



TESTIMONY OF  
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BEFORE THE  
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE AND THE  
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OF THE  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM  
U.S. HOUSE OF REPRESENTATIVES

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Chairman Lynch, Ranking Member Chaffetz, Members of the Subcommittee, thank you for your invitation to testify before you. I represent the American Catalog Mailers Association or ACMA, a relatively new group owned and controlled by catalog marketers and their suppliers. While catalogers, with few exceptions, have not been particularly active in postal policy until recently, I am a long time student of postal affairs and am honored to be able to represent such a fine segment of the mailing industry.

Half of America buys from catalogs. For those who are active catalog shoppers, the catalog's arrival in the mail is an exciting event; one that helps keeps mail interesting and relevant. Catalogs also provide significant social and practical benefits by delivering goods and services to shut-ins, infirm, elderly, handicapped or rural citizens, none of which can access stores with any ease. Catalogs are also eco-friendly. In essence, they are America's biggest carpool; they relieve congestion and save both fuel and time. Catalog shopping is particularly helpful to time-starved single parent families and dual-income households.

When Congress first set up the Postal Service with the Postal Reorganization Act in 1970, it realized it did not want to be in the business of arbitrating postal rates. In its wisdom, it set up the Postal Rate Commission and defined a deliberately contentious process, similar to a full-blown litigation, where competing interests argue their case to get what they need from the government-sponsored monopoly. What developed over 36 years of intense litigation was a series of rate structures supported by a postal accounting system that, to my knowledge, has no parallel in either GAPP accounting or the private sector.

In 2006, Congress modified this cost-based rate-making system with instructions to the postal community to consider market conditions, efficiency, predictability, and value to sender and recipient. It was designed to grow volume, creating a financially-sound Postal Service. Congress also reaffirmed the content value of

what gets delivered each day with the continuing importance of the educational, cultural, scientific or informational value of mail.

While the Act is clear that products are to cover their costs “*through reliable causal relationships*,” cost is now but one of many considerations. Moreover, the postal accounting system in use today was built through intense litigation. It is not the same as a standard cost system built using generally-accepted methods by operational and financial experts. Just as the rate-setting process has changed with the Postal Accountability and Enhancement Act of 2006, it is also time to change the cost accounting approach. Time does not permit me to delve deeply into these issues other than to note that the setting of prices and the allocation of costs is a complex issue properly placed with USPS management with the review and concurrence of its Regulator.

Today, we have an amalgam. We are not only on a necessarily long path to recognize market forces in pricing decisions, but we also still struggle with a legacy of cost-based rate setting. Old habits die hard.

Given the changing postal landscape, I would suggest that we consider a more accurate and more appropriate way of viewing things. Today, technology provides a variety of non-mail communication substitutes. This is particularly important in a high fixed cost system operating well below its available capacity. As more volume leaves the system, the cost on all remaining pieces goes up. Using a non-standard cost justification to push the prices up further just perpetuates the downward spiral.

The financial standing of the USPS makes it clear that it is time to do things differently. In fact, from my experience with turning businesses around I can conclude that when things are dire, it is exactly the time to stop doing the same things as they have always been done and instead press forward to innovate rapidly. With this must come an increased tolerance for making mistakes but it is

often riskier to not change at all. To my view, Congress and the postal regulator would do well to encourage the USPS to innovate at an accelerated pace, even recognizing that this means we will try some things that work, and some that don't.

Useful concepts can be found in private industry. For almost every company, the profitability of products varies and customers often buy in more than one product category. Companies regularly look at the totality of sales into each customer segment to calculate that segment's profitability. It is instructive to understand a customer's use of all products and the intertwined relationship between them.

Applying this to catalogs, we mail in Standard Mail flats, a product determined by traditional postal accounting methodology to be not covering its costs. However, catalog marketers also send catalogs in nearly equal proportions in Carrier Route rate bands, a product category clearly covering its costs and generating a net contribution to the USPS. From the customer perspective, these are inseparable as marketers send catalogs in both of these rate groupings in the very same mailing event. Actually, if one were to combine the two catalog rate categories in to a single service classification, the total would be net positive in contribution.

Catalogers also originate profitable Standard Mail letters and postcards. They also send considerable First Class Mail for things such as invoices and FTC required notification letters, among other communications. Even with widespread Internet use, catalog end consumers still return significant numbers of written orders via First Class mail. Meanwhile, catalog marketers spend nearly as much to ship packages to customers as they do to mail catalogs; the USPS share of this business is relatively minor, representing another opportunity for additional USPS revenue growth.

The key point of my entire testimony, and perhaps one of the most significant keys to the future survival of the Postal Service, centers around *the total*

*customer segment contribution* to operating the Postal Service. As illustrated above, taking decisions in a single product category can lead to changes in volumes in other categories from that same customer segment and thus affect the total financial standing of the entire system either positively or negatively, depending on how the customer segment is managed.

Given the complex commercial relationships across a diverse customer base, segmenting its customer portfolio into progressively finer and finer break-outs until homogeneous customer segments are achieved will allow the USPS to better understand the behavior of its customers and define where it adds value to each business relationship. With this knowledge, the USPS can increase the total contribution from each market segment by optimizing the price and volume relationship.

The greatest segment contribution is not always achieved by the highest price per piece. Sometimes a lower price, which generates maximum volume, is the one that is more profitable and sustainable. This is especially true in a volume-sensitive system with excess capacity. A customer-segmented approach also allows the USPS to manage the content proportion of the mail stream—the amount of highly valued mail from the recipient’s point of view. With all the communications alternatives today, it is critical to keep Americans engaged and interested in mail. Managing the content in the mail does that.

Perhaps ironically, just when the USPS is automating the flats mail stream that there are developments that threaten the amount of flats being processed. The USPS expects to dramatically reduce its cost to process flats with this equipment. But this will only occur if we do not drive flats volumes out of the mail before automation comes on line.

In a similar way, we must resist the temptation to have Congress function as a 538-person board of directors for the USPS. We already have a structure for

appropriate supervision of the Postal Service. USPS managers should be responsible for running their business. The Board of Governors should provide oversight. The Postal Regulatory Commission should provide checks and balances to a government-sponsored agency with what are effective monopoly powers. Congress should allow this established mechanism to do the heavy lifting unless it is clear the structure is breaking down. A time of crisis is exactly when stakeholders should support its management team, not second-guess it, unless the crisis is determined to be of their making. An economically-driven volume decline is not. On the other hand, improper pricing of products that drives industries out of business, improperly encroaching on the private sector using the massive resources of government, or discriminating against interests that cannot protect themselves are all appropriate areas Congress can act on if there is a breakdown in the total established postal policy apparatus.

#### Summary:

A unique postal accounting system developed through years of litigation may not accurately reflect postal costs and certainly does not capture market behavior of customer groups.

It is clear that cost is now only one of many determinants to making postal product pricing decisions.

It is clear that the infrastructure of the USPS is very hard to reduce and that the system needs to retain and grow volume. It is also clear that the catalog industry, which has a significant demographic tailwind behind it, is a great segment for USPS managers to focus on for long-term, sustainable growth.

It is also clear that as catalog postage goes up, catalog volumes are going down. The rapid and dramatic change to catalog postage costs in 2007 (as a result of the R2006-1 rate case) fundamentally altered the economics of this industry segment, reducing its mail volumes. In fact the entire catalog supply chain

remains severely strained from these large postal rate hike catalogs so that even today, three years later, many catalog companies are still trying to reduce their use of mail.

In a high-fixed-cost system, as units leave the mail, the fixed-cost load must be spread over fewer units. This is significantly increasing the cost of catalogs. In fact, the Standard Mail flats category was covering its costs until the 2007 increase triggered a dramatic reduction to catalog circulations.

Now is precisely the time to abandon approaches that no longer serve us. We must truly move to a market-based postal system if we are to have a sustainable agency, for without these postal customers, the one's that provide over 90% of the cost of running a national post, the cost of universal service as well as all the future obligations of the USPS will necessarily become an added burden to the taxpayer. This is obviously something none of us want or need.

Thank you for the opportunity to testify before you today. I would be happy to answer any questions you may have.