Postal Service too should focus on making its products and services *more* available to its customers, not less. Dropping Saturday delivery would create a hole in the Postal Service's current operations that would make customers have to wait a day longer, or more, to get their mail. It would also, for example, force customers who work during the week and who are not home to accept packages have to spend part of Saturday waiting in the pick-up line at the post office. It would inevitably cause customers to look to alternatives.

Eliminating Saturday delivery would also do harm to the Postal Service in less tangible, but no less significant ways. The Postal Service correctly describes letter carriers as "excellent ambassadors in promoting the agency's image," (USPS-T-1, at p.3), yet eliminating Saturday delivery would mean that many customers who work during the week would no longer have the chance to see and speak to their letter carrier.

Reducing the frequency of service would also send a signal to customers that their needs and preferences no longer matter to the Postal Service. It would reinforce the negative stereotype of the Postal Service as an inefficient government entity rather than a vital service-oriented enterprise. Such a negative stereotype would not only dampen the public's demand for postal services but would erode its support for the Postal Service as an institution.

Saturday delivery provides the Postal Service a competitive advantage over its package-delivery rivals. Rather than eliminating Saturday delivery, the Postal Service should be touting it. But the Postal Service has to a large extent failed to exploit this advantage. Most

businesses with a competitive advantage use advertising to remind individuals of the benefits of their service. Yet the Postal Service does little advertising to explain the advantages of Saturday delivery to its customers.

**V. THE POSTAL SERVICE SHOULD ADOPT  
A CONSUMER-ORIENTED STRATEGY**

When I was CFO of the Postal Service, we adopted a business strategy that put an emphasis on the individual customer. We recognized that the preferences of the individual customer is what drives mail volume and that what was important to the individual customer were things like convenience, courtesy, safety, security of the mail and consistency of delivery. And we tried to make it easier, not harder, for consumers to use our services. Just one example: in 1993, the Postal Service began accepting payment by credit card and customers responded enthusiastically.

Our focus on the customer in those years paid rich dividends. Mail volume rose nicely despite the advent of the Internet. From FY 1995 through FY 1998, the Postal Service posted billions in profits. During that period, the Postal Service was able to pay off its debt and triple its capital spending. Indeed, many in the mailing community expressed the view that the Postal Service was earning too *much* money and that the profits were excessive. After my tenure, new Postal management promised to solve that problem, and solve it they did. Billion-dollar profits were soon replaced by billion-dollar losses.

Rather than continue its failed approach of focusing single-mindedly on cost-cutting, the Postal Service should focus again on strengthening its relationship with consumers, because that undoubtedly is where long-term success lies.

We live in an era where service companies are *increasing* days and hours of operation to appeal to their customers. The Postal Service should take the same approach. For

example, as Chairman Goldway has suggested, the Postal Service should consider having a network of post offices in key locations that are open more hours, and even on Sundays, and should maintain at least one 24/7 post office in every big city.

Yet the Postal Service has been going in the opposite direction, apparently ignoring the desires of its customers. For example, while the Postal Service increased the number of collection boxes in the 1990s, it began eliminating them in the following decade. It eliminated 24,000 such “blue boxes” in 2009 alone. Individual customers cannot help but notice these changes and see that the Postal Service is making it more difficult for them to use the postal system.

Reducing the frequency of mail delivery would mark yet another retreat by the Postal Service from the consumer market. Unfortunately, it would give customers yet another reason to abandon the mail and to seek out alternatives.

## **VI. CONCLUSION**

Contrary to the Postal Service’s assertions, eliminating Saturday delivery is not necessary to improving its finances. In my opinion, what the Postal Service needs is a reasonable price increase for market-dominated products, relief from the PAEA’s unfair retiree health pre-funding requirement and a revival of the economy. Indeed, going to five-day delivery is not only unnecessary but would be harmful to the long-term health of the Postal Service. To be a successful service-oriented enterprise, the Postal Service must focus on making its services more, not less, available to its customers.