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**U.S. Senate Committee on Homeland Security and Government Affairs  
"Solutions to the Crisis Facing the U.S. Postal Service"  
February 13, 2013**

**Joel Quadracci, Chairman, President & CEO  
Quad/Graphics, Inc.**

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Good morning, Mr. Chairman, Ranking Member Coburn and Members of the Committee. I want to thank you, Mr. Chairman, for your leadership, and the rest of the Committee for your focus and efforts on the urgent matter of restoring the Postal Service to financial stability. This is a vitally important issue for communications and commerce in our country. A financially hobbled postal system cannot provide the service the public needs and deserves; indeed, it could be forced to dramatic service curtailments. The Postal Service cannot cut enough to solve its financial challenges. It needs help from Congress. So, with respect, I urge you and your colleagues to act as quickly as possible.

As we know all too well, the Postal Service is losing money at a rate of nearly \$25 million a day with the total loss in 2013 expected to be \$7.6 billion. This is clearly unsustainable. This financial instability and the constant threat of insolvency is obviously troubling for the Postal Service, but it is even more troubling for the American economy overall. Since 2009, the mailing industry lost 4.5% of its jobs. Although the Postal Service is financially challenged it is still a \$65 billion business that supports a private sector economy worth more than \$1 trillion, employing some 8 million private sector workers, and accounts for 7% of our nation's Gross Domestic Product (GDP).

The Postal Service is the backbone of the private sector mailing industry and it plays an integral role in the modern economy ranging across every type of mailer and the printing, paper and technology industries that supply them. These businesses support services in a marketplace that includes cost-effective advertising, magazines, catalogs, e-commerce, prescription drug fulfillment, and what is still a huge amount of statements, bills and greeting cards as well as an expanding package delivery segment. These are products that consumers in all 50 states crave, and in some cases rely on, and they depend on the Postal Service to deliver them right to their door.

While it is clear that the printing and mailing industries are a vital part of our economy, there is no doubt that our industries are changing and change can be challenging. The biggest problem facing the printing industry is the same problem the Postal Service faces: excess capacity. This is a problem that we, at Quad/Graphics, are addressing head on. We continue to work hard to acquire market-share by attracting and retaining customers and through strategic acquisitions both large and small. Over the past three years we have completed two major acquisitions (WorldColor Inc. and Vertis Holdings Inc.). Through these acquisitions we acquired more volume. At the same time, we acquired more capacity and, therefore, had to make the tough but necessary choices to close facilities and consolidate work in to other facilities where we believe we can produce it most efficiently and competitively. These are decisions are necessary in a mature industry and challenging marketplace.



The Postal Service must make similarly difficult decisions. It must take an honest look at its business model and make sure that the size of its business matches the reality of its market. Right now, the Postal Service has too much capacity and must be “right-sized.”

Our company, Quad/Graphics, is one of the largest mailers in the United States, accounting for nearly 12 billion pieces of mail each year. We print magazines, catalogs, retail inserts and direct mail for many well-known publishers and marketers. For example, Quad/Graphics has contractual relationships with leading magazine publishers, including Conde Nast, Hearst Magazines, Meredith Corporation, The National Geographic Society, Rodale Inc., The Reader’s Digest Association Ltd., Source Interlink Media, LLC, Time Inc., Sports Illustrated, and Wenner Media LLC. Quad/Graphics prints catalogs for industry-leading marketers such as Cabela’s Incorporated, J. Crew Group, Inc. L.L. Bean, Limited Brands Inc. (Victoria Secret), and Redcats USA’ and direct mail products for companies such as Charter Communications, American Family Insurance, American Eagle Outfitters, Publishers clearing house, Inc. and Weight Watchers International, Inc. The success of Quad/Graphics and its 20,000 American workers -- which include 6,700 in Wisconsin, 700 in Oklahoma, 500 in Michigan, 225 in Ohio and 630 in Kentucky and many more throughout 28 other states, is directly tied to the existence of an efficient and cost-effective Postal Service. Those 20,000 workers are counting on this committee and this Congress to take the necessary steps to help them succeed.

Point being, you are not alone on this journey. We are part of the Direct Marketing Association, PostCom, American Catalog Mailers Association, Alliance of Nonprofit Mailers, The Association of Magazine Media, and the Coalition for a 21<sup>st</sup> Century Postal Service all of which stand beside us, ready to continue their work with you to ensure the future of the Postal Service as well as the 8 million American families that depend on the Postal Service for their livelihood.

The continued sluggish economy and the decline in mail volumes pose a threat to the Postal Service’s sustainability. These challenges can be overcome with bold reforms, cost-cutting and streamlining – the same types of tough measures that thousands of American businesses like ours have made during these difficult economic times. In addition to measures the Postal Service must take, Congress can help by alleviating the unreasonable financial burdens that have been placed on the Postal Service. Without Congressional action, not only will the financial situation of the Postal Service continue to be dire, but the uncertainty for our clients and the entire mailing industry will stifle volume as customers make decisions about how to spend their advertising budgets, among other concerns. Many are referring to this as a “crisis of confidence.” Many clients may choose to move away from print only because they do not have confidence that the Postal Service will continue to be a viable option. This uncertainty can be resolved by Congress taking decisive action to show that the Postal Service will remain a strong and practical option for our marketers and publishers to distribute and advertise their products.

The recent action taken by the Postal Service to move to 5-day delivery by eliminating Saturday service is impactful. While we understand why the Postal Service feels this is a necessary step in order to help bring costs in line with revenues. It is important to understand that the Postal Service will not be completely shut down on Saturdays. Quad/Graphics and other mailers have a critical need for the Postal Service to continue accepting mail drop-offs on Saturday, process that mail



on Saturday and move it around the country on Saturday in order for it to be in place for delivery on Monday. The impact on our customers will be felt on an individual customer basis. For some of our clients, the change to 5-day delivery will mean simply adjusting the delivery date expectations. For others, they will need to decide how best to continue Saturday delivery through an alternative carrier if they feel weekend delivery is business critical. Regardless, Quad/Graphics will work with all of our clients to ensure they are receiving the best value for delivery of their printed products.

### **RECOMMENDATIONS FOR CORE ELEMENTS OF LEGISLATION TO STABILIZE THE USPS**

Extended amortization of payments to prefund retiree health benefits. Prefunding retiree health benefits is admirable but is virtually without precedent in the private or public sector, especially on the massive scale of \$5.5 billion per year. It is simply unaffordable and already we have seen the Postal Service default on two payments. Thus, the business community, including Quad/Graphics, complete supports the need by the Postal Service, postal labor unions and others to modify the prefunding schedule for retiree health care and endorses the 40-year amortization included in last year's S.1789.

Return FERS overpayments. Another disadvantage facing the Postal Service has been a continual overpayment into the federal government's pension funds. While there is some dispute over whether there was an inappropriate overpayment in to the Civil Service Retirement System (CSRS), there is no such dispute over overpayments into the Federal Employees Retirement Systems (FERS). This overpayment has resulted in billions in extra funds pouring into FERS ultimately at the expense of the private mailing industry. Due to the fact that the Postal Service relies almost exclusively on postage fees, these overpayments are paid for not by the USPS or the taxpayers, but rather by the customers and clients of companies like Quad/Graphics and any other company that uses the Postal Service as a means of commerce. This has amounted to a vast hidden tax on our industry, which accounts for 90% of postal revenues.

Returning the overpayments to the Postal Service is the fair and responsible approach, yet there has been some rhetoric surrounding these proposals as a "bailout." Nothing could be further from the truth. In this circumstance it is postal ratepayers (the majority of whom are businesses) who have been bailing out the government. We are gratified that this Committee and the Senate were undeterred by the inaccurate bailout characterization, and included FERS repayment in last year's bill. We urge you to include it again in any reform legislation this session.

Enable the Postal Service to continue to streamline its network. With the precipitous plunge in mailing volumes, the network of postal facilities has become far too large for the business the system has or is likely to have in the foreseeable future. It, therefore, must downsize. It is in the process of doing precisely that, having closed a number of facilities last summer with little operational disruption. The Postal Service also heard Congress loud and clear, and instituted a well-received program to keep rural and small post offices open. We urge Congress to exercise its customary thorough and cautious oversight of the Postal Service as it downsizes, but not to unduly inhibit or restrict its ability to do so, and do so quickly.



In summary, we as an industry, request that Congress, at a minimum, act on the following:

Assuring USPS the Authority to Streamline its Service

- Mail volume has declined 25% since its peak year in 2006. The associated revenue drop has vastly outpaced the Postal Service's actions to cut costs.
- The USPS has the infrastructure and capacity to handle and process more than 300 billion pieces of mail. Unfortunately mail volume continues to decline and is expected to be only 153 billion pieces of mail in 2013 (of which Quad/Graphics accounts for approximately 12 billion pieces of mail).
- The USPS must reconfigure its system (facilities and workforce) to the business it has and projects over the coming years.
  - The decline is unlikely to be substantially reversed, but further losses may be slowed.
  - The USPS has a plan in place to consolidate and close processing facilities and reduce post office costs without widespread closings. These plans ought to be allowed to proceed without Congressional interference.
- The USPS must be provided with and use its authority to continue the effort to "right-size" its system to current and anticipated future mail volumes.

Reamortization of Payments for Prefunding Retiree Health Benefits

- Ensuring retiree health is not an unfunded liability is financially sound.
- The current 10-year amortization results in unaffordable payments \$5.5 billion annually, which the Postal Service has defaulted on twice.
- Extended amortization guarantees full pre-funding at much lower annual payments.
- The 40-year amortization schedule, as proposed in the Senate bill last year, would accomplish all of the foregoing goals.

Return to USPS of its Overpayments to the Federal Employees Retirement System (FERS)

- Depending upon the calculation, the USPS has overpaid into FERS by \$3.0 billion-\$12.5 billion.
- Since the USPS operations are funded by postage, not taxes, mail users and especially the business community (which is responsible for about 90% of postal volume) have been overcharged.
- Returned funds can be used as incentives for early retirement, debt reduction and more.

Provide USPS with needed flexibility to manage health care costs

- Health care costs are a significant issue for every business and making sure their employees get the necessary services at an affordable price is paramount to business success.
- Quad/Graphics has a unique, in-house, health care model, called QuadMed, which focuses on preventive primary care, based on a wellness model that rewards employees for choosing a healthy lifestyle. It generates a significant amount of savings for the company and the employee while improving the quality of care.
- Due to this unique model, Quad/Graphics has seen a significant reduction in health care costs.



- The USPS should be allowed to go out in the marketplace and negotiate for better service at a lower cost, which is something it has explored and recommends to Congress. Those beneficial options do exist and can save the Postal Service money.

The issues laid out above are the items that, at a minimum, ought to be included in any postal reform legislation. There are also a few items that have been discussed over the last few years that would be extremely harmful to the Postal Service as well as, have direct consequences on Quad/Graphics and the mailing industry if they were to be enacted.

There are three main components to printing a magazine, catalog, retail insert or direct mail piece: the cost of the physical printing of the item, paper and postage. It may be tempting to address the Postal Service's financial situation by simply raising postage rates to "cover the costs," but I cannot stress enough how damaging postal rate increases are to our industry. We believe that the issue of "underwater" classes is a symptom of the larger problem – extreme excess costs in the USPS system. Furthermore, there is a direct negative correlation between rate increases and volume. Our customers demand predictability and affordability and if prices suddenly increase more than expected they react by reducing their volume to cover the extra postage or move away from print altogether. Of course, this hurts the revenue of the printer but also reduces the volume going to the Postal Service which further exacerbates the problem. Over the last 25 years, through technological advances and process changes resulting in productivity gains of more than 4% annually, the printing industry has been able to actually reduce the price for printing (adjusted for inflation). The Postal Service should address its problems by achieving the same cost control success.

Paper prices have fluctuated during that same period based on supply and demand. To ensure that we are providing our clients with the lowest possible cost and highest quality product, we have dedicated Quad/Graphics staff who continually work with the paper manufacturers to coordinate with transportation companies (be they rail or over-the-road-trucking) to ensure the most cost-effective and timely delivery of paper from the mills to our plants. We've also developed and initiated standards for managing inventories and waste, all in an effort to be the low-cost provider and deliver quality products for our customers. Despite the fact that we are not in control of paper prices, these efforts have resulted in the management of paper prices and costs for our clients for our printed products.

During that same time period, the price of postage has continued to increase and as a result the single largest expense of printing is now the postage associated with delivering the final product. In order to help to control these costs, Quad/Graphics and other printers provide co-mail services that combine and then ship numerous, individual clients' mailpieces together to relieve the Postal Service of significant sorting, handling and transportation costs. A large volume of the product we co-mail is sorted to the individual letter carriers and sequenced exactly in the order in which they walk their route. This reduces Postal Service costs and qualifies our company and our clients for postage discounts. These "work share" discounts were put in place in cooperation with the Postal Service at a tremendous capital expenditure for the printing industry. The equipment necessary to provide these co-mail services is expensive. However, the private sector is able to provide this service efficiently, saving the Postal Service the added expense of installing this technology in its own processing



facilities. This not only reduces the Postal Service's costs, but helps to control the cost of postage, and provides our clients with a significant return on their marketing dollar. Except for the ability of Quad/Graphics and other mail service providers to help clients manage their postal costs through work sharing, mail volumes would have been reduced to an even greater extent over the last decade.

As discussed, above-inflation postage rate increases cannot be part of this solution (whether they are from straight rate increases or reductions in work-share discounts). The rate caps enacted as part of the Postal Accountability and Enhancement Act of 2006 (PAEA) have worked well to control postage rates and provide our clients with that much needed certainty. These caps must be retained and action taken by Congress must lead to a cost-effective Postal Service. As confidence grows that the USPS is a long-term viable option marketers will have the wherewithal to make volume and pricing commitments into the future to the benefit of both the Postal Service and the industry as a whole.

Quad/Graphics remains bullish on print. We live in a multichannel world where customers have choices. If the Postal Service can manage its costs and maintain an affordable pricing structure, its business can remain sustainable and ours, in turn along with it. We are encouraged with the direction we have seen the USPS take over the last year-and-a-half. We've seen a difference in the way the USPS manages the "customer experience" with new products and services being developed. Innovation is what drives our business today; we invest in new technologies and ways to keep print on the forefront of our multichannel world. We believe print is the foundation of successful multichannel strategies for both marketers and publishers. Our own innovations with tablet and Smart-phone apps related to QR codes and image recognition, augmented reality and near-field communications keep Quad/Graphics on the cutting-edge of our industry and give our clients a competitive advantage, and we need similarly innovative thinking from the USPS.

As an example, the Postal Service recently initiated a new strategy for growth through incentive promotions tied to value-added products and services and partnering with its customers and mail service providers. The principle is simple: value-added = greater response = growth. As we know from our experience with our clients, the risk really isn't that great when it comes to using mail to drive response. Therefore, we consider this a good example of the Postal Service using its pricing flexibility under PAEA to drive the growth of mail, and we fully support those efforts.

I thank the Chairman, the Ranking Member and the Committee for allowing us the opportunity to discuss our company and the importance of the Postal Service to the 8 million families our industry supports. I look forward to working with you to enact reforms that will put the Postal Service on a path to sustainability. I applaud you for making the Postal Service a priority, and I would be happy to answer any questions that you may have.