

# Is Home Delivery FOREVER?



If this were a race, the United States Postal Service—the deliverers of “snail mail”—would be the tortoise.

Anyone you designate as their competitors—FedEx, UPS, the Internet—would be the hares.

As in the fable, the USPS is not in the lead.



The postal service conjures up images of bulkiness and slowness. For good reason: They have 574,000 employees; they operate 260,000 vehicles (the largest fleet in the world, which in 2009 consumed 444 million gallons of gas at a cost of \$1.1 billion); and in 2011 they delivered 177 billion pieces of mail.

They've been hit hard by their competition. Their revenues have declined sharply. Thanks to a strong union, they are among the highest-

paid government employees, averaging about \$83,000 per year. Their cost structure remains as inflexible as a mailbox. They have been saddled with prefunding their retirees' health benefits by making annual payments of about \$5.5 billion in a 10-year span. And they are restricted in their ability to create new revenue streams by their own stepparent, the U.S. government.

Can the United States Postal Service survive? Can they even finish the race they are in?

#### RETURN TO SENDER

“Their hands are tied,” says Jaimi Goodfriend, adjunct lecturer of finance and director of the Investment Banking Academy for the College of Business. “Other firms have a wide range of options to improve profitability, but the post office is severely limited in its flexibility. For example, most firms can cut costs by exiting unprofitable business lines. The post office loses money every time it delivers a letter, but they can't cut that. Further, they don't get to merge like

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Legislation has required the USPS to pay \$5.5 billion each year for 10 years to prefund retirees' health benefits



There are 574,000 employees in the USPS, and the average salary is \$83,000 per year



More than 400 million gallons of gas are used each year to operate nearly 260,000 vehicles



The USPS delivers more than 177 billion pieces of mail each year and operates 31,000 offices



It is estimated that by discontinuing Saturday delivery the USPS could save \$2 billion per year

a FedEx and Kinko's does to vertically integrate, cut costs, and diversify their revenue streams."

A primary problem is their business structure, says Seung-Hyun Hong, associate professor of economics. "Their cost structure is inflexible, partly because of the universal postal service obligation that requires the USPS to provide services even in unprofitable areas."

Hong notes that the USPS was given the postal monopoly to meet the universal service obligation, but that's not enough these days because of declining revenues. "One solution to the current problem is to find other sources of revenues as foreign postal services have done when modernizing their services," Hong says. "I don't know if the USPS would be successful; that's another story. But the problem is that's not even possible at this moment. Their hands are tied in terms of both costs and revenues. Especially with the law enacted in 2006, the post office cannot do non-postal business anymore."

In addition to the business structure problem, the 2006 Postal Accountability and Enhancement Act (PAEA) forced the USPS to prefund its future health care benefits to retirees—to the tune of about \$5.5 billion per year through 2016.

"They have this ridiculous debt burden due to government mandates that would bankrupt any business if you think about it," Goodfriend says. "Historically, the post office was profitable, but it was forced to borrow to fund its obligations. Now it's so steeped in debt



"The problem is it's a quasi-federal agency. Everything is determined by Congress, and they have to follow what they say. They can't run like a private business."

Seung-Hyun Hong

that all of its cash flow—and then some—is being used to repay it. Without the [PAEA] in place, they would have been fine."

Goodfriend points to other struggling companies who have been bailed out by their parent companies. "But the USPS is funded by a very

broke parent," she says. "They are largely restricted by the government with their business development. The sustainable, door-to-door delivery service operates at a loss, so it's not likely they can use that to fund growth. Management can't ask mom and dad to improve things."

Indeed, when the postal service announced earlier this year that it would reduce annual costs by about \$2 billion by trimming Saturday delivery service, Congress mandated that they continue Saturday delivery. "Stopping Saturday service would help a little bit, but not a lot," says Hong. "The fundamental problems are still there with the declining revenues. It's not going to change the trend."

"The problem is it's a quasi-federal agency," Hong continues. "Everything is determined by Congress, and they have to follow what they say. They can't run like a private business."

#### SIGNED, SEALED, DELIVERED?

Hong notes that while the USPS earned more revenue in 2012 than UPS and FedEx (\$65 billion to \$53 billion to \$43 billion, respectively), the rate of compensation to revenue tells the truer story. "The ratio of com-

penetration and benefits for current employees in the USPS is about 73 percent of their revenue," he says. "For UPS and FedEx, it is about 52 percent and 38 percent, respectively. It's worse when including pension and benefits for retirees—then it's about 94 percent for USPS. Of course, this is partly because of the universal service obligation that needs manpower to deliver mail everywhere, but it still suggests a serious problem facing the USPS."

Hong says the postal service peaked financially around 2006, but that the PAEA was only one reason for its decline. "The fundamental problem is that its revenues are determined by market forces, but its major costs related to compensation and benefits are determined by the federal government," he says. "And the market has changed over time. People are using the Internet for email and for online bill payments. Revenues from single-piece first-class mail deliveries have dropped from about \$20 billion in 2000 to about \$10 billion in 2012. But despite their efforts to reduce costs, the USPS does not have much flexibility in adjusting the main part of its costs, unlike its counterparts in the private sector," Hong says.



"They have this ridiculous amount of debt due to government mandates that would bankrupt any business."

Jaimi Goodfriend

"The cost structure is ruining the post office," Goodfriend agrees. "Most businesses would be able to reduce costs to survive. They need to have Congress step in and work on their cost structure."

When the mandate of the PAEA ends in 2016, "it will ease the burden a little bit," Hong says. "But the main problem is that if they keep doing the

same thing they are doing and don't find new sources of revenues, their profit is going to decline. That's pretty clear."

In 2011 the postal service announced it would eliminate 28,000 jobs, closing 252 of its 461 processing centers (at its peak, it operated 673 processing facilities). But that's a few drops in the bucket for an agency

that operates 31,000 post offices and has more than half a million employees.

#### GETTING THE STAMP OF APPROVAL

So what would help the USPS? "There are two solutions," Hong says. "You can go back to the original system, when they were a full government agency. It would still be a problem, but it would be part of a bigger problem. Another solution is to renounce the universal service obligation, and let everything become private and let the post office start new businesses. Of course, neither solution is ideal."

For all of their problems, Goodfriend says, the USPS is still relevant. "You have to get mail," she says. "And there are certain types of mail that cannot be emailed or replaced electronically. Door-to-door delivery must continue to exist. Bulk mail has to be mailed. There's a place for their service. There's a decreased need, but it's still there."

Hong agrees. "They will survive. The government won't let the USPS go bankrupt. They won't disappear. And, over time, when the problem becomes even more severe, they may come up with a better solution." •

Tom Hanlon