

## **Why the USPS is More Valuable than Microsoft**

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Several months ago, when I was asked by the Financial Times to speak on the subject of “Why the USPS is more Valuable than Microsoft,” I no doubt gave the challenge too little serious consideration before agreeing to speak. I reasoned that the USPS is one of a handful of the largest institutions in the world and the owner of one of the most recognized and trusted brands in America. We have proven ourselves a formidable competitor in the marketplace. So I said, “Sure, I’ll do it” and put the task of making the case aside for future thought.

In a matter of days my decision had begun to look a little rash. In the early fall of 1999, the stock markets caught a case of the jitters over the future of the high tech stocks that had been fueling growth for the past several years. But as 3<sup>rd</sup> quarter earnings came in, Microsoft proved to be the salvation of the Dow Jones Industrial Average, surprising the market with its performance.

A few cynics later pointed out that once again Microsoft had worked hard to manage expectations. The Microsoft financial managers had talked down the market’s anticipation of their report. But however skillfully they presented the news Microsoft’s growth in earnings was solid, maintaining the increases of 17 percent that had become their tradition.

I realized that I would be comparing the *Postal Service*, the symbol of the old order, the father of *Snail Mail*, with the biggest powerhouse in the American economy. I began to worry about my task. Some research was in order.

## **Business at the Speed of Thought<sup>i</sup>**

Microsoft has only existed for a very short time in comparison with the Postal Service that was formed prior to the Revolutionary War in 1776. Bill Gates and Paul Allen founded Microsoft in 1975. But it was IBM that put the company on the map in 1981 when the DOS operating system was selected to power the new IBM PC. In 1986 Microsoft went public. In 1990 Microsoft introduced *Windows 3.0*. The most important Windows innovation came in 1995 with the August launch of *Windows 95*. Microsoft was set on a course to sustain its powerful market position with proprietary Microsoft applications<sup>ii</sup>.

But on December 7, 1995 Bill Gates announced one of the most important strategic decisions of recent business history. He committed Microsoft to support Internet communications with all of its products. Gates' vision understood the power that the PC revolution had given to the individual and it reached beyond, to the next revolution. The potential for multiplying the PC's empowerment with Internet communication was so great that Gates turned the direction of his entire company. In addition to the operating system and Windows platform, Microsoft today is committed to a vast array of personal productivity and consumer application products, each with its Internet connection.

Bill Gates has become a leader in shaping the vision of the future of business. The network vision that he has articulated would make it possible for business to run at the speed of thought. Net communities of common interest will rewrite the marketing textbooks while back end electronic processing will bring new efficiency to traditional corporate processes.

But Microsoft's aura is built on solid business results as much as upon Gates' vision of the future. Since 1996, Microsoft has doubled its net revenue. In their most recent year earnings per share continued to grow as they made nearly 20 billion dollars. Roughly 32,000 employees generated \$7.5 billion in earnings last year. The market capitalization of Microsoft reached 473 billion dollars. Over the last five years their earnings per share have grown by 40 percent which compares with 30 percent for the computer software industry and 10 percent for the S & P 500<sup>iii</sup>.

## **Snail Mail and the Information Superhighway**

So Microsoft is a powerhouse. But even if you didn't know that, you would have been cautious about my speech topic if you knew what I knew about the US Postal Service.

I knew that the USPS, as we define it today, is not exactly a growth stock, even though it may have briefly starred as "one of the great turn around stories of the 90s."<sup>iv</sup> Not only are USPS revenues only barely growing today but 80 percent of the contribution, or profit, that supports the entire \$62 billion USPS comes from letters.<sup>v</sup> And the letter is a very vulnerable form of communications.

One of the characteristics of the U.S. Postal Service that is often poorly understood is its enormous size. With almost 900,000 employees, the USPS delivers to more than 130 million mailing addresses six days a week. With 40,000 retail outlets and 250,000 drop boxes, the Postal Service is a ubiquitous presence in America.

But the economics, if not the physical presence, are rocky. At its heart, \$17 billion of revenue comes from handling bills and statements. One of the hottest areas of potential development on the Internet is billing and bill presentment. The technology of the competition is here today. Thus a third of the revenue of this enormous institution is at risk. In late November, the Senate of the United States joined the House of Representatives and passed a new bill that would make digital signatures as acceptable as written ones. So almost all First-class Mail will soon be under review by the mailers who are looking forward to technology that will help them operate faster, less expensively and with improving quality.

The implications of the USPS' dependency on bills is dramatic. We can expect that a significant shift of current mail use will take place in coming years. The question is when will the shift happen and how fast? Today only three percent of American consumers pay their bills electronically. But if this number jumped to 20 percent, as many expect that it will, and if the shift takes place in a matter of months, postal management will be unable to shed costs quickly enough to avoid financial crisis.

What is more, there are powerful forces of inertia that protect the traditional postal model and inhibit any serious response to the threat. Price changes and product introductions are regulated by a Postal Rate Commission which must hold complex public hearings before acting. Labor rates are most often set by compulsory arbitration. Postal management has only a limited influence over prices, products and costs. This is the very definition of a business that is difficult to manage.

What is more, the First-Class letters associated with bill paying are not the only vulnerable part of the Postal Service's business. The direct marketing industry, such as the catalogers, have become intrigued by the economic potential of Internet communications. In recent years, their investments have focused on improving their Web sites, not their mailing lists. Moreover, the two parts of the letter mailstream are related to one another. The same decision-makers that are trying to make their companies more profitable by creating an electronic billing backend are also using the new technology to improve the efficiency of their marketing programs.

OK, you say. What about becoming a new age Internet services provider yourselves? Well, this is a strategy with which I am very familiar.

Since 1994 I have had a rare opportunity—to work on the questions that will shape the future of the Postal Service. I was recruited from a colorful, if crazy, telecom venture capital deal with the Russian Space Command by Bill Henderson, the man who is now Postmaster General. He hired me to create new electronic products.

We did just that. We created the Electronic Postmark and the first postal card, the First-Class Phone Card. Our other investments committed the Postal Service to create new hybrid mail services, process banking transactions, build universal addressing, provide kiosk access to services and enhance connections between the mail and the electronic age generally. In 1996 I took on the new position of corporate Vice President for Strategic Planning.

But the electronic experiments that I started and those of my successor developers, however exciting, have not taken off yet. One of biggest problems is the politics. The competitors of the Postal Service do not want new entrants in the market. Even the suppliers and the business partners of the Postal Service are sometimes nervous that a protected government competitor would enter their markets. Regulators and policymakers raise the question of competence. For the mailing customers, the picture is somewhat mixed. Of course they are interested in new enhanced services. But the customers want to be sure in their money is being used to create services that will benefit *them* and not someone else.

Postmaster General Bill Henderson recently earned the USPS a place on the cover of Forbes magazine as one of ten companies “that got it” about the Internet by cutting through this thicket. He committed to three Internet investments that are closely related to the traditional mission of postal services. He created teams to work on electronic bill paying, universal address databases and package shipping. Few could argue with the proposition that prudent management would be developing the modern version of these core responsibilities of the Postal Service. But even though Bill Henderson’s initiatives may have stepped up to the politics of redefining the letter, these new developments will not soon replace mail volume that is likely to be diverted from traditional sources.

The business model of the Postal Service is under stress that will become increasingly apparent in coming years. Three years ago the strategic plan of the Postal Service focused on continuous performance improvement. Today, the intensity of competition has made it clear that it is not possible to simply do the traditional postal job better and hope that customers will still demand services in the 21st century. The future will require vision. At a minimum, the methods for carrying out the traditional mission—serving as the trusted third party—will have to evolve in the coming decade.

To return to my speech task, comparing the Postal Service, a cumbersome government bureaucracy, with an economic powerhouse with a market capitalization of nearly \$500 billion would seem to be a tenuous argument in light of this perspective on the USPS.

### **A Bend in the Road**

But this is a time of amazing changes in fate.

Only weeks after Microsoft saved the U.S. economy, Judge Thomas Penfield Jackson, a District Court Judge in Washington D.C. handed down his conclusions of fact in the Microsoft antitrust trial. The Microsoft public trial had lasted from October 1998 to

June 1999. Judge Jackson heard the case without a jury.

Microsoft has been on trial for violating the Sherman Antitrust Act that sets forth the rules for competition. In November, the Judge found that Microsoft was a monopolist and that they had acted in a predatory manner. In the end the argument revolved around the process of innovation.

On the Microsoft Web Site today there is a button that connects the browser to the new "Microsoft.com Freedom to Innovate Network." The company's response to the Justice Department's lawsuit has been to argue that they produced quality products and the freedom of the marketplace had provided incentives for innovation and competition that had benefited consumers.

Judge Jackson, on the other hand, found that

"There is insufficient evidence to find that, absent Microsoft's actions, [Netscape's] Navigator and [Sun Microsystem's] Java already would have ignited genuine competition in the market for Intel compatible PC operating systems. It is clear, however that Microsoft has retarded, and perhaps altogether extinguished, the process by which these two middleware technologies could have facilitated the introduction of competition into an important market."<sup>vi</sup>

What was surprising was the strength of Judge Jackson's clear and ringing language

"Most harmful of all is the message that Microsoft's actions have conveyed to every enterprise with the potential to innovate in the computer industry. Through its conduct toward Netscape, IBM, Compaq, Intel and others, Microsoft has demonstrated that it will use its prodigious market power and immense profits to harm any firm that insists on pursuing initiatives that could intensify competition against one of Microsoft's core products. Microsoft's past success in hurting such companies and in stifling innovation deters investment in technologies and businesses that exhibit the potential to threaten Microsoft. The ultimate result is that some innovations that would truly benefit consumers never occur for the sole reason that they do not coincide with Microsoft's interests."<sup>vii</sup>

After the Judge handed down his opinion, the experts advanced a number of theories about what should be done about Microsoft. Under one theory Microsoft would be broken up in the way that ATT was broken up in 1984. In another approach Microsoft would be forbidden to connect its browser to Windows and other guarantees would reinforce the principle of "open access."

As a technical matter, this trial will first be turned over to a mediator. Judge Richard Posner has been asked by Judge Jackson to enter this dispute. Any number of possibilities could emerge from the negotiations.

But the outcome is bound to affect the long-term value of the company no matter what is decided. In the short-term, the share price has not been affected. In the aftermath of Judge Jackson's decision a flurry of state lawsuits were filed. In California there was a suit alleging predatory practices. In Florida and Ohio lawsuits were filed on behalf of consumers who may have been overcharged for the Windows operating system. Additional suits have been filed in New York, Alabama and Louisiana and many other states.

No matter what happens to Microsoft, the trial will have been a very important one. The fundamental theories that are now being debated involve new protections for the process of innovation in the digital age. Can a "self interested" player shape the process of innovation? Or should there be structural and other barriers erected by the government to guarantee a free market for new ideas? One results is that the role of the government in the digital market has been established (or reestablished) by Judge Jackson in a clear and unequivocal manner.

### **Atoms, Bits and Bytes**

In the meantime, within a day of the issuance of the opinion in the Microsoft case, a new event took place—United Parcel Service (UPS) went public. The market saw yet another key Internet drama play out.

United Parcel Service, a key competitor to the Postal Service—by their standard or by ours – sold 10 percent of its company in the largest Initial Public Offering of American business history.

The market bought the basic case—UPS was an internet stock. As the on-line shopping business has grown from a surprising multibillion Christmas during the first "eChristmas" in 1998 to what is predicted to be nearly a double digit billion dollar market this year, UPS has captured the vast majority of the ePackage shipping business. They begin from a good position—UPS has more than 80 percent of the package delivery market. Their investment in electronic messaging has made them a natural Internet shipper's ally. Even if commerce moved onto electronic networks, the atoms would still have to be delivered by the likes of UPS. They were hot. Their stock rocked.

But to return to my task of comparing Microsoft and the USPS, the United Parcel Service deal suggests some interesting math. UPS went public and their stock climbed by more than a third on the first day.

Last year UPS had revenues of a little more than \$20 billion. This is highly profitable revenue. But let us put that aside for a moment.

The math? The Postal Service is three times the size of UPS which now has a market capitalization of nearly 90 billion dollars. Does that give the USPS a potential market cap of 270 billion? OK, you say, what if? How does this compare to Microsoft's \$467 billion? But remember we are talking pre-settlement of the Microsoft case with the federal government and resolution of the state law suits.

And remember that UPS only sold 10 percent of their company. Does this mean that 1 tenth of the Postal Service is equal in value to half of Microsoft's market capitalization? Not yet, first we have to return to the sticky matter of profits. The Postal Service is a public sector legislated monopoly that must, by law, break even.

### **The P Word**

The numbers are interesting and they begin to make the case that the USPS could indeed have more value than Microsoft. They also nudge the discussion toward one of the most controversial concepts that economists and policymakers now raise about the USPS— what would the value of postal privatization be?

The very concept of privatization has traditionally been opposed passionately by the workers of the USPS and many others who are responsible for this American institution.

Feelings run deep on this subject. The traditions of the U.S. post go back centuries and are intertwined with some of the most important events in U.S. history. The post predated the Declaration of Independence, supported the development of the post roads and the new nation's westward expansion.

Alexis de Toqueville wrote about the American postal system of the early nineteenth century's role in supporting citizen participation in democracy. This is not an institution that is an early candidate for an asset sale in the usual sense of privatization as it has been seen around the world.

But there are also economic reasons that privatization of the USPS is not going to take place very quickly. As a private company, the UPS can set its prices on its own. As we have discussed, the USPS can neither control its prices nor its costs in the short term.

And in this context there are constraints that may be even more important. The USPS is America's universal service provider of postal delivery services. Significant costs are mandated by the public service mission of the Postal Service.

There are four elements of universal service as it is understood in the U.S. today: products, services, prices and access. That is to say, first, universal service is not limited to First-Class Mail. Some policy makers have wishfully written about the limited obligations of the USPS. But the customers, managers and others who handle publications, advertising mail and parcels do not understand the scope of the USPS' obligations to be flexible to adjustment to fit market demand. Likewise the service

standards that the Postal Service observes are seen to be universal in their application.

Also, pricing in the U.S. is uniform. Often services could be priced differently in different markets and there would be a revenue benefit to doing so. But this is not currently seen to be a freedom that is available to the post. And finally, access to postal services may be the most expensive and cumbersome element of the Postal Service's service obligations. The 40,000 post offices and the national postal infrastructure create a presence that is of great significance to many communities. In some rural communities people believe that the life of their town is anchored by the post office.

These characteristics of the universal obligations of the U.S. Postal Service are all important factors that contribute to its value. At the same time, they inflict costs that would have to be managed by a private enterprise. Achieving permission to reduce the cost burden by changing the methods through which these universal services are delivered would be one of the most significant tasks of any transition from the Postal Service today to a future one. What they illustrate is any simple multiplication that would treat the UPS as a market comparable analogy would be misleading, at least at this time. You can't look at the revenue and ignore the profits.

### **Digital Democracy and The Hybrid Highway**

So if simple multiplication is not a good way to think about the value of the USPS, how should we think about economic value? A more compelling approach would be to think about value in terms of the future marketplace as opposed to the present one. And this is the most interesting perspective of all.

The most provocative pictures of the future have been drawn by the advocates of the all electronic service vision. But, while the possibilities for the future are incredible, they are not likely to produce an all-electronic market in the next decade. More likely is the prospect of a "hybrid" highway in which there will be a digital divide between the electronically enabled citizens and those who still rely on the mail. There are at least five significant reasons why the highway will be a mixed use pathway—part paper and part electronics—for some time to come: infrastructure, applications, ease of use, security and business models.

The infrastructure has not yet been deployed to wire the entire market. Getting permission to complete the task, much less financing the job will require that a great deal happen.

The speed and convenience that are demanded by most consumers and the ease of use that new applications will have to provide have not yet been developed. For example, when we talk about the concern that electronic bill paying could replace hard copy mail more rapidly than a transition could be managed, we must also recognize that the applications that would make this possible do not currently exist in network deployed form. Nor do the current applications provide consumers with the security and trust that

will be needed to encourage rapid adoption of new applications.

Most difficult of all, the new services have not yet been organized into the framework of new business models. What has often happened in the early days of the Internet has been the introduction of new services, like the reverse auction services that provide value by making new efficiency possible, have required an Amazon.com or an eBay.com to step forward and take the entrepreneurial risk. The business models are still evolving. Until they are set, the all-electronic future is not going to define tomorrow's market.

Where does this leave the USPS versus Microsoft? Quite possibly in a more interesting position than it might have seemed.

First, the Microsoft case has established one clear point: innovation will not be left to the market alone. Judge Jackson has left us with a ringing endorsement of the role of government.

Second, if the market will not be all-electronic but instead will be part paper and part electronic, there will be a key role to be played by a universal service provider for some time to come. One of the key features of the role of the government will be to guarantee the rights of citizens who are caught at the digital divide. The USPS must shape every investment in new business and service according to public interest principles. If it can do so, the new age of digital democracy will not be defined in Silicon Valley or in Cyberspace but instead, thanks to the Microsoft case, in the unique dance that we call public policy making.

Third, and finally, the USPS has a critical role to play—whether it is a public or a private institution— in defining electronic-paper universal service. The question of future profits is a public policy decision more than a question of managerial performance. The U.S. Postal Service today possesses the unique ability to contribute to a part paper-part electronic marketplace irrespective of its ownership.

Dozens of new paper based technologies are today being developed in places like MIT's Media Lab and in the laboratories of America's most innovative companies. New opportunities to create a generation of paper entrepreneurs will evolve in a world where things begin to think<sup>viii</sup>, where microchips in consumer products become networked and intelligence is distributed throughout the delivery system.

The future value of the Postal Service is very much in the hands of this great American institution and in its ability to define its role in the next century. The pathway clearly leads toward public sector support for private innovators who can act in the interest of the public. Profits and price earnings multiples will be byproducts of the demonstration of the ability to create value. The journey along this public-private pathway will not be a simple one. But in the end it will deliver the greatest value of all.

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<sup>i</sup> Gates, William with Collins Hemingway, *Business at the Speed of Thought: Using a Digital Nervous System*, Warner Books, 1999.

<sup>ii</sup> Data on Microsoft cited from the Microsoft website (Microsoft.com), November 25, 1999.

<sup>iii</sup> Yahoo Financial Data, November 26, 1997.

<sup>iv</sup> This quote came from the Amtrack annual executive meeting in the spring of 1999 where Bill Henderson, the Postmaster General spoke. He was a surprise speaker, the example of businesslike government success. A management consultant had held the USPS up to the audience as the model to emulate.

<sup>v</sup> Data on the USPS taken from the USPS website (USPS.gov), November 25, 1999.

<sup>vi</sup> Opinion of Judge Thomas Penfield Jackson, *US v. Microsoft*, page 206.

<sup>vii</sup> Opinion of Judge Thomas Penfield Jackson, *US v. Microsoft*, page 207.

<sup>viii</sup> Taken from MIT Professor Neil Gersenson's work, "When Things Begin to Think."

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