



Assessment of Worksharing

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Executive Summary

For more than 30 years, the U.S. Postal Service has offered worksharing — an innovative partnership with its customers that touches all aspects of its operations. Worksharing is a form of outsourcing where mailers perform specific activities in exchange for reduced postage prices. From modest beginnings, worksharing has evolved into a complex program affecting most mail volume and driving fundamental Postal Service operations. It has also caused much debate. To some, it liberated an upstream supply chain to the private sector, increased efficiency, grew mail volume, and allowed the Postal Service to provide more customized pricing consistent with its customers' needs. To others, it exposed the Postal Service to revenue risks, provided subsidies to big mailers, and sacrificed postal jobs to unfair competition.

The U.S. Postal Service Office of Inspector General Risk Analysis Research Center assessed the worksharing program and offers the following key findings.

- *Worksharing has rapidly grown to dominate the Postal Service's business and today represents over 80 percent of mail volume. Worksharing determines where mail is deposited and how it is processed.*
- *Worksharing has supported the growth of a large mailing industry that allowed mailers to take on a much larger role in preparing and presenting their mail.*
- *The Postal Service provided \$15 billion worth of discounts for work that saved \$14.8 billion in avoided costs in fiscal year 2008.*
- *Worksharing has a crowded field of influential stakeholders with widely differing views on how it should operate. While many are concerned about the price of postage, others are concerned about the level of the discounts or the competition for work and jobs.*
- *The Postal Service's ability to retain earnings under the Postal Accountability and Enhancement Act of 2006 may create an incentive for the Postal Service to set discounts to be less than the Postal Service's avoided costs, especially in areas where discounts greatly exceed mailer cost.*
- *Because workshare discounts may greatly exceed mailer costs, there could be instances where less efficient providers might be engaging in worksharing in opposition to lowest combined cost principles of economic efficiency.*
- *As worksharing has grown, it has created unintended consequences. Complicated rules and rates may shut out new entrants or less experienced mailers and make it hard to ensure the correct rates are being paid.*
- *While some may criticize the Postal Service's worksharing efforts, the Postal Service is recognized as having the largest, most sophisticated, and most transparent worksharing program in the world.*

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Assessment of Worksharing

Background

The issue of worksharing was once a relatively quiet economic debate conducted solely by interested parties during rate case proceedings within the confines of the Postal Regulatory Commission (PRC).¹ Today, it has become a heated and highly politicized public debate that has spread even to the halls of Congress. As workshare discounts became more widespread, they also became more controversial. In general, mailers and Mail Service Providers (MSPs) favored larger discounts while Postal Service competitors and the American Postal Workers Union (APWU) favored smaller or no discounts.

PRC Docket R2006-1 was the fourteenth and final omnibus rate proceeding under the Postal Reorganization Act of 1970 (PRA). The omnibus rate proceeding was a public forum that allowed postal stakeholders an opportunity to intervene and inform policy deliberations, and over the years, worksharing evolved as a product of those deliberations. However, under the Postal Accountability and Enhancement Act of 2006 (PAEA), the omnibus rate case was eliminated although the PRC retained regulatory authority to review worksharing and ensure compliance. Today, the Postal Service proposes price changes to the PRC 45 days before the new prices become effective and changes must comply with certain rules for establishing worksharing rates and prices. Adjustments to prices at the class level are limited by an index of inflation² and workshare discounts cannot be more than the cost the Postal Service avoids, except in four limited exceptions.³

The public forum in the PAEA environment consists of the PRC issuing a public notice to open a docket to discuss a specific issue. Stakeholders are encouraged to provide their written comments as well as reply to written comments made by others. If necessary, the PRC will hold public forums or hearings. However, what was once a closely organized, highly technical, proactive discussion and review of the topic is now a reactive administrative procedure with limited interaction.

While much of the discussion surrounding worksharing is very complicated and open to interpretation, there is much that can still be said to inform the debate. As part of this

¹ To learn more about the basics of worksharing, see the General Accounting Office (GAO) report, *U.S. Postal Service, A Primer on Postal Worksharing*, July 2003, GAO-03-927.

² Adjustments are limited by Consumer Price Index for All Urban Consumers (CPI-U). Classes of mail include First-Class Mail, Standard Mail, Periodicals, and Package Services.

³ PAEA Section 3622(e)(2) Exceptions: (1) If the discount is new or a change to an existing postal service and it will be phased out; (2) If the amount of the discount above costs avoided is necessary to mitigate rate shock and it will be phased out over time; (3) If the discount is provided in connection with subclasses of mail (i.e., Periodicals) consisting exclusively of mail matter of educational, cultural, scientific, or informational (ECSI) value; or (4) If reduction or elimination of the discount would impede the efficient operation of the Postal Service.

effort to make an independent assessment, the U.S. Postal Service Office of Inspector General (OIG) interviewed stakeholders including the Postal Service, the PRC, unions, mailers, and congressional staffers. We also conducted our own analysis. We present the following key findings.

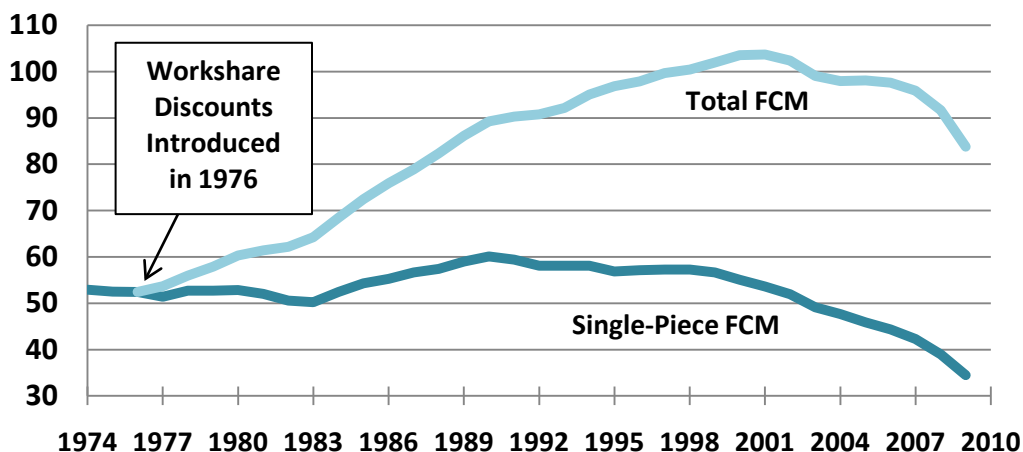
Key Worksharing Findings

1. Worksharing Has Rapidly Grown to Dominate the Postal Service's Business

From humble origins, worksharing has grown to become a key piece of the Postal Service's business. In 1976, the Postal Service introduced workshare discounts for presorting First-Class Mail (FCM). Over the next several years, the Postal Service expanded this early concept to Periodicals and Standard Mail. Starting in the late 1980s and early 1990s, the Postal Service introduced automation and destination entry discounts which also spread across most mail classes.

Worksharing has proven to be very popular with business mailers and has grown rapidly in all major mail classes. The following three figures depict the increase in mail volume when worksharing was introduced to FCM, Standard Mail, and Parcel Post. Figure 1 depicts how FCM volume increased tremendously upon introduction of workshare discounts in 1976 while single-piece FCM remained relatively flat until its recent declines.

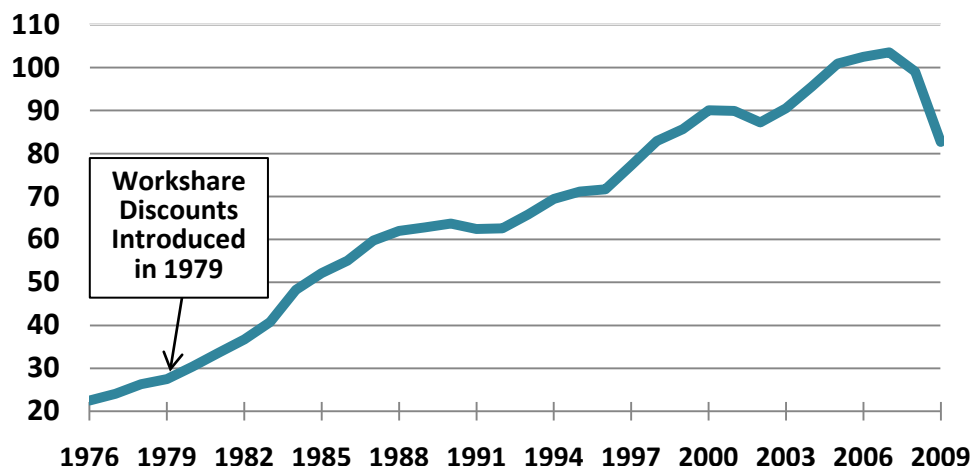
Figure 1: First-Class Mail Growth
(Billion Pieces)



Source: OIG Analysis, based on RPW data.

Figure 2 shows mail volumes also increased significantly when worksharing was introduced to Standard Mail in 1979.

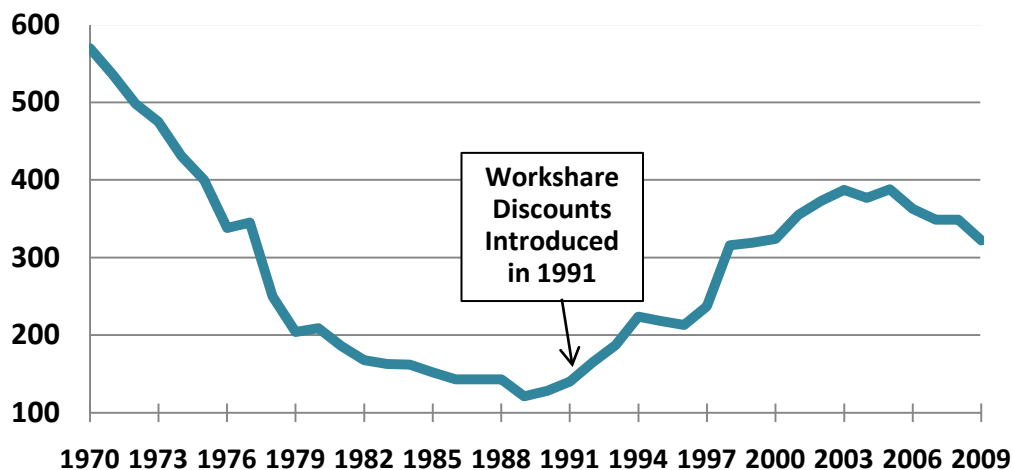
Figure 2: Standard Mail Growth
(Billion Pieces)



Source: OIG Analysis, based on RPW data.

Parcel Post witnessed a dramatic increase in 1991 when worksharing was introduced as depicted in Figure 3. Many observers credit worksharing with creating a parcel consolidation industry and reversing the significant volume decline of Parcel Post.

Figure 3: Parcel Post Growth
(Million Pieces)



Source: OIG Analysis, based on RPW data.

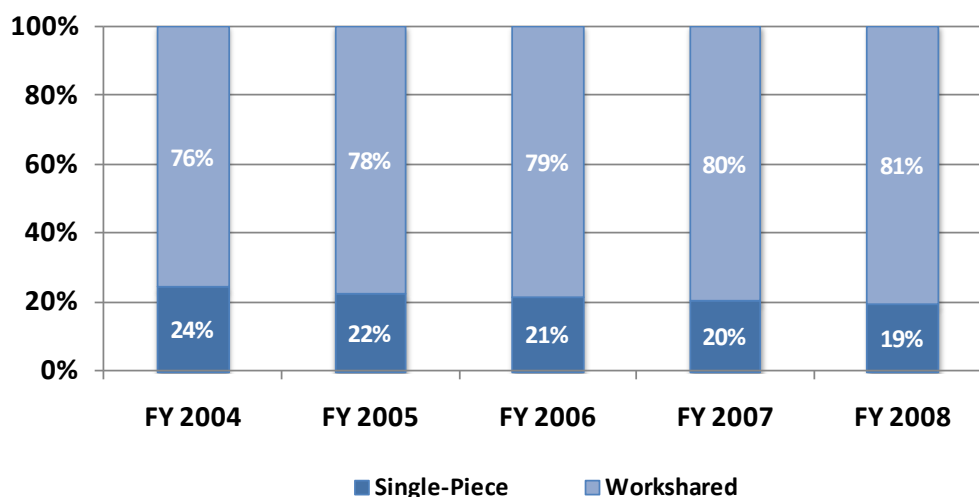
It is important to note that the volume response to workshare discounts has sometimes greatly exceeded standard price sensitivity measures. Worksharing provided discounts which clearly incited mailers to presort, pre-barcode, and drop ship their mail pieces. However, even before workshare discounts were introduced, some mailers were already engaging in those activities to improve service or for other reasons related to

their own business goals. In addition to worksharing incentives, it is also important to note that technological and automation changes enhanced growth as well.

Worksharing did not simply provide discounts, it helped change the way mail was created, processed, and delivered. It amounted to a de-facto outsourcing of large portions of the mailstream that helped lower mailer costs, supported improved service, and engaged influential stakeholders in a new and sophisticated mailing industry.

Today worksharing is mature and stable and has grown to cover over 80 percent of total mail volume and dominates nearly every aspect of Postal Service marketing, business mail entry, and processing operations. OIG analysis identified three prevailing worksharing trends in the figures depicted below. Figure 4 compares single-piece mail volume to workshared mail volume in the three major classes of mail (FCM, Standard Mail, and Periodicals) and shows that the proportion of workshared mail reached 81 percent in FY 2008, reflecting the maturity of the program.

Figure 4: Single-Piece vs. Workshared Mail in the Three Major Mail Classes

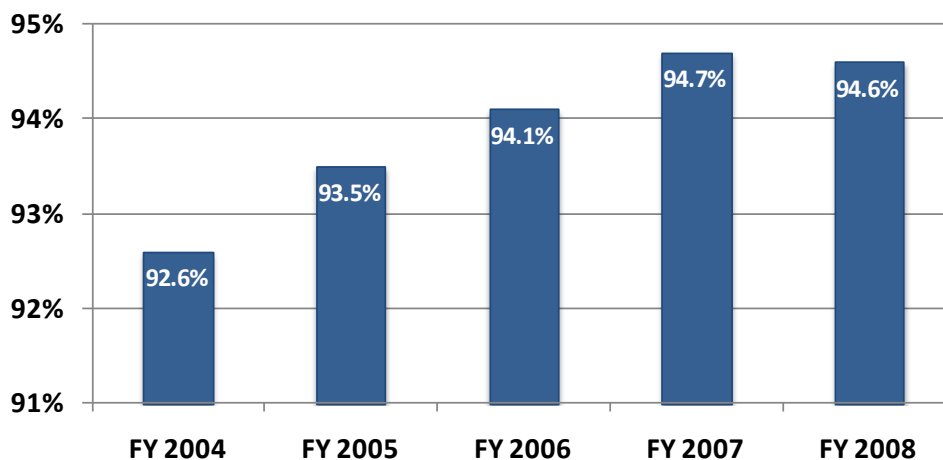


Source: OIG Analysis, based on RPW data.

The second trend reveals that almost 95 percent of workshared mail volume is now entered at automation rates as depicted in Figure 5. Workshared mail volume in the three major classes of mail that qualified for automation rates increased slightly from 93 percent in FY 2004 to 95 percent by FY 2008.⁴

⁴ These percentages were calculated using only the non-Carrier Route volumes. Because Carrier Route mail is not always processed on a machine, not all Carrier Route pieces require a barcode. Thus, including these volumes in the analysis would cause misleading results.

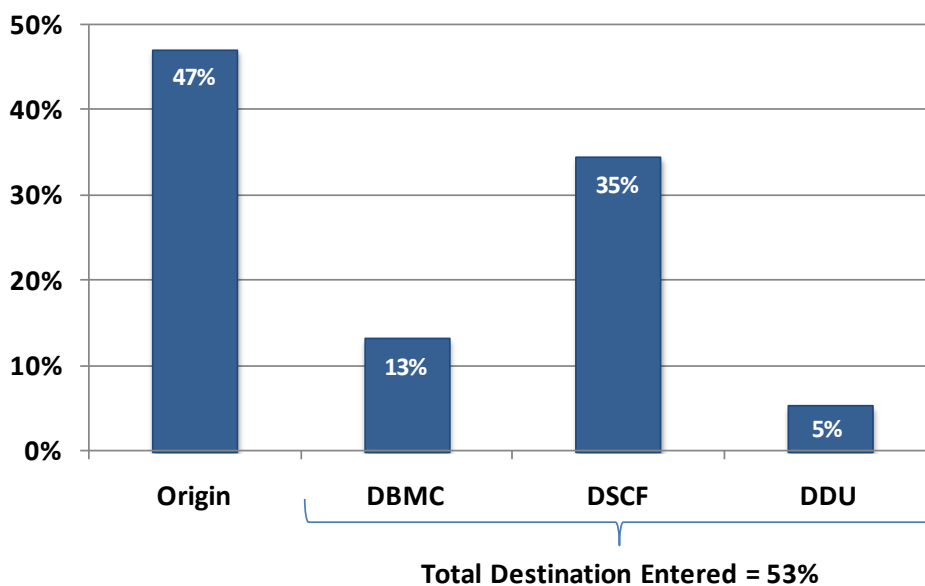
Figure 5: Percent of Workshared Mail Entered at Automation Rates



Source: OIG, Based on NGI Solutions, Inc. Analysis.

Figure 6 depicts the move towards destination drop shipped mail. In FY 2008, over half (53 percent) of all pieces in the three major mail classes received discounted rates for being transported closer to destination. While most of this mail was entered at the destination sectional center facility (DSCF), sizeable shares were also entered at the destination Bulk Mail Center (DBMC) and the destination delivery unit (DDU).

Figure 6: Percent of Workshared Mail by Destination Entry Rate



Source: OIG Analysis, based on RPW data.

2. Workshare Discounts Supported the Growth of a Large Mailing Industry that Shared \$15 Billion in Postal Service Discounts in FY 2008

Workshare discounts have become an essential piece of a mailing industry that has an economic impact of over \$1 trillion and is a source of employment for around 8 million people.⁵ It has allowed mailers to take on a much larger role in preparing and presenting their mail to the Postal Service. It has allowed them to be innovative and cut costs. Worksharing has created new markets. It has allowed rates to be more customized and mailers to use the Postal Service in the specific ways that suit their unique business needs. Workshare discounts have also allowed mailers to improve both service and consistency of service while reducing postage costs. However, this success raises a question: How much of this progress could have occurred anyway at somewhat lower discounts?

Worksharing has also spurred a mailing support industry to help mailers comply with the complicated rules and rates. Many large companies have in-house mailing operations or outsource mail preparation to MSPs. MSPs perform different activities and include direct marketing firms, software vendors, list servicers, presort bureaus, letter shops, printers, fulfillment centers, and mail transporters and consolidators.⁶ Smaller mailers may use MSPs because of the need to efficiently meet minimum volume and other mail preparation requirements to obtain better discounts. Large and small mailers may use MSPs because they need help with complicated mail preparation rules. Others outsource mail preparation to MSPs simply because they want to focus their internal resources on their primary business. Appendix A highlights key members of the worksharing supply chain and some of the activities they perform.

Based on analysis we sponsored, in FY 2008 the Postal Service provided \$15 billion worth of discounts for work that saved \$14.8 billion in avoided costs.⁷ Table 1 depicts the breakdown of cost avoidance by mail class and the discounts passed through to mailers. Overall, the total discounts were more than the costs the Postal Service avoided by \$200 million. Appendix B outlines the details of the calculations.

⁵ 2008 Economic Job Study Final Report issued by the Envelope Manufacturers Association, June 2008.

⁶ The mailing industry supply chain also includes paper manufacturers, envelope fabricators, mail equipment companies, designers, and meter manufacturers. The companies vary in size from small family-owned businesses to major companies that are publicly traded and employ thousands. According to the Postal Service's *Business Insights Report 2010-2014, Quarter III, FY 2009*, list servicers, presort bureaus, letter shops, consolidators, and logistics services share annual revenues of \$24 billion; while printers, graphic artists, and document production and processors share revenues of \$55 billion.

⁷ These figures are generally consistent with the total FY 2004 cost avoidances (\$14.4 billion) and discounts (\$14.1 billion) presented in a PRC Staff Study, *Worksharing: How Much Productive Efficiency, at What Cost and at What Price*, Cohen, Robinson, Waller, and Xenakis, edited by M. A. Crew and P. R. Kleindorfer, 2006, Boston: Kluwer Academic Publishers.

Table 1: FY 2008 Worksharing Cost Avoidance & Discounts by Class of Mail
 (In Billions)

Class of Mail	Total Cost Avoided by the Postal Service	Total Discounts Provided to Mailers	Difference
First-Class Mail	\$4.1	\$4.2	\$ - 0.1
Periodicals	2.0	1.7	+ 0.3
Standard Mail	7.9	8.3	- 0.4
Package Services	0.8	0.8	0
Total	\$14.8	\$15.0	\$ - 0.2

Source: OIG, Based on NGI Solutions, Inc. Analysis.

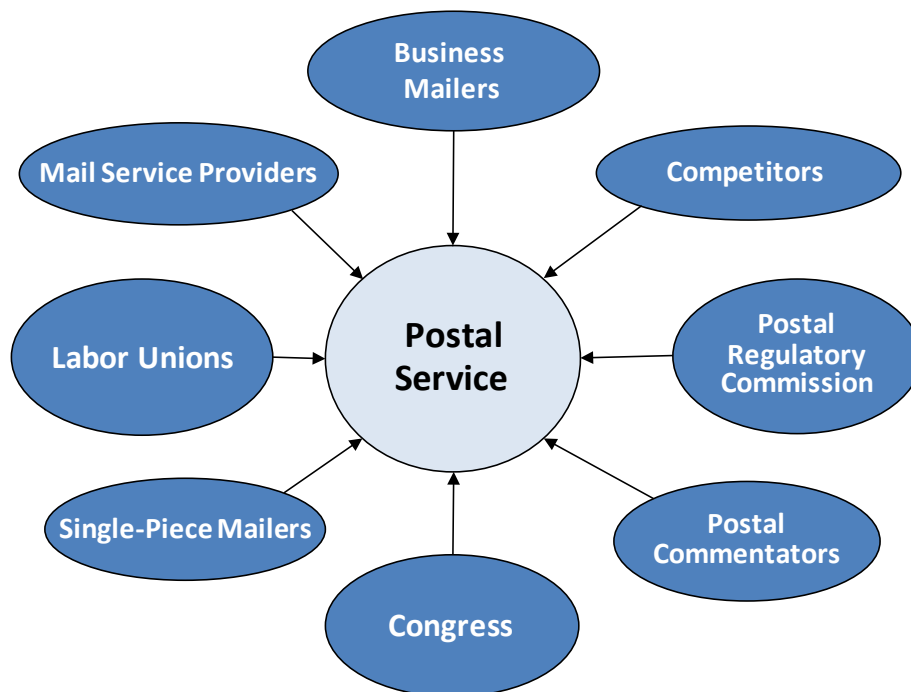
Table 1 shows that, in total, Postal Service discounts were slightly more than the avoided costs. However, it also shows that for some mail classes, discounts are less than avoided costs. While not shown in the table, it is also true that within each mail class, some discounts are *more* while some are *less* than avoided costs.⁸ A key point to understand is that problems with discounts that are set too high (discounts more than the avoided costs) are not eliminated by discounts that are lower than avoided costs even though such problems appear to largely offset each other in summaries like those shown in Table 1.

3. Worksharing Has a Crowded Field of Influential Stakeholders with Conflicting Interests

There is a crowded field of stakeholders with great influence and opposing views and needs. While many are concerned about the price of postage, others are concerned about the level of discounts or the competition for work and jobs. Stakeholders include business mailers, MSPs, Postal Service competitors, Congress, the PRC, unions, and the general public (single-piece mailers). Figure 7 depicts worksharing stakeholders with the Postal Service at the core. Appendix C outlines the landscape of stakeholders and their individual interests in worksharing.

⁸ The PRC, in its *FY 2009 Annual Compliance Determination* report, stated that of the workshare discounts that were examined, 30 discounts exceeded (were more than) the avoided costs. Of those 30 discounts, the PRC determined that 17 were justified by one of the four exceptions outlined in PAEA; however, 13 were not.

Figure 7: Worksharing Stakeholders



The PRC's interests include compliance with PAEA, ensuring adequate revenues and maximizing incentives to reduce Postal Service costs. The Postal Service is primarily interested in worksharing to increase mail volume and reduce costs through efficient operations, staffing, and workload. The unions are interested in increased mail volume as well. However, the APWU⁹ also views mailers and MSPs that perform worksharing activities as competition for union jobs and is focused on discounts not exceeding avoided costs.

Worksharing represents a financial incentive for mailers and MSPs to influence the postal policy debate. Not surprisingly, there have been controversies over the size of workshare discounts, how they are calculated, and how broadly they are applied. The mailing industry is large, representing billions of dollars in revenues and millions of jobs. Mailers and MSPs have developed relationships that have evolved over the 30 year history of worksharing and in FY 2008 saved \$15 billion in postage discounts.

However, the interests of mailers and MSPs are not always aligned. Mailers are focused on postage expense, which can be a very large portion of their mailing budget. For mailers, the mail is a means to an end and is used to accomplish other goals, such as selling products and services and communicating with current and potential customers. Lower prices mean mailers can send more pieces for the same total cost.

⁹ See "New Heights – of Absurdity – In Rate Setting," *American Postal Worker*, November/December 2009, www.apwu.org. The APWU has requested that the Postal Service "discontinue the exorbitant postage discounts that are offered to large mailers and allow members of the APWU to perform all mail processing."

The business model for some MSPs, on the other hand, depends on the level of workshare discounts rather than on postage costs. Some MSPs live on the spread between the basic rates and the discounted rates. As a result, an MSP might be concerned if specific discounts decreased even if overall postage costs declined. For example, if workshare discounts were eliminated, but average postage rates declined significantly, the mailers would be happy, but some MSPs might cease to have as large a role.

Even within the same segment of stakeholders, different sub-segments can have very different views. For example, mailers in different mail classes, such as FCM or Periodicals, can disagree on how discounts are calculated and implemented. Postal unions are divided on the impact worksharing has on jobs. Postal commentators have widely differing views on many aspects of worksharing.

4. *There Could be a New Incentive and Opportunity to Set Workshare Discounts at Less Than Avoided Costs*

The PAEA pricing flexibility and the wide gap between Postal Service discounts and the mailer cost to workshare may create both an incentive and opportunity to set discounts at less than the avoided costs.

PAEA may create an *incentive* for discounts to be less than avoided costs

Efficient Component Pricing (ECP) has governed worksharing economics for over 30 years. ECP principles require workshare discounts to be set equal to avoided costs.¹⁰ For example, if it is estimated that a given activity saves the Postal Service 10 cents per piece, then 100 percent of this avoided cost should be offered to the mailer and the Postal Service sets the discount at 10 cents per piece, thereby lowering the mailer's price by 10 cents per piece.

However, while the mandate of the former postal law — the PRA — was to *break even*, the mandate of PAEA is to *retain earnings*. PAEA also introduced pricing flexibility through the move to price cap regulation. Recent theoretical research sponsored by the OIG revealed that under PAEA the Postal Service may find it profitable to reduce discounts below avoided cost. If this result receives empirical support, the Postal Service may be able to improve its net income by reducing discounts.¹¹ This initial research requires careful, independent analysis to test its practical implementation and might set the tone for the next generation of worksharing.

¹⁰ Docket No. MC95-1, the PRC provided rationale for ECP as the economic premise supporting worksharing and how worksharing discounts should be developed. Docket No. R2006-1, the PRC's Opinion and Recommended Decision, Volume 1, February 26, 2007, the PRC outlines the role of ECP. Also see ECP discussion in the PRC *Annual Compliance Determination, US Postal Service Performance FY 2008*, March 30, 2008.

¹¹ OIG report, *Postal Service Pricing Policies after PAEA* by John C. Panzar, Ph.D., February 8, 2010, (RARC-WP-10-002). Dr. Panzar's research also points out that such discount reductions could be viewed as exclusionary and may cause problems under the antitrust liability also introduced under PAEA. The empirical support for reducing discounts would rely on the relative price elasticities and unit contribution of workshared and non-workshared mail. The specific volume responses of mail categories or individual mailers to small price changes vary over time and could impact net income in either direction.

For example, if a given activity saves the Postal Service 10 cents, past practice would have been to say the discount should be set at 10 cents. But, the new incentives under PAEA suggest the discount could be set at less than 10 cents. The Postal Service could set the discount say at 8 cents and keep 2 cents to channel back into the business.

Discounts that exceed mailer costs to workshare create an *opportunity* for setting discounts at less than avoided costs

While changed incentives may encourage the Postal Service to set discounts at less than avoided costs, it is essential that the spread between the mailer's cost and workshare discount be large enough so that there is an opportunity to lower the discount. When calculating workshare discounts, the Postal Service estimates the cost that it avoids largely by creating models that mimic Postal Service mail processing and transportation activities. Cost inputs used in these models are obtained from various statistical programs and are based primarily on averages and statistically sampled data.¹² There has been controversy over the Postal Service's cost savings estimates, and pre-PAEA rate cases often spent a great deal of time on those issues. It is important to note that those savings are projected estimates only.¹³

The costs for mailers to engage in worksharing activities have not been part of the debate about cost savings estimates. However, a PRC staff study estimated that for mail processing discounts, the costs to the largest and most efficient mailers and MSPs was never greater than 20 percent of the discount received. The study also estimated that for transportation discounts the cost to the mailer was never more than 50 percent of the discount received.¹⁴ The OIG applied the PRC staff study cost estimates to the \$15 billion in Postal Service FY 2008 discounts to mailers. Table 2 below shows the resulting estimates of the costs for mailers to perform mail processing and transportation workshare activities. If this simple application of the PRC cost estimates is accurate, mailers and MSPs earned \$15 billion in discounts in FY 2008 for engaging in worksharing activities that may have cost them only \$4.3 billion.

¹² For more information about Postal Service cost models, see OIG report, *Management of Special Studies*, CRR-AR-10-002, March 19, 2010.

¹³ There has been no organized effort to determine if there were actual savings in line with the estimates. Any efforts toward such validation might help provide objective evidence to address some of the disputes around the Postal Service's cost savings.

¹⁴ See the PRC staff paper, *Worksharing: How Much Productive Efficiency, at What Cost and at What Price*, Cohen, Robinson, Waller, and Xenakis, edited by M. A. Crew and P. R. Kleindorfer, 2006, Boston: Kluwer Academic Publishers (p. 3). The cost estimates were based on a very small focus group conducted jointly by the PRC and the Postal Service. The two members of the focus group responsible for these estimates are well known and very knowledgeable members of the postal community and cannot be named according to the ground rules for participation in the focus group.

Table 2: The Value of Workshared Activities in FY 2008
 (In Billions)

Worksharing Activity	Postal Service Discounts to Mailers	Mailer Cost to Workshare*	Mailer "Profit"
Mail Processing	\$10.7	\$2.1	\$8.6
Transportation	\$4.3	\$2.2	\$2.1
Totals	\$15.0	\$4.3	\$10.7
<small>*Mailer Cost to Workshare was derived by taking the percentages identified in the PRC staff study – 20% to process and 50% to transport – and multiplying them by the <i>Postal Service Discounts to Mailers</i>.</small>			

Source: OIG Analysis.

Regardless of the precise measures, it is clear that it costs at least some mailers and MSPs substantially less to perform worksharing activities than the discounts they are provided. Worksharing is lucrative for the mailing industry because mailers and MSPs can benefit if their costs are lower than Postal Service costs.

Mailer costs, by their very nature, will generally be less than Postal Service costs. While most presort bureaus use sorting equipment similar to that used by the Postal Service, their costs can be lower if there is greater productivity or if employees are paid lower wages.¹⁵ In addition, presorting electronic address data before the mail piece is produced is inherently cheaper than sorting the physical piece as the Postal Service has historically been required to do. Likewise, printing a barcode under the address as the mail piece itself is originally produced is inherently less expensive than having to barcode a live piece of mail in the Postal Service's system.

With the wide gap between mailer costs and the discounts they receive, combined with the new post-PAEA incentives to retain earnings, it appears the time is ripe for the Postal Service, the PRC, and the stakeholder community to reevaluate ECP and explore discounts that continue to encourage worksharing, but could be *less* than estimated cost savings for the Postal Service. However, to ensure maximum benefits in this new environment, interested parties and stakeholders need to explore this important issue through further rigorous and independent analysis.

5. Because Discounts May Greatly Exceed Mailer Costs, Some Less Efficient Providers of Mail Services Might be Engaging in Worksharing

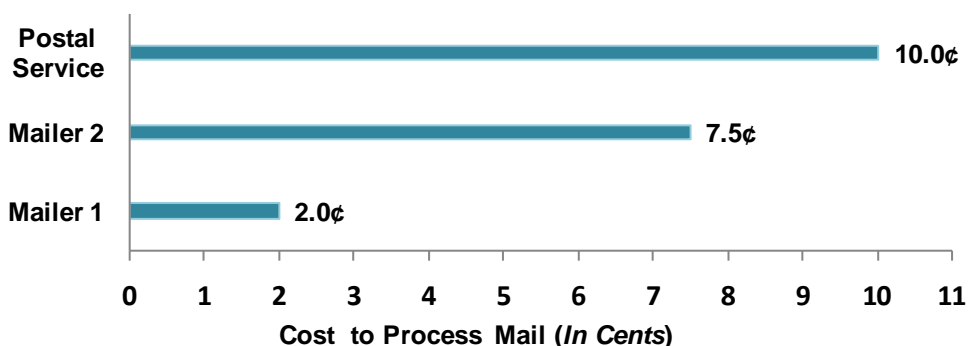
The goal of worksharing has been to enhance the combined economic efficiency of both the private mail industry and the Postal Service. Thus, another important and long standing principle that underlies worksharing has been "lowest combined cost." While

¹⁵ Presort bureaus typically share some portion of the discount with the mailers who tender their mail to them. The largest volume mailers may get a much greater share of the discount than smaller mailers.

the current system has attempted to address Postal Service inefficiency by offering others the opportunity to do the work, it has not addressed potential inefficiencies within the private mailing sector. The current worksharing environment may be allowing some less efficient providers of mail services to workshare because the discounts are set well above the inherent mailer cost.

The following figure provides a hypothetical example of mail processing costs for different mailers or MSPs performing worksharing activities. Figure 8 depicts how much it might cost the Postal Service to perform a certain mail processing activity and how much it might cost two different mailers or MSPs to perform the same activity. In this example, suppose it costs the Postal Service 10 cents to perform a given mail processing activity and it extends a 10 cent discount. All mailers who can do the work for less than it costs the Postal Service have an incentive to do so. However, if the same 10 cent discount is accepted not only by the more efficient mailer (Mailer 1), who can do it for only 2 cents, but also by Mailer 2, for whom it costs 7.5 cents, then lowest combined costs may not be achieved. This assumes that the more efficient Mailer 1 is willing and able to do Mailer 2's work for 2 cents.

Figure 8: Cost of Mail Processing Activity by the Postal Service & Mailers



Source: *OIG Analysis.*

To maximize efficiency of Postal Service operations and to keep postage costs at a minimum for all mailers, only the most efficient mailers should perform worksharing activities.¹⁶ However, as discussed previously, discounts may be set larger than are truly necessary to incentivize worksharing. In fact, it may also be encouraging less efficient providers of mail services to perform worksharing activities.

¹⁶ While ECP has guided pricing policy, many stakeholders and academic economists have argued for using a Ramsey pricing approach, which takes into account the price sensitivity of the mailer to setting the discounts. Ramsey pricing principles would allow the Postal Service to charge a higher price for products that are less price-sensitive and a lower price for more price-sensitive products. The Postal Service would still have to adhere to price caps and other limitations on workshare discounts.

6. Worksharing Has Created Unintended Consequences

In addition to our key findings regarding costs, incentives, discount levels, and efficiency, there are also some more general comments on the unintended consequences that worksharing has created. The Postal Service offers workshare discounts to mailers who perform work that the Postal Service would otherwise have to do itself. To be fair and consistent in determining the bases for the discounts and to maximize efficiency, the Postal Service provides very specific instructions on how mail must be presented in order to receive those discounts. The Postal Service also provides mailers with an extensive list of options that allow for highly customized postal rates. Although the complicated rules and the numerous rate options have created benefits, they have also created difficulties.

Some mailers may feel they are being shut out

The most recent Postal Service rate list is 44 pages long and contains over 10,000 different prices.¹⁷ In addition, the Postal Service's Domestic Mail Manual (DMM) contains over 1,700 pages of mail preparation requirements that can be overwhelming to new entrants and less experienced mailers. While each workshare discount may have made sense upon introduction, the cumulative effect of these discounts has been a complicated set of rates that may not best suit the needs of all mailers. Some mailers are outspoken and happy with the wide variety of options and complicated rules and continue to push for even more discounts. Some mailers support the numerous rate options, but are unhappy with the complicated eligibility rules. However, our discussions have revealed that some mailers do not feel like they have been well served by worksharing and would prefer a more streamlined price list and simpler rules. Consequently, these mailers may either turn to MSPs or choose not to use mail at all.

Revenue assurance problems

Complex rules and rates make it hard for postal clerks to assess if mailers have complied with all the mail preparation requirements and if the Postal Service is fairly and responsibly collecting all the revenue it is due. Business mail acceptance procedures are critical to the Postal Service's revenue assurance efforts and are intended to ensure that the mailers actually perform the work that saves the Postal Service costs. However, enforcing such rules in a live environment where hundreds of millions of mail pieces are processed every day can be difficult. According to the Postal Service, more than 60 percent of revenue (\$39 billion) comes through business mail acceptance.¹⁸ The problems with revenue enforcement for workshared mail go back decades and seem to be an inherent problem stemming from billions of pieces of mail, millions of customers, thousands of prices, complex rules, and a fast-paced mail acceptance environment. The OIG and the GAO have both conducted audits on the Postal Service's business mail acceptance practices and have long noted such problems.¹⁹

¹⁷ Postal Service *Price List*, (Notice 123), Effective March 14, 2010.

¹⁸ USPS News Link article, *Focus on Sarbanes-Oxley*, January 14, 2010.

¹⁹ See OIG audit report, *FY 2009 Financial Installation Audit – Business Mail Entry Units*, (Report Number FF-AR-10-051, December 22, 2009). See GAO reports, *U.S. Postal Service: Stronger Mail Acceptance Controls*

7. The United States Has the Largest, Most Sophisticated Worksharing Program in the World

We analyzed postal worksharing in three of the largest European markets (France, Germany, and the UK) and compared them to the Postal Service's worksharing program. The three posts together account for almost two-thirds of the letter volume in the 27 countries of the European Union. The postal products and the discount schemes offered in the three countries are different from one another and different from those offered in the United States. Appendix D provides a summary of postal products, types of discounts and the extent to which worksharing is regulated and used. While some in the United States criticize the Postal Service's worksharing efforts, the Postal Service's worksharing program is recognized as by far the most extensive and sophisticated in the world. In general, worksharing in the United States has a longer history, and the percentage of mail that is workshared is considerably larger than in France, Germany, and the UK.

Europe does not have the same degree of transparency in the discounts or in the underlying cost avoidances. Under European legislation, there are no specific pricing rules for workshare discounts, although there is a general requirement for prices to be cost based. Worksharing in Europe is strongly affected by a competitive mail market. Overall, workshare discounts in Europe tend to be based less on robust cost analysis, and reflect more the commercial competitive strategies of postal operators. Competitive pressure seems to be leading to high workshare discounts that are relatively similar to the regulated discount levels in the United States.

Conclusion

In many ways, worksharing has been a resounding success in the United States and a model for other posts to emulate. It has come to completely dominate business mailings and is an integral part of the U.S. postal system. Yet, there are still problems to be addressed and opportunities to be explored. First, the Postal Service should find a way to balance the value of workshared rates against the complexity of worksharing. More discounts may not always be better. Second, there is an opportunity for the Postal Service to strategically use worksharing to transform its business. Many businesses use pricing to help manage capacity and operations. The Postal Service could do the same. In an environment of volume declines and excess capacity, the Postal Service's prices should reflect the market conditions and the operational environment of *today* and not *yesterday*. Third, there may be an incentive for the Postal Service to enhance earnings by setting discounts below avoided costs and it should evaluate this possibility. Feeding such earnings back into the business could be of benefit to all. Worksharing has been a phenomenal success and served the Postal Service and its customers well for the last 30 years. The time is right to reexamine it for the next 30 years.

(continued from previous page)

Could Help Prevent Revenue Losses (GGD-96-126, June 25, 1996) and *U.S. Postal Service: Changes Made to Improve Acceptance Controls for Business Mail* (GGD-00-31, November 9, 1999).

Appendices

Appendix A Key Players in the Worksharing Supply Chain

MSP	SELECTED ACTIVITIES
Direct Marketing (Media, Print, & Creative Firms)	<ul style="list-style-type: none"> • Assist mailers with making the business decision to use the mail, or other alternatives
Writing Paper and Envelope Manufacturers	<ul style="list-style-type: none"> • Supply the mailing industry with paper and envelopes
Software Vendors	<ul style="list-style-type: none"> • Supply programs to update mailing lists and to apply barcodes • Supply software to assist mailers in properly preparing presorted mail according to Postal Service regulations • Have capability to run the software against mailer lists to check for accuracy
List Service & Customer Relations Management	<ul style="list-style-type: none"> • Supply lists to mailers and MSPs • Supply customer analytics
Presort Bureaus (Service Bureaus)	<ul style="list-style-type: none"> • Virtual presorting — sort addresses and prepare barcodes on the computer prior to physically producing mailpieces • Sort and when necessary, pre-barcode First-Class Mail for mailers with volumes insufficient to presort on their own • Sort Standard Mail using spare capacity during the hours when they are not busy sorting First-Class Mail • Consolidate mail picked up from the firms that they service, physically sort mail and deliver it to the local post office • Handle “residual” mail from large volume mailers. Residual mail is mail that large volume mailers are not able to sort deeply enough to get the desired discounts. Presort Bureaus are able to consolidate residual mail from various mailers to obtain larger discounts • Frequently provide or arrange transportation of mail they produce. The bureau may have its own fleet of trucks or will subcontract this function
Letter Shops	<ul style="list-style-type: none"> • Collate mailing package components, addressing, folding, inserting, and preparing mail using Postal Service regulations for entry into the mailstream • Prepare large volume mailings • May offer creative services such as copywriting, list compilation, and list maintenance
Printers	<ul style="list-style-type: none"> • Print letters, catalogs, and magazines • Virtual presorting — the mailing lists are presorted on the computer prior to the labels being placed on the mail piece in the printer’s bindery line, where they are separated into bundles and placed on pallets (or sacks). This activity is universal and is usually bundled into the printing cost • Co-palletize bundles of mail from different mailings to achieve the minimum pallet weights required for entry into the system • Co-mail different titles into bundles that (at a minimum) meet the minimum piece count to qualify for increased discounts • Frequently provide or arrange transportation of mail they produce. The printer may have its own fleet of trucks or will subcontract this function
Fulfillment Centers	<ul style="list-style-type: none"> • Sell products and services such as subscriptions, book club memberships, catalog merchandise, and fundraising • Activities include mail opening, caging, order entry, customer service, address label printing, presorting, merchandise picking and packing • Frequently provide or arrange transportation of mail they produce
Transportation & Consolidators	<ul style="list-style-type: none"> • Pick up and consolidate less than full truck loads and drop ship the mail deeper into the Postal Service network and as close to the destination as time and cost allow • Specialize in logistics and full truck loads

Appendix B Cost Avoidance & Discount Calculation Methodology

Total worksharing cost avoidance and discounts were calculated for FY 2008 by multiplying volumes or weights for each rate category by the corresponding cumulative per-piece or per-pound cost avoidances and discounts. The source of the unit cost avoidances and discounts was obtained from the PRC's FY 2008 Annual Compliance Determination. The volume data was obtained from multiple sources; however, the ultimate data sources were Postal Service Billing Determinants and Revenue, Pieces, and Weight (RPW) by Shape Reports.

The calculations assume that in the absence of workshare discounts, mailers would perform none of the work required to receive these discounts. However, this assumption is not fully plausible since before there were workshare discounts mailers performed some of this work even though they were not compensated. The \$14.8 billion cost avoidance estimate is a lower-bound estimate for the following three reasons:

- The calculations only include worksharing activities for which there is a benchmark allowing a cost avoidance to be calculated. For example, it does not include any costs avoided by mailers entering Periodicals at destination facilities because information on where these pieces would otherwise have been entered is not available.
- Some mailers perform uncompensated worksharing (e.g., entering Media Mail at destination facilities to improve service even though there are no discounts for doing so), the extent of which is not tracked.
- Figures for mail in the former Standard Mail Enhanced Carrier Route (ECR) subclass are calculated using ECR Basic as the benchmark from which cost avoidances and discounts are calculated. Using a Mixed AADC benchmark would significantly increase the total Standard Mail cost avoidance and discount estimates.

The costs avoided by presorting and barcoding are presented as a single line item because cost models generally estimate these cost avoidances jointly. The vast majority of the worksharing cost avoidances and discounts are generated by mailer presorting and barcoding, rather than by transportation. This is partially due to the absence of transportation discounts in First-Class Mail. The Package Services class (including Parcel Select) is an exception. Because parcels are much bulkier than letters and flats and thus more expensive to handle (e.g., cross dock), Package Services rates — in particular, Parcel Post and Bound Printed Matter — generally emphasize drop ship. Presorting is generally relegated to an ancillary requirement to qualify for transportation discounts.

In addition, the FY 2008 cost avoidance estimate by Mixed AADC Automation letters (relative to Mixed AADC Nonautomation letters) is negative 1 cent. This suggests that barcoding these letters increases sorting costs. By setting this cost avoidance equal to zero, the total Standard Mail cost avoidance increases to \$8.4 billion, slightly more than the corresponding Standard Mail discounts. Periodicals drop ship cost avoidance is not applicable because there is no benchmark for the Periodicals Outside County product from which to estimate this cost avoidance.

Appendix C Stakeholders and their Opposing Interests

STAKEHOLDER	Why the Stakeholder Cares About Worksharing	Worksharing Advantages	Worksharing Disadvantages
Postal Service			
<ul style="list-style-type: none"> •Operations •Pricing •Finance •Legal •Mailing Standards •Mail Acceptance •Inspection Service 	<ul style="list-style-type: none"> •Represents 80% of Mail Volume •Represents \$15 Billion in Dollars Associated with Cost Avoidance •Compliance with PAEA •Efficient Staffing & Workload •Efficient Processing, Operating, and Transportation Networks •Effect on Stakeholders 	<ul style="list-style-type: none"> • Increased Mail Volume • Costs Reduction • Allows Increased Product Line Diversification • Encourages Efficient Operations • Efficient Mail Stream & Supply Chain • Customized Pricing 	<ul style="list-style-type: none"> • Balance Stakeholder Interest • Disputed Cost Systems & Models • Perception that Discounts Provided to Large Mailers are at the Expense of Small Customers • Increased Regulatory Risk – the Law vs. Regulatory Oversight • Increased Administrative Burden to Protect Revenue • Must Manage Operation for Diverse Product Lines
Postal Regulatory Commission			
<ul style="list-style-type: none"> •Commissioners 	<ul style="list-style-type: none"> •Compliance with PAEA •Interpretation of PAEA •Accurate Cost Methodologies 	<ul style="list-style-type: none"> • Increased Mail Volume • Encourages Efficient Operations • Reduces Postal Service Costs 	<ul style="list-style-type: none"> • Balance Stakeholder Interest • Perception that Discounts Provided to Large Mailers are at the Expense of Small Customers • Disputed Cost Methodologies • Law vs. Regulatory Oversight
Labor Unions			
<ul style="list-style-type: none"> •APWU 	<ul style="list-style-type: none"> •Impacts Jobs 	<ul style="list-style-type: none"> • Increased Mail Volume 	<ul style="list-style-type: none"> • Compete with MSP • Displaced Workload or Content • Loss of Jobs • Loss of Members
<ul style="list-style-type: none"> •National Association of Letter Carriers/National Rural Letter Carriers Association 	<ul style="list-style-type: none"> •Impacts Jobs 	<ul style="list-style-type: none"> • Increased Mail Volume 	
<ul style="list-style-type: none"> •National Postal Mail Handlers Union 	<ul style="list-style-type: none"> •Impacts Jobs 	<ul style="list-style-type: none"> • Increased Mail Volume 	<ul style="list-style-type: none"> • Compete with MSP • Displaced Workload or Content • Loss of Jobs • Loss of Members
Mailers			
<ul style="list-style-type: none"> •Financial •Merchants •Services •Publishers •Federal Government •Nonprofits 	<ul style="list-style-type: none"> •Low Postage Cost •Faster and More Consistent Service 	<ul style="list-style-type: none"> • Provides Reduced Postage Rates • Efficient Mail Stream & Supply Chain • Allow Mailers to Play a Larger Role 	<ul style="list-style-type: none"> • Ever-Changing and Complicated Rules & Rates • Small Increases in Postage are Expensive • May Not Obtain ROI for Equipment and Other Items Purchased to Adhere to New Rules
Mail Service Providers (MSP)			
<ul style="list-style-type: none"> •Printers •Presort Bureaus •Lettershops •List Services •Software Companies •Logistics: Transporters & Consolidators 	<ul style="list-style-type: none"> •Impacts Mail Volume •Level of Discounts •Impacts Jobs •Some MSPs Rely on the Workshare Discount Spread 	<ul style="list-style-type: none"> • The Price Spread Provides a Business Model • Increased Mail Volume • Efficient Mail Stream & Supply Chain • Knowledge of Complicated Rules and Rates Benefits MSP and May Increase Demand for Services 	<ul style="list-style-type: none"> • Ever-Changing Rules & Rates • May Not Obtain ROI for Equipment and Other Items Purchased to Adhere to New Rules
Political			
<ul style="list-style-type: none"> •Congress •Congressional Oversight Committees 	<ul style="list-style-type: none"> •Writes the Law •Stakeholder Interests – Including Constituents •Jobs in the Postal Service •Jobs in the Mailing Industry 	<ul style="list-style-type: none"> • Success Story for Interaction with Customers in a Commercial Marketplace 	<ul style="list-style-type: none"> • Balance Stakeholder Interests • Decisions May Not be in Postal Service's or Mailing Industry's Best Interest
American Public			
<ul style="list-style-type: none"> •Single-Piece Rate Payer 	<ul style="list-style-type: none"> •Lower Cost to Mail 	<ul style="list-style-type: none"> • Lower Cost to Mail 	<ul style="list-style-type: none"> • Larger Mailers may Benefit More

Appendix D Worksharing at Other Posts

Country	Types of Workshared Products	Types of Workshare Discount Activities	National Regulatory Authority & Role of Regulation	Extent Worksharing is Used
FRANCE La Poste	<ul style="list-style-type: none"> •First-Class Mail Letters •Second Class Mail Letters •Advertising Mail 	<ul style="list-style-type: none"> • Presorting • Bundling • Franking • Machinability • No discounts for drop shipping 	<p>Autorite de Regulation des Communication Electroniques et des Postes (ARCEP)</p> <ul style="list-style-type: none"> • No legal requirement to offer workshare discounts • No regulatory approval • No pricing legislation • Price Cap based on CPI-X • Prices must be cost-oriented and non-discriminatory • Workshare discounts must take account of cost avoidance but no specific standard has been established 	<ul style="list-style-type: none"> • Workshare discounts offered since early 1980's • Discounts to large mailers are roughly 20 percent of full postage • 34 percent of all letter post items were workshared in 2007 • Majority of workshared items were advertising
GERMANY Deutsche Post	<ul style="list-style-type: none"> •First-Class Mail •Advertising Letters 	<ul style="list-style-type: none"> • Presorting • Bundling • Franking or PPI Impression • Volumes of posting and combined volume per quarter of year • Drop shipping • No discounts for barcoding or address quality 	<p>Bundesnetagentur fur Elektrizitat, Gas, Telekommunikation, Post und Eisenbahnen (BNetzA)</p> <ul style="list-style-type: none"> • Mandated drop ship discounts for First-Class Mail in 1999-2000 • Rates must not be excessive, predatory, or discriminatory 	<ul style="list-style-type: none"> • Discounts offered to mailers, but not MSPs • Mailing houses cannot consolidate advertising mail from different mailers to obtain higher discounts • Very limited discounts for First-Class Mail • In 2008, 6 percent of mail was workshared • In 2008, 10.7 percent of letters were delivered by competitors
UNITED KINGDOM Royal Mail	<ul style="list-style-type: none"> •First-Class Mail Letters •Second Class Mail Letters 	<ul style="list-style-type: none"> • Presorting to areas • Presorting to delivery sequence • Accuracy of addresses and machinability • Barcoding • Franking or PPI impression • Volumes of posting • Royal Mail has agreements with consolidators for drop ship discounts at the DSCF • "Sustainable Mail", or environmentally friendly mail <p>Royal Mail Wholesale</p> <ul style="list-style-type: none"> • Separate legal entity used to manage access contracts • Manages access contracts for drop ship discounts for First Class Mail products only 	<p>Postal Services Commission (Postcomm)</p> <ul style="list-style-type: none"> • Created in 2000 • Regulates Standard workshare discounts in a price cap regime • Drop ship rates do not require regulatory approval 	<ul style="list-style-type: none"> • In the financial year ending in March 2008, 20 percent of the mail was workshared • Of which, 57 percent was handled by consolidators • No competition for the delivery of letters • Drop ship discounts only offered for First Class Mail products

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This is a Risk Analysis Research Center (RARC) white paper. It summarizes our research work on this topic and provides our analytical review and conclusions. The purpose of RARC white papers is to provide data and analysis for management review and deliberations and to provide information to other interested parties.

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