



Testimony of Hamilton Davison
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Postal Service, and the District of Columbia
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Good morning, Chairman Davis and distinguished members of the Subcommittee. My name is Hamilton Davison, and I am the Executive Director of the American Catalog Mailers Association, or ACMA. Thank you for inviting ACMA to testify today.

I would like to address three topics:

1. Why catalog mail is unique, valuable, and critical to the U.S. economy and, in particular, to the future of the Postal Service.
2. How the unexpectedly large postage increases—on the order of 20 to 40%—will harm the catalog industry and the Postal Service if no remedial steps are taken.
3. Why the Postal Service's ability to respond to its customers in a business-like manner is essential to both the survival of the catalog industry and the commercial success of the Postal Service. In this respect, I will suggest specific steps the Postal Service should take to respond to the crisis in our industry created by the recent postage increases.

I. Catalogs are Critical to the U.S. Economy and the Postal Service.

A. Catalog Companies Play a Key Role in U.S. Commerce.

ACMA represents a growing list of the estimated 20,000 business-to-business and business-to-consumer catalogers nation-wide, from household names like Crate & Barrel to smaller companies unrecognized outside of their niche markets. Catalogs

have a deep and wide reach into the U.S. economy. An estimated 49% of consumers buy from catalogs. (*Source: MediaMark 2006.*) Virtually every major catalog company today has a significant web presence to provide details of its products and accept online orders. The combination of catalog and online sales drive revenues of more than \$270 billion a year—or roughly a million dollars every two minutes.

Catalogers boost the U.S. economy in a number of other ways as well. Directly and indirectly, we employ an estimated three million Americans in relatively high paying white collar and blue collar jobs. We pay hundreds of millions of dollars in state, local, and federal taxes. We also provide a way for smaller, mom-and-pop companies to connect with consumers in a market increasingly dominated by large, consolidated retail stores.

Despite the growth of online business, the mailed catalog remains the primary driver for new customers and product sales. In fact, studies show that catalogs play a role in 80% of online sales. (*Source: Interactiveretail.com.*) Moreover, even those companies that derive most of their sales from other channels still view the catalog as a vital communications tool. As a result, the U.S. Mail remains critically important to catalog companies.

Unfortunately, the Postal Service is only now beginning to realize the potential contribution catalogs make to its long-term success. For example, the Postal Service does not yet calculate catalog-specific demand elasticities (i.e., how much an increase in postage price will affect catalog volumes), nor does it track the total number of catalogs mailed, even though industry estimates put the annual number of catalogs at 20-30 billion pieces—which means that catalogs constitute a significant percentage of the Postal Service's total business.

B. Catalogs Add Value to the Mail as a Form of Communication.

In addition to billions of dollars in revenue and contribution derived from postage, catalogs make the entire mail stream a more viable distribution channel because *people like catalogs*. A glance in any mailbox will show that advertisements make up more and more of today's mail, but unlike other advertising mail that is often pitched unopened, consumers welcome catalogs. Postal Service surveys show that people look forward to receiving catalogs; they read, save, and order from them. People like catalogs for the same reasons they like magazines: they offer products, ideas, and information relevant to their specific interests like home decorating, fly fishing, camping, cooking, or other activities. Moreover, catalogers do their best to send their relatively costly mail pieces only to those who enjoy a specific hobby or need their products. For businesses, catalogs offer essential products that cannot be bought at a

retail store, such as workplace safety equipment or employee training materials. In short, catalogs help keep the mail relevant.

For these reasons, internet commerce has not sounded a death knell for catalogs. To the contrary, synergies between the two have grown. Even for those who have internet access, catalogs offer something the internet cannot: an exciting, hard copy presentation to thumb through and products to plan for and dream about. For those in isolated areas without specialty retail stores or high-speed internet access, catalogs open the door to almost any kind of product one may need: from swimsuits to swimming pools, linguini to lingerie. This service is particularly important for the millions of Americans who, on account of advanced age or disability, cannot easily drive or walk through enormous retail stores or shopping malls.

Catalog companies are not “occasional mailers.” They mail *every* month *every* year and spend billions in postage annually as a result. Catalogs also have a “multiplier effect” that provides recurring revenue for the Postal Service. Every time a catalog company receives a response to a prospect catalog, it generates 30 to 40 new pieces of mail in the form of future catalogs, invoices, and packages. Thus, if the Postal Service wants to increase its volume, it needs look no further than the catalog industry. For its part, the catalog industry remains intimately tied to the Postal Service because postage makes up so much of its overall marketing costs. A better partnership between the Postal Service and catalogers will only benefit both.

II. The Unexpectedly Large Postage Increases Have Hurt the Catalog Industry and its Potential for Growth, and Will Harm the Postal Service Unless Immediate Action is Taken.

How has the R2006-1 rate increase affected our industry? I wish I could say that the catalog industry has simply taken the rate hike in stride and moved on, but I cannot. To the contrary, the unexpectedly large 20-40% increases (in contrast to the 9-12% increases widely expected) hit us hard. Catalogers are particularly sensitive to such rate increases for several reasons:

- Postage makes up from 8% to over 20% of overall costs, the largest component aside from the cost of the product itself. Any increase in postage—particularly a large and unexpected increase—is keenly felt.
- The catalog business is a comparatively high volume, low profit undertaking. A well-run catalog company typically has a 5% profit margin. But if you take such a company and apply a 35% increase to a cost center that represents 8% of sales (and for catalogers postage generally represents 8% or more), it will

reduce that 5% profit company to a 2% profit company, and the business can no longer fund growth. If it has any bank debt or outside investment at all, it may not be able to earn its cost of capital, and over time will cease to exist.

- Of necessity, catalogers face long planning cycles. A successful catalog business requires careful planning and experimentation. We test and carefully measure everything extensively—different covers, sizes, and layouts, different sources for prospects, different offers—and we tweak that formula gradually over time based on success. Catalogers are also locked into long-term print and paper contracts and make forward commitments to merchandise and build inventories to be able to ship orders promptly.

These industry characteristics make it hard to “turn on a dime” and respond to unexpected—and unexpectedly large—rate increases. At ACMA, we have interviewed many catalogers who have seen much of their profit and cash flow for this year wiped out overnight by the postage rate increase. As you might expect, this has caused many catalogers to rethink not only their marketing plans but also their entire business plan. Such heavy reliance on the vagaries of postage rates now seems a major vulnerability to their business.

How have our members responded to the rate increases in the short term? Some are actively pursuing substitutes to mail to reduce their reliance on mail, which ultimately hurts the Postal Service. Once a company leaves the mail stream and makes the investment necessary to support other advertising channels, it will be much harder to get them back.

Others are reducing the volume of catalogs they mail. As the cost of a mailing increases, the number of customers who generate enough business to justify a catalog decreases, forcing the cataloger to trim circulation.¹

¹ Catalogers have also tried to mitigate the effects of the rate increases by changing their mailing practices. Nevertheless, most of our members cannot, for example, easily fold a catalog in half—turning it into a letter—because their catalogs are often far too thick. But even if they could, doing so would likely devastate the response rate. Covers of catalogs—the most carefully designed part of all—play a key role in converting prospects to customers and inducing regular customers to open the catalog, browse through it, and place an order. Repeat customers have also come to expect a particular look and feel. Mail pieces define a brand, and simply changing formats—without extensive testing and validation—poses a huge risk. Similarly, co-mailing, whereby mailers group their mail together to qualify for a lower postage rate, does not offer a practical solution for most of us. First, printers must get a return on their investment on expensive co-mailing equipment and take a not insignificant portion of potential savings. Second, most printers currently lack the capacity required and, in any event, often give

The response that should alarm the Postal Service most is that catalogers are deciding to *cut prospect mailings—a vital source for new business and the key to the industry’s continued growth*. In prospect mailings, a cataloger sends handpicked consumers a sample catalog. As I mentioned earlier, every successful conversion of a “prospect” to an active “customer” results in several dozen additional pieces of mail per year for two to three years. Through prospecting, catalog companies expand their list of customers. But prospecting can be a risky and expensive proposition, and postage remains the biggest component of this expense.

Cuts in prospect mailings should concern the Postal Service because, if the trend is not reversed, it will be hard to check a downward spiral in volumes.² A vibrant, thriving catalog industry offers huge benefits for the Postal Service, not only by increasing mail volumes but also by keeping mail a relevant and welcome form of communication. This past year’s drastic rate increases endanger the goose that laid the golden egg, and we would like to work with the Postal Service to reverse that trend.

preference to magazines. Lastly, co-mailing requires a cataloger to time production with other catalogers—something that sounds fine in theory, but proves extremely difficult in practice.

² Consider the real-life effects of the R2006-1 rate increase on one of our members: Positive Promotions, headquartered in Hauppauge, NY. The company sells ribbons, certificates, lapel pins, bookmarks, coloring books, pencils, pens, and other products that educate and inform people on public interest topics ranging from breast cancer and drug abuse to fire safety and Black History month. Its customers are schools, non-profit organizations, fire departments, and small businesses. Companies like Positive Promotions reflect the face of America. They are a union shop, and employ nearly 600 people, including a wide range of white collar and blue collar workers, like graphic designers, photographers, writers, layout experts, database managers, IT staff, accountants, buyers, sales and customer service representatives, managers, and factory and warehouse workers of all kinds. Over half of their employees are minorities. Others are immigrants, and they offer an ESL (English as a Second Language) class on the factory floor.

Like most catalogers, Positive Promotions expected postal rates to increase in the R2006-1 rate case. They expected, however, a worst-case increase of about 9%. As a result, the company was stunned to discover that its annual postage costs would increase by 35%—nearly four times more than their worst-case scenario. That translates into a \$2.2 million hit—a huge hit for a company that size—and one that they anticipate will cut pre-tax profits by 40%. Positive Promotion has seen postage take a large bite out of cash flow they need to fund growth. Growing companies need additional working capital to fund inventory expansion, additional accounts receivable, additional mailings (catalogs and postage), and other expenses.

Positive Promotions operates on tight margins, which means that it has to make up the postage increase money somewhere else: by cutting staff, cutting capital investment, and/or cutting circulation. Beyond that, the unexpected rate increase puts the company on an entirely different trajectory, changing it—almost overnight—from a vibrant, growing company into one forced to tread water. Put differently, it means that, in the future, the company may not be able to do prospect mailings to generate new

III. Setting Catalog Rates in a More Business-Like Manner Will Help Both the Catalog Industry and the Postal Service Succeed.

We believe that the new Postal Accountability and Enhancement Act (the “PAEA”) provides the Postal Service with the tools it needs to address the crisis in the catalog industry created by the R2006-1 rate increases. We support the Postal Regulatory Commission’s proposed regulations that implement the PAEA and give the Postal Service greater flexibility to set prices in a businesslike manner. And we applaud Chairman Dan Blair’s leadership in getting the first set of regulations out well ahead of schedule. With the ability to consider not just costs but market characteristics as well, the Postal Service can now respond quickly to shore up the catalog industry, a move that would benefit the Postal Service itself in both the short term and the long term. We have a shared goal with the Postal Service: to ensure that mail remains an important and vibrant channel of communication for many years to come.

The Postal Service can use its new authority to help our industry in the following ways:

1. First and foremost, we want the Postal Service to get to know us as an industry and as individual customers. In the past, the Postal Service may have thought of us as just another mailer of Standard Mail flats, but we are a unique industry and an eager customer. ACMA was created to provide an identity and voice for catalogers separate from other mailers. The Postal Service has thus far welcomed our contribution.
2. Catalog mail represents a unique product, different from other forms of Standard Mail. We have a different business model and a different approach to mailing decisions. Catalogs benefit other forms of Standard Mail and the entire mail stream by adding value and keeping mail relevant and interesting. As a result, catalog mail should be priced differently.
3. Creative pricing arrangements are essential during this crisis period and for the future of the industry. In particular, we need to explore together innovative rates to encourage prospect mailings. Given their high multiplier effects, prospect mailings can translate into significantly more mail pieces—and therefore significantly more revenue—for the Postal Service.

business, to increase circulation, to hire new employees, or to provide new or greater benefits to existing ones.

4. Many of our members want to pursue Negotiated Service Agreements (or “NSAs”) with the Postal Service. Volume incentive discounts not only encourage catalogers to send more mail, they also offer the Postal Service an opportunity to get to know us and our business needs better. But many of our smaller members—the very companies hit hardest by the rate increase—may be considered “too small” to justify the significant commitment of time that it takes for Postal Service executives to complete an NSA negotiation. The Postal Regulatory Commission has done its part to streamline the regulatory approval process, but we need the Postal Service to respond with an NSA program that is accessible to mailers of all sizes.
5. We also need the Postal Service to work with catalogers directly in regard to both the operational and pricing details of its new Flats Sequencing System (FSS) machines. Already reeling from the postage increases, our industry faces additional disruption as the Postal Service rolls out FSS over the next few years, and we want to be prepared for it and have a say in the decision making process. ACMA has recently been invited to participate in the Mailers Technical Advisory Committee (MTAC), and we look forward to participating in that group.

Chairman Davis and members of the Subcommittee: We greatly appreciate the role that Congressional oversight plays in safeguarding our national postal system and in supporting U.S. industry. The recent PAEA, which you were so instrumental in passing, provides the Postal Service with critical new tools to move forward in a more business-like manner. We realize that Congress is not in a position to address many of the specific issues we have raised today, but there is one thing you can do: Since no innovation takes place without support from the top, we urge you to endorse the Postal Service to embrace innovation and rational experimentation in its efforts to become a more business-like entity.

In this new world of the PAEA, we will do our part to work with the Postal Service to craft creative solutions and to make the best business case why encouraging catalog mail is in the best interests of the Postal Service itself.

Again, thank you for the opportunity to testify this morning, and thank you for taking the time to understand these issues that are so crucial to our industry and to the future of the Postal Service.