

**Submission to the
Strategic Review**

Canada Post: **A Blueprint for Change**

September 2, 2008

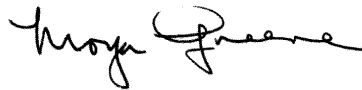
Every business day, Canada Post plays a significant role in helping Canadians communicate with one another, run their companies, and ship goods around the world.

On behalf of the Board of Directors of Canada Post, we are pleased to table this submission to the Canada Post Strategic Review, which highlights our achievements as a company, the challenges we face, and recommendations that will allow us to fulfill our enduring service promise to Canadians and meet our requirement to be financially self-sustainable.

This Strategic Review comes at a critical time in our evolution, and we are grateful to the Minister responsible for Canada Post for initiating this important project. We are pleased to make the following submission for the Panel's consideration and as a basis for ongoing dialogue with the Minister about our future.



Marc Courtois
Chairman of the Board of Directors



Moya Greene
President and Chief Executive Officer

CONTENTS

EXECUTIVE SUMMARY	1	3. FINANCIAL SUSTAINABILITY IS MORE THAN BREAKING EVEN ..	25
1. CANADA POST: A MODERN POST	6	3.1 A Definition of Financial Self-Sustainability	25
1.1 Service Provider of Choice	6	3.2 We Have Lagged Behind Other Posts	26
1.2 Employer of Choice	7	3.3 Closing our Funding Gap	27
1.3 Socially Responsible Company	8	3.3.1 Revenue Certainty Through Pricing.....	28
1.4 Transformation to a Modern Post	8	3.3.2 More Effective Use of Available Cash – The Problem of the Pension Solvency Calculation	30
1.5 More Change is Required to Address Major Challenges	9	3.3.3 Access to Capital Markets	31
• Improving the mechanisms to fund our public duties			
• Achieving financial sustainability			
• Changing our culture			
2. THE OLD DEAL IS BROKEN	10	4. WE NEED TO CHANGE OUR CULTURE	33
2.1 The Reserved Market is Under Pressure	11	4.1 Operating Rigidities Make it Difficult to Provide Great Service	33
2.2 Competition in Other Parts of the Business is Fierce	12	4.2 Link to Other Cultural Challenges	35
2.3 Remailers are Already Operating in the Reserved Market	14	4.3 How to Break Through	36
2.4 Market Liberalization Requires a Controlled, Measured Approach	15	4.3.1 Setting the Right Environment for Collective Bargaining	37
2.5 The Cost of our Traditional Obligations Continues to Grow	17	4.3.2 A Tool to Accelerate Employee Engagement	38
2.6 Better Retail Outlet Alignment for Better Service	19	4.3.3 Empowering the Board of Directors to Drive Cultural Change	40
2.7 Postal Transformation is Critical	21	CONCLUSION	43

EXECUTIVE SUMMARY

Canada Post Corporation exists to serve Canadians. “From anywhere... to anyone”™, our employees deliver more than 40 million pieces of mail, parcels and messages every day to more than 14 million addresses in every corner of this vast country. Our purpose is to provide Canadians with world-class postal service while remaining financially self-sustaining. Fulfilling this objective requires an efficient and strong Canada Post.

Our vision for Canada Post is to remain a service provider that Canadians value, an employer of choice, a socially responsible company, and an organization that can continue to reinvest in its service because



Our purpose is to provide Canadians with world-class postal service while remaining financially self-sustaining.

of its financial success. Just as we have evolved during the course of the past 27 years since we became a Crown corporation, we are committed to transforming Canada Post for the future.

The environment in which we operate has changed, and we face many challenges. In response, we have undertaken an ambitious program of investment and innovation in our services, our infrastructure and our culture. This is crucial to being able to provide the level of service Canadians and Canadian businesses require from us now and into the future. But this alone is not enough. A number of factors have put our financial position at risk, and measures beyond our direct control must be taken to ensure our continued success.

We welcome the Strategic Review as an important opportunity to reaffirm to Canadians our enduring commitment to service, discuss the issues we are facing, and present our recommendations for change. We have organized our submission and recommendations along three principal themes that address the questions raised in the terms of reference for the Strategic Review. Each of these is discussed in detail in our submission, and a summary of the discussion and recommendations follows.

™Trademark of Canada Post Corporation

THE OLD DEAL IS BROKEN

Canada Post is the only market participant to provide delivery of letters and parcels to every Canadian resident and business, every day, a uniform postage rate for basic domestic letters, and broad access to postal services through our vast network of post offices, street letter boxes, website and thousands of retail stamp shops. To pay for this, a portion of the postal market was reserved for Canada Post.

But the reserved market is under pressure on many fronts – electronic substitution, competition and the threat of liberalization – and no longer has the same value that it once had. At the same time, for a number of reasons described in this submission, Canada Post has been constrained in its ability to shed costs. The introduction of Bill C-14 in the House of Commons has opened a discussion about liberalization of the Canadian postal market.

Any consideration of opening the reserved area should reflect the scope and funding of the universal service obligation, and be undertaken in a measured and controlled manner to allow Canada Post to adjust to a liberalized market.

The cost of our obligations is growing. These obligations were to be funded by revenues in the reserved market – now under pressure. Our ability to replace this revenue is limited by vigorous competition in the parcels and direct marketing parts of our business. Moreover, we are also expected to provide services beyond the core mail service for reasons of public policy (e.g., Parliamentary Mail, Library Book Rate, Food Mail Program). These services are not fully compensated in a timely manner and are putting further pressure on our ability to financially sustain postal service.

Canada Post is pleased to deliver any postal-related public policy service it is asked to provide. However, compensation at market levels and on commercial terms should be adopted to facilitate timely payment and ensure the costs of such services are not borne by postal users through higher rates.

Canada Post recognizes that the provision of retail postal services remains one of the cornerstones of public policy in the postal sector. We maintain a vast network of 6,600 post offices (corporate offices and dealers), most of which are located outside urban areas. We understand the importance of the post office in rural communities and will continue to ensure that rural Canadians are well served by their local post office in keeping with the Government's rural moratorium. To do this requires a clear definition of what is considered rural and a periodic updating of which communities fit that definition, given shifts in populations over time. Flexibility in how we deliver on our service promise – both in our operations and in our retail postal network – would help ensure we can better meet the postal needs of all Canadians.

In order to leverage and adapt our retail network to best serve all Canadians, Canada Post recommends the adoption of a proximity-based standard of service and a clear definition of rural and urban communities across the country.

FINANCIAL SUSTAINABILITY IS MORE THAN BREAKING EVEN

The *Canada Post Corporation Act* established a dual mandate for Canada Post by stating that the Corporation should “establish and operate a postal service” and “conduct its operations on a self-sustaining financial basis.” The result of competitive pressures across all our business, including the reserved area, and the cost of our public obligations put our continued financial self-reliance at risk.

Our plans for postal transformation, which include significant investment in our plants, equipment and technology, are critical to assuring the functioning of our operations today, meeting the changing demands of our customers, and realizing the productivity improvements and cost savings that will allow us to be financially self-sustainable. Putting off these investments is not an option. It would significantly increase our risk to service, health and safety, and financial stability. Most other Posts around the world have already gone through this evolution and are reaping the benefits.

Funding these investments will be challenging but achievable if we are given the financial flexibility to better manage our revenues through price, better control our cash position which is negatively affected by unreasonable pension solvency funding requirements, and borrow in the capital markets.

Canadians enjoy one of the lowest stamp prices in the industrialized world, despite the cost of delivery in a country as large as Canada with such a widely dispersed population. For the last several years, price increases for the basic domestic letter have been determined by a Consumer Price Index-based formula that prevented Canada Post from recovering even inflationary increases on our costs. This formula does not reflect the cost pressures facing Canada Post. In addition, it does not properly reflect the responsibility for pricing decisions appropriately given to the Corporation in its Act, given that the company is best placed to assess market data, customer data and economic indicators that all factor into pricing decisions.

Canada Post should continue to exercise its regulatory responsibility established through the Canada Post Corporation Act to set prices, with the government retaining its right to disallow such prices in exceptional circumstances. Pricing decisions should be made by Canada Post based on customer consultations, market research and economic indicators, and should be communicated well in advance of their taking effect.

Our pension plan is one of the largest in Canada. While it is fully funded on a going-concern basis, the regulatory rules related to solvency calculations require Canada Post to fund any solvency deficits. This requirement creates a significant and unpredictable drain on cash, even while the likelihood of Canada Post being wound up is remote due to its Crown corporation status. It requires the Corporation to put theoretical pension considerations ahead of operational and investment requirements.

As with Crown corporations in provincial jurisdictions, Canada Post should be either exempted from funding solvency deficits or the government should agree to guarantee payment for any such deficit, in the unlikely event that the company was wound up and a solvency deficit materialized.

With pricing flexibility and the ability to conserve cash as a result of relief from the pension solvency calculation, we can reduce the borrowing required to fund critical investment. However, access to capital markets will still be required and our current borrowing limit does not match our needs. Additionally, external lenders will bring discipline to our investment decisions, and help ensure we do not waiver from completing our investment program and see the benefits materialize.

Canada Post's borrowing limit should be increased to a level commensurate with its requirements for capital to meet its current and ongoing investment needs.

WE NEED TO CHANGE OUR CULTURE

Canada Post's culture has developed over the course of our history, dating back to the days of being a government department. It has been, and is today, influenced by a number of internal and external factors – unions, federal public servants, political representatives, suppliers, customers, competitors and management. The result is a great company with numerous achievements and much potential. But some of these forces have led to a culture that holds us back from meeting our full potential.

Even if we make investments to transform Canada Post and are given the flexibility we require to be financially self-sufficient, we will not reach our full potential unless we change our culture. Breaking through the cultural barriers that exist today will require strong will and effort on the part of Canada Post and others. We are recommending action that will bring external discipline to the cultural forces at play and help open a path to positive change.

Our internal operating culture is defined by the collective agreement with the Canadian Union of Postal Workers (CUPW), our largest operating union. The agreement is uncompetitive and rigid. It is weighed down with clauses that prevent us from making changes to improve our customer focus and our efficiency. History has shown that we will not be able to make significant change to this agreement through the normal cycle of bargaining. We need the environment to be set in a way that helps ensure a significant shift in approach – to one that would allow us to better meet our customers’ needs and secure our financial position.

The Government of Canada should appoint a third party to review the CUPW collective agreement and table a public report on its competitiveness. It should also signal that it expects the next round of collective bargaining with the CUPW, in 2011, to result in changes that will ensure both excellent postal service and the financial sustainability of Canada Post.

We are committed to honour our people’s job-security provisions. But we need their commitment to help us improve productivity levels and our focus on the customer. Our employee engagement initiatives are beginning to show results. Frank and ongoing dialogue with employees will gradually bring changes to our internal culture. However, we need an effective tool that will more quickly help strengthen the connection between the everyday actions our employees take and the success of the company, and serve as a discipline on the rigid internal operating culture.

The Government of Canada should provide its final approval for Canada Post to implement an employee share ownership plan as provided for in the Canada Post Corporation Act.

As the sole Shareholder, the Government of Canada has the prerogative to express its desires for the future of Canada Post. It appoints the Board of Directors and the Chairman of the Board and, in so doing, the government exerts considerable influence over the strategic direction of the company. The Board is accountable to the Shareholder for carrying out the government’s expectations. The President and Chief Executive Officer is, in turn, accountable to the Board for achieving the corporate targets it sets and for all the company’s activities.

However, the Board of Directors is not currently empowered to best carry out its duties or to mitigate the interests of multiple external stakeholders who impose additional process and oversight on the company, impairing its ability to excel. Strengthening the role of the Board of Directors is another important tool to help break through our cultural barriers and ensure we can continue to meet our commitments.

To help change the culture of the company and improve the governance of Canada Post, the role of Canada Post’s Board of Directors should be clarified.

Canada Post is proud of its role in connecting Canadians. This strategic review of Canada Post presents an opportunity to position us to serve Canadians and Canadian businesses well into the future. We believe that the recommendations we have put forward in this submission will set in motion the changes necessary to assure our continued success.

1. CANADA POST: A MODERN POST

Canada Post Corporation is in the business of connecting Canadians. Our 72,500 full- and part-time employees work around the clock to deliver more than 40 million pieces of mail, parcels and messages every day to every corner of this vast country. Our purpose is simple: to provide Canadians with world-class postal service that they value and rely upon. Fulfilling this objective requires an efficient and strong business that has the means to sustain itself.

By many measures, we succeed. Since the Government of Canada undertook its last review of Canada Post in 1995, we have consistently met our Lettermail delivery performance targets, introduced innovative services, maintained an expansive network of post offices – in communities and online – and our domestic basic letter rate remains the third lowest among industrialized countries.

In that time, the Corporation has produced 13 years of consecutive profits, a decade of labour peace, and more than \$1 billion paid to the Government in the form of revenue from taxes, dividends and return of capital. As one of the biggest Crown corporations, Canada Post had consolidated revenue of \$7.5 billion and contributed \$6.6 billion in real Gross Domestic Product in 2007.

Becoming a Crown corporation 27 years ago has driven positive change for the organization. We are committed to ensuring that we do not revert to the days when Canada Post was a drain on taxpayers, with annual operating deficits of \$500 million, and was characterized by frequent and sporadic labour disruptions.

To ensure this, Canada Post wants to remain a service provider Canadians are proud to call their own, to be an employer of choice, a responsible corporate citizen with strong roots in every region, and a business that can continue to reinvest in its service because of its financial success.

1.1 SERVICE PROVIDER OF CHOICE

We Embrace our Mandate of Service to Canadians

Delivering exceptional value and service to customers is the best way to achieve enduring success, and remain relevant to the public and business community. Canada Post is working diligently to put the customer first by upholding high-quality standards across all aspects of our business. This means creating value for our customers by listening to them and providing the services they need. It also means meeting or exceeding delivery standards by continually improving our delivery processes. Achieving this vision requires Canada Post to offer products and services that are relevant, innovative, affordable and convenient to use. This requires continuous investment.

Promise to Canadians

Canada Post's service commitment is an enduring promise to Canadians. We strive every day to provide Canadians with:

- delivery of letters and parcels five days a week to every Canadian resident and business through a variety of channels: community mailboxes, rural mailboxes, post office boxes, and door-to-door service;
- letters delivered within a two-, three- and four-day service standard with an on-time performance rate of 96 per cent;
- a uniform postage rate for basic domestic letters, regardless of the distance to recipients;
- access through a vast network of retail postal outlets, stamp shops, street letter boxes, the Internet and call centres; and
- conveniently located retail postal outlets with extended hours of operations.

Public opinion surveys have consistently shown that Canadians have a favourable opinion of Canada Post, including satisfaction with our products and services. Canada Post has the highest comparative favourability rating out of seven organizations (including FedEx, UPS, General Motors and Bell Canada) tested in a February 2008 survey conducted by Nanos Research.

Nearly nine out of ten Canadians have a favourable impression of Canada Post. When it comes to the products and services they receive from Canada Post, the majority of Canadians (71 per cent) indicate they are very satisfied. Other key highlights of the research:

- 80 per cent are satisfied with the delivery of their mail;
- 80 per cent of Canadians agree that Canada Post's delivery standards are appropriate;
- 79 per cent are satisfied with their access to retail postal services.

A May 2007 poll conducted by the Strategic Counsel indicated that Canada Post was the most trusted of many public institutions in Canada, with higher public opinion scores than the Canadian Broadcasting Corporation, the Canadian military, the House of Commons and the Supreme Court of Canada.

1.2 EMPLOYER OF CHOICE

Our Success Depends on our People

As one of the largest employers in the country, Canada Post understands that its success is tied directly to the well-being and productivity of its employees. We are striving to become a model workplace – with every employee contributing to, and sharing in, the Corporation's success. We are making progress in this regard: for two years in a row, in 2006 and 2007, Canada Post has been named as one of the Top 100 Best Places to Work in Canada in an independently conducted survey published in Maclean's magazine and Canwest newspapers.



Canada Post is working hard to change our culture. We are committed to communicating openly and directly with employees at all levels; ensuring the safety and security of our people regardless of the job; building a culture of fairness, respect, inclusion and opportunity; and offering fair compensation.

1.3 SOCIALLY RESPONSIBLE COMPANY

We recognize the importance of the role we have to play as a socially responsible company. No other public or private institution touches more Canadians, in more places, on any given day than Canada Post. We believe that strong communities benefit all Canadians and companies – including Canada Post.

Canada Post aims to have a positive impact in the communities in which it operates. For years our employees have been doing that through food bank drives, coaching local sports teams, building relationships with Aboriginal communities, and participating in many other local charitable events. Nationally, we are long-term supporters of the United Way, raising more than \$2.5 million last year for worthy causes across the country.

As a company, we work to support Canadians and their communities. We have a sponsorship program that supports mental health as the Corporation's "cause of choice." We recognize literacy skills and accomplishments; we support our national freestyle skiing team; and we back a broad range of initiatives that promote community growth and vitality.

We are equally committed to acting responsibly toward the environment. We recognize that our environmental impact is substantial, due to the size, scope and nature of the business and the printed communications we deliver. We are adopting cleaner modes of transportation; ensuring that our buildings are more energy efficient; making buildings more sustainable by design; and reducing the environmental impact of parcels, advertising mail and letter mail products. We have committed to targets for reducing our greenhouse gas emissions by 14 per cent by 2012 (compared to 2002 levels). And we are working to reduce what we send to landfills by rolling out a national recycling program.

1.4 TRANSFORMATION TO A MODERN POST

Canada Post is committed to achieving our goals and building a Modern Post. We have already made much progress towards achieving our vision. But, we must do more. This means investing to ensure we can continue to meet our service obligations. We must also offer competitive products and services so we can continue to be relevant in the future, and we must find ways to do this while remaining financially self-sufficient.

The nature of our business requires us to focus on the network and equipment on which we rely. Today, our network needs to be revamped. Our facilities are aging and our sorting equipment cannot handle needs as efficiently as it should. Our customers increasingly want and need services our current technology cannot deliver such as timely tracking information for parcels and easy-to-use online mailing tools.

Investments in the postal network are overdue. For a number of years, like many other government-owned organizations, much of our required large infrastructure investments, beyond regular maintenance and upgrading, were delayed. The results of such an approach are beginning to show their impact at Canada Post, just as they are affecting much of the infrastructure of this country, including roads, bridges and ports. Antiquated and obsolete infrastructure, equipment and technology are jeopardizing our ability to provide Canadians with the services they expect, and thus our ability to remain relevant.

We have begun implementing our transformation plans to invest in our infrastructure to address this obsolescence and to prepare the company for the future.

1.5 MORE CHANGE IS REQUIRED TO ADDRESS MAJOR CHALLENGES

Our plans to invest in and transform to the Modern Post are critical to our future. But in order to achieve our vision, more is required.

I Improving the mechanisms to fund our public duties

We need to change almost all aspects of the framework in which we operate. When we were first created as a Crown corporation, the approach taken assumed, similar to other countries, that all service obligations could be paid for by reserving a portion of the communications market for the Post. Initially, this was a workable approach, but it is no longer sustainable. Our obligations have evolved and become more costly to fulfill, and the market has changed such that the reserved area is no longer of sufficient value to cover all of these costs. The result is a shortfall between the costs of our service obligations and the mechanisms to fund them.

II Achieving financial sustainability

Simply covering costs is not adequate to maintain and improve the service we provide to Canadians. Long-term financial self-sustainability requires that Canada Post generate sufficient cash flow to fund essential investment, working capital and dividend payments to our Shareholder, the Government of Canada. It also requires that Canada Post achieve and maintain an earnings level adequate to generate a commercial return on equity and generate sufficient earnings to borrow without a government guarantee.

III Changing our culture

The culture of any organization defines the way its people act. It either supports or prevents the entity's success. At Canada Post, our culture is influenced by a number of factors we are working to address. Canada Post's efforts will need to be augmented by a level of discipline that can only come from outside forces alongside internal efforts.

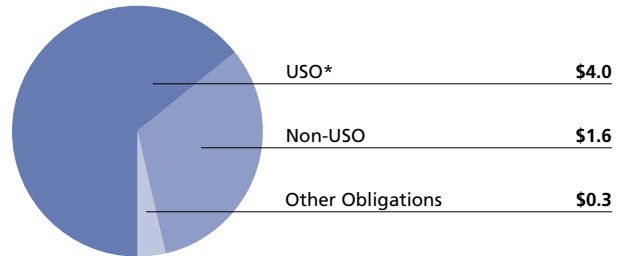
2. THE OLD DEAL IS BROKEN

Canada Post has public responsibilities of which we are proud. Our universal service obligation (USO) means that we are the only market participant to provide a basic letter and parcel service to everyone and every business, regardless of location, every day. For letters, we do this at the same price regardless of distance. We rely on a network of 21 plants, 565 depots and 6,600 post offices. Some of these are traditional corporate outlets and others are offered through our partners across the country (for example Shoppers Drug Mart, Jean Coutu and Sobseys).

The object of the Corporation, as set out in the Canada Post Corporation Act, is, among others, to establish and operate a postal service for the collection, transmission and delivery of messages, information, funds and goods both within Canada and between Canada and places outside of Canada.

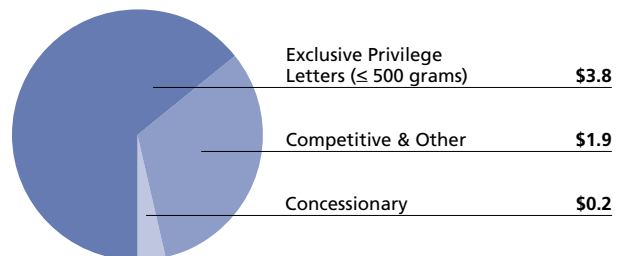
These responsibilities have a large cost. To pay for them, a portion of the postal market was reserved for Canada Post. Canada Post's reserved market is for all letters, up to 500 grams. Canada Post has the sole and exclusive privilege of collecting, transmitting and delivering letters within Canada. Canada Post estimates that it cost approximately \$4.3 billion to meet its USO and other public policy obligations in 2007. The monopoly or reserved market revenues paid for an estimated \$3.8 billion of that cost.

Funding the Universal Service Obligation Cost of USO (\$ billion)



*Collecting and delivering letters and parcels five days a week to 14 million urban and rural addresses, meeting the two-, three-, four-day delivery standard.

How we pay for public obligations (\$ billion)



There are pressures on both sides of this equation and, as a result, the gap between the costs to fulfill our obligations and the reserved market to pay for them is growing.

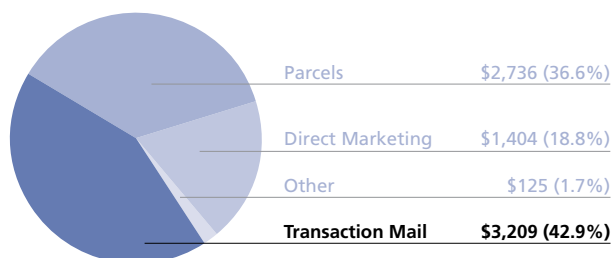
- The value of the reserved market is under pressure as letter mail volumes decline and we face electronic substitution and foreign-owned competition in this segment of the market.
- The cost to fulfill our obligations is growing, in some cases because of the way in which we are asked to carry them out.
- We have been asked to take on new responsibilities without full and timely market compensation.

The combination of these factors puts at risk our ability to deliver on our commitments to Canadians – customers and employees alike.

2.1 THE RESERVED MARKET IS UNDER PRESSURE

Lettermail (or transaction mail) – which includes bills, invoices and statements – is still the largest revenue generator at Canada Post, accounting for \$3.2 billion (43 per cent) of the Corporation's 2007 consolidated revenues of \$7.5 billion. Transaction mail competes in the \$40 billion communications market that includes telecommunications, instant messaging, email and a variety of other communications channels.

Transaction mail revenue (\$ million) The Canada Post Group* (2007)



*Canada Post and its subsidiaries and joint ventures.

However, growth in this line of business has been flat for the last five years. We expect that Lettermail will decline at a rate of about one per cent a year in the future. This is attributable to a number of factors:

- Canadians are increasingly using email as their primary means of communication – just as they once used letters.
- Consumers increasingly pay their bills online and use electronic bill presentment services.

- Large mailers are bundling their service offerings, leading to bill consolidation. For example, many Canadians now receive a single bill each month for their home phone, cable and Internet services where they used to receive three.
- A growing number of consumers and small businesses favour electronic filing services for transactions such as income taxes.

In 2006, among the G8 group of countries, Canada had the highest broadband subscription rate with 60% of households subscribing to high-speed Internet services. Over 93% of Canadian households were able to subscribe to broadband service.

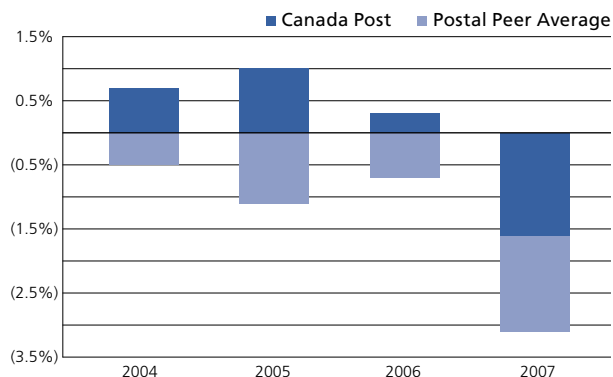
As well, more than 200,000 new addresses are added to the Canadian postal network each year, thus increasing our delivery costs. Since mail volumes per address are declining, this leaves us with less revenue per address to cover rising network costs.

Lettermail volume trend

	2003	2004	2005	2006	2007
Lettermail Volume	5.35 B	5.41 B	5.45 B	5.46 B	5.40 B
Delivery Addresses	13.55 M	13.81 M	14.05 M	14.29 M	14.49 M
Lettermail Items per Address	395	392	388	383	373

This trend is not unique to Canada Post. Other major postal administrations have experienced similar levels of decline and are pursuing a mix of strategies to mitigate the impact.

Year-over-year letter mail volume change among major postal administrations



Postal Peers = Australia, Deutsche Post, La Poste, Posten, TNT, USPS

Replacing the revenue loss from the decreased volume of letters per household in our letter carriers' bags is challenging. The mail with which we can replace letters – addressed and unaddressed direct marketing mail – is sold at much lower prices per piece than a letter. This means that to replace one piece of 52-cent mail, we need almost two 35-cent pieces of addressed advertising mail or seven pieces of 8-cent unaddressed advertising mail.

Canada Post has been responding to this challenge by focusing on and building new services that increase the effectiveness of our customers' key communications. This includes epost™, our online bill presentment service, and SmartFlow™, a suite of services that optimize, simplify and manage our customers' key documents and can provide end-to-end document management services. We have been expanding our customer base to be less dependent on our top 200 enterprise customers, and aggressively focusing on providing solutions to small and medium-sized businesses in Canada.

By building on the growing adoption of electronic bill presentment services, Canada Post can help Canadian businesses lower their costs and improve the ways they serve their customers. We see opportunities to embed additional self-service capabilities within these electronic services for the benefit of Canadian consumers and businesses.

Canada Post has also responded to the migration of key business communications from letters to electronic channels by creating electronic trust services such as the Electronic Post Mark (EPM). The Canada Post EPM service adheres to the standards set out by the Universal Postal Union (UPU). Based on these standards, and the trust model set out by the UPU, any transaction postmarked by one Post can be verified by another Post's EPM service. Canada, France, Italy, Portugal, and soon the U.S., have a UPU-compliant EPM service. Canada, however, does not offer a legally recognized electronic version of the date and time stamp of letters. Canada Post will be exploring ways to formalize this service to further enable Canadian businesses to optimize both electronic and physical communications.

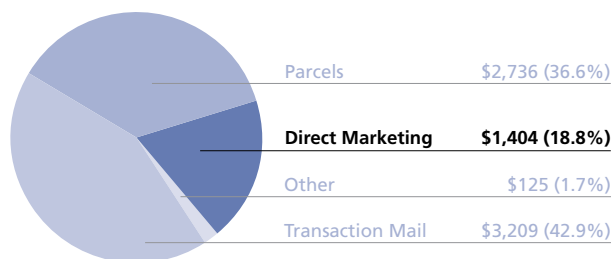
2.2 COMPETITION IN OTHER PARTS OF THE BUSINESS IS FIERCE

We now face competition in many areas of our business, including direct marketing and parcel and courier services. Consumers and businesses have a range of choice in these areas. Improving our market share and revenues in these competitive areas is one option for recovering lost Lettermail revenue. However, for a variety of reasons that we outline, this is not easily achieved under present conditions.

Direct Marketing

Direct marketing mail accounts for \$1.4 billion of Canada Post's consolidated revenue. This is our share of the \$24-billion Canadian advertising industry. Addressed advertising mail, which is used by mailers to communicate directly with customers (for example, credit card applications) and unaddressed advertising mail (for example, store flyers) are the two main offerings of this line of business.

Direct marketing revenue (\$ million) The Canada Post Group (2007)



Direct marketing is the fastest growing segment of the advertising world. At the same time, it is facing fundamental changes as traditional media advertising investments are being redirected to building cost-effective, high-return online solutions. While Canada Post's business in this space is currently growing by as much as six per cent per year, the weakened economy is creating cost pressures for our customers and provoking a migration to a more economical means of communicating with customers. As a result, the lower-priced unaddressed advertising mail volumes are growing at the expense of the higher-priced and premium addressed advertising mail.

As well, the publications industry is seeking alternatives for delivering magazines, such as bundling them into newspapers. Although we deliver magazines at a mail rate that is approximately one third of what we charge for other, equivalently sized packages, some in the publications industry nonetheless argue that our mailing rate is high.

Our strategy for direct marketing focuses on enabling industry's customer-centric marketing initiatives by developing and providing the building blocks to expand our business with our large enterprise customers, and to support the development of the small and medium-sized businesses and direct retailers. We want to expand our product and service offerings to address the emerging needs for multi-channel and interactive solutions with a robust suite of data and analytical tools. We also want to improve the customer experience by enhancing every interaction with Canada Post. Canada Post will continue to grow its direct marketing business while remaining conscious of Canadians' environmental concerns, assuming a leadership role in the marketing community, and striving to improve the efficiency of mail.

The fastest growing segment of the direct marketing industry is the interactive market and this poses a challenge to Canada Post, which currently operates primarily in the physical space. However, with the right investments and strategic alliances, Canada Post is trying to become a leader in the direct marketing space. But this requires profitability.

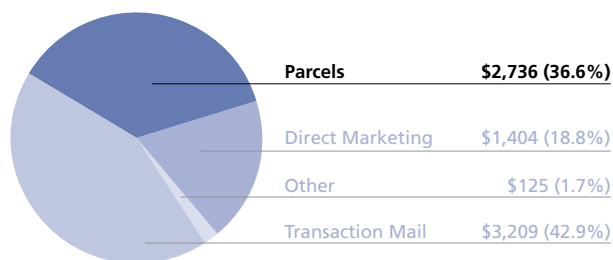
Parcels

The parcel business is a fiercely competitive sector with a number of international, national and regional players vying for a share of an increasingly fragmented market. International players in this sector have more money to invest and can often use Canada as a loss leader in their local contracting – beating Canada Post out on price.

In 2007, Purolator Courier Ltd., which is 91 per cent owned by Canada Post, was the market leader in Canada with revenues of \$1.4 billion. Canada Post Parcels Division was second with \$1.2 billion of revenue. Other competitors in this market include United Parcel Service of America Inc. (UPS), FedEx, DHL, Midland and Dicom Express. The Canadian shipping and delivery market is part of the larger Canadian logistics and supply chain management market that is worth \$45 billion. Consolidation and acquisitions continue to drive growth in this market.

Parcel revenue (\$ million)

The Canada Post Group (2007)



Includes Logistics segment revenue.

Canada Post has been able to successfully use its core competency in home delivery to take a leading position in the business-to-consumer market segment, as well as the consumer and small business drop-off segments that are growing due to a rise in online shopping. But even in this market, Canada Post faces new competitive threats in its

retail parcels business, as competitors have also established a retail presence. UPS, for example, has re-branded more than 280 Mail Boxes Etc. store locations in Canada as The UPS Store where consumers can drop off and pick up parcels. FedEx has increased its storefronts to 22 locations in Canada with plans to further grow its retail network.

Canada Post struggles to compete in the business-to-business shipping segment due to antiquated technology and operating constraints that make it difficult for the Corporation to match the speed of its competitors when sorting parcels. This puts us at an immediate competitive disadvantage.

Online purchases are driving momentum in the shipping and delivery market. However, outdated technology makes it difficult for Canada Post to keep pace with tech-savvy competitors. We cannot offer the same track and trace functionality as our competitors who are investing hundreds of millions of dollars per year in technology. We have only recently upgraded our scanning system to industry standard to enable more efficient delivery.

Our strategy for this part of the business is to focus on maintaining and growing our leadership position in the business-to-consumer segment by making investments in technology, tracking visibility, and improving our performance by leveraging synergies throughout The Canada Post Group.

2.3 REMAILERS ARE ALREADY OPERATING IN THE RESERVED MARKET

As noted above, the reserved market is already under pressure due to e-substitution and bill consolidation. Moreover, competition already exists in this market in Canada from international remailers – despite the fact that the letter market is reserved for Canada Post.

Remailers, such as Spring Canada and Key Mail that are owned by or associated with foreign Posts, are active in Canada. These companies take mail produced and collected in Canada and ship it outside the country to be inducted in a foreign postal stream. This practice contravenes the *Canada Post Corporation Act*. Remailers make a profit in Canada without having to shoulder any of the costs and obligations of providing universal service throughout Canada. The end result is that Canada Post is deprived of revenue from outbound international mail, while maintaining significant legacy costs here in Canada. This has a direct impact on our bottom line.

In 2007, the Government introduced Bill C-14 in the House of Commons. This Bill, if passed, would open Canada's international outbound market, legalize remailing, and eliminate a portion of the reserved market for Canada Post. This would reduce Canada Post's ability to cover its costs of service.

2.4 MARKET LIBERALIZATION REQUIRES A CONTROLLED, MEASURED APPROACH

Opening a portion of the market to remailers is seen by some as just the first step in a larger liberalization of the Canadian postal market. Once the letter market is open to competition from private-sector companies, new entrants would quickly focus on growing their business in Canada in high-density urban markets such as Montréal, Toronto and Vancouver. They would try to effectively "cream skim" our business in the most profitable markets.

Unless Canada Post were relieved of some of its obligations at the same time, or given support to quickly cut its costs, this would result in an immediate widening of the current gap between the cost of our public responsibilities and the means we have to pay for them. Large operating deficits could occur very quickly that would have to be funded by taxpayers.

Canada Post faces unique challenges in delivering on its service commitment given the large size of this country with its relatively small population, particularly when compared to European countries.

Experiences in other jurisdictions demonstrate that liberalization without an orderly transition can result in reductions or disruptions in service. For example, the experience in the United Kingdom shows that any liberalization must be phased-in over time and that the incumbent postal administrator must be given time and support to adjust its cost structure as new entrants erode its revenues.

Royal Mail in the United Kingdom was already struggling with declining letter mail volumes and a rigid cost structure. Its market was liberalized before it was able to implement changes to its costs and adjust service standards. As a result, Royal Mail was pushed to the edge of bankruptcy, as private-sector foreign competitors quickly moved into lucrative parts of the market. Royal Mail was left to continue servicing unprofitable rural routes and more-expensive-to-serve small-business customers.

An independent review of the liberalization of the United Kingdom's postal market observed that governments need to be cautious about encouraging competition in a declining market and that it is critical to reconcile the degree of liberalization with the sustainability of universal service. In its interim report, released in May 2008, the review noted the need to consider "the risk that more extensive competition [in the UK] could make universal service unsustainable."

The contribution of the reserved market to the provision of universal and affordable postal service is essential. Any erosion of this reserved market, whether through normal competitive and technological forces or through deliberate action, will undermine the ability of Canada Post to sustain service unless measures are undertaken to mitigate the impact. The gap between the cost of our public obligations and the value of the market available to Canada Post to pay for them will widen quickly.

Canada Post is not against market liberalization. However, foreign examples make it clear that a measured approach is required for liberalization to be successful for all parties.

When examining liberalization of the postal market in Canada, the federal government should take into consideration the following factors:

- The Government will be liberalizing a declining market; the letter mail market in this country is mature.
- There is a considerable amount of competition in the postal system already.
- Canada Post has decades of legacy costs that it would need to shed prior to liberalization, the full extent of which needs to be assessed and considered by the Government.

Recognizing that it is solely the Government's purview whether and how it might want to liberalize the postal market in Canada, a successful transition depends on establishing a level playing field among all participants. This requires that Canada Post undergo a period of investment that will allow the Corporation to remain viable and continue to fulfill its commitments to Canadians.

Reducing costs at Canada Post requires time and is not easy given the complexity of the business and restrictive labour contracts. Canada Post would need time, flexibilities and government support to successfully transition to a liberalized postal market. For these reasons, Canada Post favours a phased-in approach for any liberalization of Canada's postal market – a timetable that would enable Canada Post to retool its operations and measures to support a change in the culture that has, over the past 40 years, held the company back.

Recommendation #1

Given the current competitive situation in Canada and the global trend towards liberalizing postal markets, should the Government wish to open the reserved area to competition, it is recommended that, in order to do so without jeopardizing postal services to Canadians, it should consider the following:

- ***Any opening of the domestic letter market to new entrants should not commence until Canada Post has completed its postal transformation process.***

- ***The Government of Canada should be clear about how the universal service obligation will be funded. Canada Post’s service obligations and how they are to be discharged may need to be recalibrated to ensure the appropriate balance between the obligation and the means to pay for it.***
- ***Existing competition law, rather than any new bureaucratic structures, should apply to a liberalized postal market in Canada.***
- ***The Government should support the culture change required to arrive at a more competitive cost structure (described later in this submission).***

“Any obligations and responsibilities that a state owned enterprise is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.”

*“Corporate Governance of State-Owned Enterprises”
Organization for Economic
Cooperation and Development, 2005*

2.5 THE COST OF OUR TRADITIONAL OBLIGATIONS CONTINUES TO GROW

In addition to our core service mandate, Canada Post is also required – either formally through our legislation or less formally through other means – to undertake other public policy functions. Canada Post is pleased to be the service provider for the public policy priorities set by the Government of Canada.

It should be recognized however that, in cases where the provision of these services is not fully covered by Government appropriation or other payment mechanisms, the cost is borne by general postal users. The financial impact of these services has increased over time as the utilization of the programs has increased; yet funding is limited for this set of obligations and often lags behind the service by several years.

Two of the public policy programs Canada Post provides stem from the *Canada Post Corporation Act*: Parliamentary Mail and Literature for the Blind. The Act provides for free mail between Canadians and Members of Parliament and the Senate, the Governor General, the Speakers of the Senate and House of Commons, the Parliamentary Librarian, the Ethics Commissioner, and the Senate Ethics Officer.

Members of Parliament are also allowed to mail – free of charge – up to four “householder” mailings to their constituents each year. Beyond the provisions of the Act, Members of Parliament have access to a significantly discounted postage rate for any unaddressed advertising mail beyond “householders.” The Act also provides for the free mailing of eligible materials for the use of the blind.

Another federal program that Canada Post supports is the Food Mail Program, a program under Indian and Northern Affairs Canada (INAC) designed to reduce the costs of transporting nutritious, perishable food and other essential items by air to approximately 140 designated isolated northern communities that lack year-round surface transportation. Under the program, shippers are charged very low postage rates for the shipment of eligible items to all eligible destinations from designated entry points. Canada Post is compensated on a cost-recovery basis for the difference between the costs it incurs on behalf of INAC for shipping eligible goods and the postage paid by shippers.

The Government of Canada's Publications Assistance Program (PAP) provides for subsidized postal distribution costs for eligible Canadian publications. Canada Post has been contributing up to \$15 million annually (up to a third of the contribution made by the Department of Canadian Heritage) to the PAP fund. In 2006, Canada Post announced that it could no longer subsidize this group of publications mailers in this way. In December 2006, the Government issued a directive instructing Canada Post to continue funding the PAP by up to \$15 million annually up to March 2009.

The Library Book Rates allow libraries to move books between public libraries and to rural and remote residents at significantly reduced postage rates. There is no formal requirement for Canada Post to provide these rates, but public pressure to do so has historically been strong. There are appeals to keep the rates low and to expand them to include non-book material. Library Book Rates are well below market rates and have not been increased since January 2005. Canada Post absorbs the cost of this service; the company receives no government appropriation or compensation of any kind.

Recently, Government directives have changed our obligations without providing compensation for the associated costs. In addition to the directive on the PAP, the Government also issued a directive to maintain rural delivery while respecting all Canadian health and safety laws. We are striving to deliver to lot-line boxes as directed by our Shareholder, against a backdrop of 40 cease and desist orders from Human Resources and Social Development Canada (Labour Canada) and 1,400 complaints from our people.

Seeking an increase to funding levels has been difficult. In some cases (Parliamentary Mail and Literature for the Blind), compensation is through a Government appropriation, and the process to seek an increase is lengthy and not within the control of Canada Post. In other cases, we do not have any reasonable recourse to recover commercial rates for the services we provide. This funding shortfall results in additional pressure to our financial situation, and increases the gap between the cost of our obligations and the revenues available to pay for them.

Current public policy programs (2007)

Public Policy Programs	Estimated Foregone Revenue
Parliamentary Mail and Literature for the Blind	\$12 M
Library Book Rate	\$6 M
Food Mail Program	\$9 M
Publications Assistance Program	\$15 M

Recommendation #2

Canada Post is pleased to be the service provider for any postal-related public policy services the Shareholder wishes to support. However, costs should not be borne by general postal users through higher postal rates, a position advocated by many associations representing major mailers and marketers.

- *Canada Post should be compensated at market rates and under commercial terms, through business contracts reflecting actual mail volumes, with the appropriate federal departments for any public policy program it is asked to carry out, including Parliamentary Mail, Literature for the Blind, the Food Mail Program, and Library Book Rates.*
 - *Any new public policy obligations assigned to Canada Post should be formally set out in writing to ensure transparency. Canada Post should be compensated for these at market rates and under commercial terms through a contract with the appropriate government department.*
-

2.6 BETTER RETAIL OUTLET ALIGNMENT FOR BETTER SERVICE

As noted earlier, our service commitment to Canadians includes extensive access to retail postal outlets. To fulfill the obligation, currently, Canada Post operates the largest retail network in the country with more than 6,600 full-service post offices. There are also more than 17,000 private-sector postage stamp sales agents in Canada, including major retailers such as Costco, 7-Eleven, London Drugs, Safeway, and Couche-Tard/Mac's.

We are working to become a service provider of choice with a retail network that:

- provides service in convenient locations in Canadian neighbourhoods, where people do other shopping;
- offers hours of service that allow Canadians to access postal services when it is convenient for them, i.e., after regular work hours;
- enables Canadians to purchase a broad range of Canada Post products and services, including sending and receiving domestic and international parcels, money services, change of address, and new electronic services as they become available;
- conducts business in both English and French consistent with the *Official Languages Act*.

The breadth of our post office network is a clear competitive advantage. We want to be close to Canadians, where they live and work, because it allows us to continue to offer superior service.

There are still thousands of traditional corporate post offices across the country. But, since 1985, Canada Post has also operated a successful network of post offices operated by private-sector partners such as Shoppers Drug Mart, Jean Coutu and Sobeys. Post offices run by private-sector partners offer customer service at convenient access points with more convenient hours of operation than many of our traditional corporate post offices.

Canada Post has seen a measurable improvement to customer satisfaction ratings and financial performance. Canada Post's dealer network is a cost-effective way to deliver service. It now accounts for more than half of Canada Post's retail sales with a significantly lower operating cost.

Maintaining a customer-focused and economically efficient retail network is increasingly challenging for Canada Post. Shifting demographics and population migration from rural communities to urban centres have resulted in many of our post offices not being well located within their communities. In 1994, the Government introduced a moratorium on the closure and/or conversion to private dealers of post offices designated as rural based on an outdated criteria.

The key challenges with the moratorium are that the term "rural" was never defined, and there was no consideration of Canada Post's extensive service provided through private-sector dealer partnerships.

This resulted in freezing the retail network in many areas no longer considered rural by most Canadians, and thus limiting service options. Many of these areas are now either suburbs of large urban centres, or medium-sized metropolitan areas in their own right. Examples include: Stittsville, Ontario; Abbotsford, British Columbia; Moncton, New Brunswick; and Lethbridge, Alberta. Many such

locations would be better served by infrastructure, hours of operation and services more in line with those available to Canadians in cities.

Currently, 60 per cent (approximately 4,000) of Canada Post's network are in non-urban communities; only 40 per cent (approximately 2,600) are located in urban centres. Approximately 80 per cent of Canadians live in urban metropolitan areas.

Canada Post's non-urban retail outlets do not generate as much revenue as outlets in urban centres. In 2007, the combined sales of all Canada Post urban outlets was \$810 million, more than double the \$390 million of sales produced by non-urban retail outlets. Some of these offices have as few as five customers a day. Dwindling customer traffic and sales volumes make it uneconomical to operate many of these outlets.

However, Canada Post recognizes that business economics cannot be the sole determinant governing the provision of retail postal services in Canadian communities. We understand that many Canadians have an affinity for their existing local post offices and see them as an anchor for their small communities. The provision of retail postal services remains as one of the cornerstones of public policy in the postal sector. That said, it may be time to refresh the details of the moratorium, now in place for 14 years.

We are still committed to maintaining excellent service everywhere in Canada. To address the evolving service needs of Canadians driven by demographic and market changes across the country, the company should be able to effectively address and adjust its retail postal network as needed.

Recommendation #3:

Canada Post respects the moratorium on the closure of rural post offices, and understands that rural Canadians have a strong affinity for the post office in their community. We are not seeking to have the moratorium lifted. But the existing moratorium list should be modified to reflect the changes in Canada's population patterns, i.e., where Canadians now live. This will enhance our ability to provide superior service to Canadians.

To leverage and adapt our retail network to best serve all Canadians, Canada Post should be permitted to:

- *Adopt a proximity-based standard of service similar to ones found in other countries:*
 - *98 per cent of Canadians will be within 15 km of a postal outlet;*
 - *85 per cent of urban households will be within 2.5 km of a postal outlet;*
 - *80 per cent of rural households will be within 7.5 km of a postal outlet.*
- *Adopt the Statistics Canada definition of rural and small towns (i.e., a population of less than 10,000) for determining the network configuration and retail service standard.*
- *Revisit the list of rural post offices periodically and apply this definition to allow Canada Post to make changes that will lead to improved service for Canadians.*
- *Remove outlet-type distinctions (corporate versus dealer) in any moratorium determination as long as basic postal services are provided.*

Applying such parameters will allow Canada Post to better serve all Canadians, and particularly those living in rural and remote communities. We will continue our approach of only considering changes to rural post offices in exceptional circumstances. Where issues do arise affecting a local post office in either a rural or urban community, Canada Post will continue to consult with community leaders on finding practical solutions.

2.7 POSTAL TRANSFORMATION IS CRITICAL

As noted earlier, Canada Post needs immediate investment and the ability to transform. This is critical – both to our ability to provide service to Canadians today, and our ability to remain relevant and competitive in the future.

Most of Canada Post's 21 mail processing plants are more than 40 years old. Structural defects have been identified in Canada Post's Winnipeg plant due to corrosion; parcel sorting equipment in the main Toronto facility is so old that the technology can no longer be supported and it is hard to find replacement parts.

In recent years, Canada Post has made progress in upgrading and modernizing the infrastructure and basic information technology equipment on which virtually every modern business depends. Replacing old, unsupported computer equipment and continuing to deploy new technologies is essential for our employees to do their jobs and provide even the most basic information to our customers.

At the same time, much of our information technology is still very old, and expensive to operate and maintain. Some of our customer-oriented applications are nearly 10 years old and lack the functionality and ease-of-use capabilities offered by competitors. Although we have started to modernize our online functionality, considerable additional investment is required to reach current business standards. Our customers have told us they find our current systems difficult to use compared to other alternatives.

The technology underpinning our processes also needs upgrading. Effective tracking and traceability capabilities are now “table stakes” in the postal and courier markets – yet Canada Post does not offer this functionality at the same level as our competitors. A better address-management system is required to ensure that the Corporation can respond to the demands of direct marketing customers for targeting their mailings to certain groups of addresses. Canada Post needs new technology to capture volumes accurately and in real time. This would also allow us to adjust our staff levels for seasonal fluctuations in volume. At the same time, the availability of information about mail volumes would support standardization of our processes and consistent management across all facilities.

We do not have the technology platform we need to create an e-offering for our customers that will help sustain our business in the future. Canada Post can only succeed in reducing costs and offering newer and better services to customers over the long term if we adopt modern infrastructure and technology. Our largest customers will be looking to seamlessly integrate our systems with their own to improve the service experience they deliver to their customers. By enabling this, Canada Post will help Canadian businesses become more competitive and efficient.

Over the past three years, we have established and embarked on our Postal Transformation plan. This plan includes investing in building upgrades and replacement, and purchasing new sorting equipment that will allow us to significantly reduce manual mail sortation. It also includes introducing new technology to underpin our sorting equipment and to help us better manage our delivery standards, as well as offer new e-services to our customers, and all of the related work process change management and training that comes with a significant investment program.

Making such a large investment in a vast complex network requires huge lead times. Building a large facility can take a minimum of two years. Designing the specifications for new equipment, putting out a request for proposal, evaluating the results, and making a decision has taken 12 months. The manufacture and installation of equipment can take 24 to 36 months. A four-year lead time from project definition of postal equipment to installation is common. So it is imperative that we continue on the path to transform the Post.

If we invest now, we can avoid service disruption even as we expect a total of 27,000 retirements and other attrition from Canada Post over the next decade. Processes can be modified and modernized to enable us to avoid replacing many of these departing employees. If we do not invest in change, we will have to hire a new person behind each and every retiree at a cost to the company of wages and benefits for the following 30 years.

The saving projected to result from Postal Transformation is approximately \$350 million per year once the plan is completed in 2014. The capital investment of \$1.9 billion (of a total program of approximately \$2.5 billion) will be recovered in the five years following the completion of the investment.

Planning, executing and implementing such a major program is a challenge for any organization of our size and scale. However, if this investment is not made, even more serious challenges and risks will arise from a service, financial, and health and safety perspective.

Service Risks

Current Ability to Deliver

The longer our current infrastructure is not replaced, the more challenging and costly it will be to achieve our committed service standards. More patchwork solutions will likely be required (e.g., work-arounds, more expensive transportation modes to recover from equipment and productivity shortfall) as the number of equipment failures increase due to aging infrastructure.

Given these challenges, the ability to keep the service failures below the customer line of visibility will become increasingly difficult. These service breakdowns have major implications – equipment failures can be difficult to detect and repairs become a very time-consuming process. Over a one-year period ending in May 2008, an equipment incident resulting in disruption to operations was reported on average every five working days.

The age of our equipment makes it increasingly difficult to find the parts needed to undertake repairs. In some cases, suppliers no longer support the technology, and the upcoming attrition rates of our maintenance workforce are significant. This will make finding the expertise to maintain existing equipment ever more challenging.

We have an obligation to deliver the mail to every address in Canada. This challenge becomes even greater with so many people and businesses moving each year. Canadians and businesses are not legally obligated to tell us their whereabouts. Misdeliveries due to change of address errors are costly, and problematic to senders as well as recipients. Our delivery system needs updating and the support of technology to better manage addresses.

We also face another service risk due to the large number of retirements expected over the next decade (as discussed earlier). In the current operational setup, most of the mail processing and delivery knowledge resides with employees rather than within a central knowledge storage base. As employees retire, that knowledge will be lost, likely affecting service and productivity rates. Postal Transformation addresses this risk by significantly increasing the level of standardization across the network. This includes putting systems in place to capture address and line-of-route data. We cannot successfully standardize operations without this investment in technology and automation.

Remaining Relevant in the Future

Based on a review of market conditions in Canada and elsewhere, traditional letter mail volumes can be expected to erode. For that reason, competitive products will become even more important for us in the future. We need to improve the value and effectiveness of existing products as well as develop new products if we are to remain viable in the long term.

The strategic risk that Canada Post will not be able to maintain and improve its service will increase if Postal Transformation investments are not made now. This risk will arise from a variety of factors, including the potential for service failures, as described earlier; the growing inability of our network to efficiently handle increasing volumes of parcels and unaddressed advertising mail; and the lack of innovative product and service offerings to keep us relevant with our customers. Minor improvements and work-arounds have become inadequate and wasteful. A major transformation is needed to meet what our customers are already seeking – and what many competitors already provide. The technology platform planned under Postal Transformation will provide greater visibility and new applications that would enable multi-channel postal services.

Financial Risk

Capital spending will always strain earnings. However, delaying capital regeneration in an infrastructure enterprise is a high-risk approach. We have already delayed too long. Our plan offers the only opportunity we have to close the productivity gap between Canada Post and our competitors. Postal Transformation is expected to secure service through improved earnings results, reduced costs and improved productivity.

Health and Safety Risks

The health and safety risks related to obsolete plant and equipment are wide-ranging. Canada Post continues to rely heavily on forklifts and basic containers designed for transport rather than sorting. Close to 40 per cent of injuries to Canada Post plant workers are related to manual material handling around these containers and forklifts.

Recent reported incidents include:

- In November 2007, a belt on the Toronto bag sorter broke and fell into a working area below. Fortunately, no one was injured.
- Numerous ergonomic injuries (shoulder/back) have been reported related to manual handling (e.g., lifting mail and parcels into or out of monotainers, moving mobile conveyors) and ranging in duration from two days to several months.

Material-handling processes at many foreign postal operations are safer and more ergonomically sound, because they have implemented better-designed containers and rolling carts that enable mail to be safely moved on and off vehicles.

It is difficult to assess the actual financial cost of these risks or the level of certainty as to when a serious breakdown or accident would occur. However, it is clear that minimizing investment would defer and impede anticipated reductions in injury on duty absence rates and uncertified sick leave absence rates.

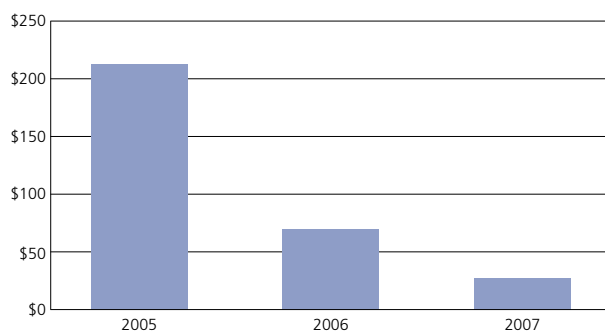
3. FINANCIAL SUSTAINABILITY IS MORE THAN BREAKING EVEN

The *Canada Post Corporation Act* established a dual mandate for Canada Post by stating that the Corporation should “establish and operate a postal service” and “conduct its operations on a self-sustaining financial basis.” We work every day to fulfill both of these elements.

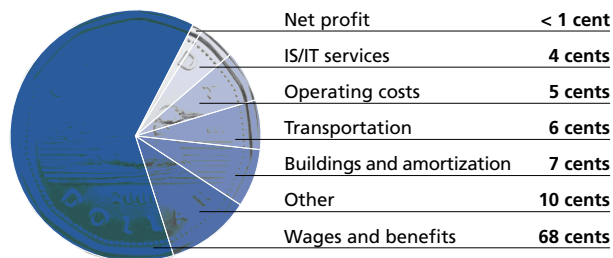
The result of the diminishing reserved market, new entrants, competitive pressures across our business and the cost of our public obligations is an unsustainable financial situation for Canada Post. Unless we can improve our earnings, it will become increasingly difficult for us to meet our service promise to Canadians.

Today, Canada Post is barely profitable. While the Corporation recorded its 13th consecutive year of profitability in 2007, our revenues were lower than expected and our operating margin of 1.3 per cent was razor thin. Operating-cost increases outpaced revenue growth. Only through the greatest control of costs that can be exercised in the current situation, did the company remain in the black. But we continue to face increasing cost pressures from wages, transportation and other operating expenses.

Income from operations (\$ million)
Canada Post segment



Canada Post keeps less than one penny for every dollar of sales (2007)



3.1 A DEFINITION OF FINANCIAL SELF-SUSTAINABILITY

Like Canada Post, companies operating within the telecommunications, courier, pipeline, gas distribution and electric utility industries have both regulated and competitive parts of their businesses. They are also, like Canada Post, infrastructure companies with high legacy costs under pressure to adapt to new realities, driven by technology change, market shifts and more nimble competitors. We have much to gain by reference to the experience of these industries.

Management, investors, regulators and bond-rating agencies have shaped these companies. They provide for us a mature and market-tested definition of financial self-sustainability. This definition shows just how far Canada Post is from making the mark.

Providing service to Canadians is of primary importance, but without financial self-sustainability our service objectives cannot be achieved. This fact is often overlooked by some stakeholders, including some customers, our Shareholder and certain of our unions.

As noted earlier, financial self-sustainability means the ability to:

- generate sufficient cash flow to fund essential investment (both in our infrastructure as well as growth opportunities), working capital, and dividend payments to the Government of Canada;
- achieve and maintain an earnings level adequate to generate a commercial return on equity; and
- generate sufficient earnings before interest, tax, depreciation and amortization such that a government guarantee is not needed to raise critically needed capital in debt markets.

Ensuring sufficient cash flow to continuously reinvest in the business is of the highest importance.

Based on this definition of financial self-sustainability, TD Securities Inc. (TDSI), who conducted an evaluation for Canada Post of its financial situation, has come to the conclusion that: "Canada Post Corporation's profitability and ability to continue as a financially self-sustaining entity is in jeopardy."

To meet the test of financial self-sustainability, Canada Post would have to be making significantly higher earnings in 2008 than the \$25 million that is currently planned. Given our size and cost structure, and the unpredictable fluctuations in the economy, this level of earnings is so slim that it is nearly impossible to determine where we will end the year.

The current levels of projected earnings are not adequate to fund the necessary investments in our infrastructure, putting service at risk.

We are at a critical stage: continued positive financial performance will be achieved only if Canada Post can modernize its infrastructure and address its cost structure.

Currently, taxpayers do not financially support Canada Post's operations. In fact, approximately 85 per cent of Canada Post's revenue comes from large commercial and mid-market mailers such as banks, telecommunications companies and retailers. Canada Post's top 20 customers are organizations such as the Royal Bank of Canada, Rogers Communications and Sears Canada. The top emerging customers include Amazon, eBay and Dell Canada. The support of these customers will disappear if we do not invest to respond to their changing needs.

3.2 WE HAVE LAGGED BEHIND OTHER POSTS

The Corporation's operating performance has been materially lower than leading postal peers for the last five years. Even in one of its best years (2005), Canada Post's operating margin of 3.8% fell below the average performance of the majority of its peers and well below the consistent best-in-class performances exhibited by Australia Post or the Netherlands' TNT.

Financial performance of Posts (2003-2007)

Company	Operating Profit Margin Range
Australia Post	11% – 13%
New Zealand Post	6% – 14%
Deutsche Post AG	5% – 8%
TNT	6% – 13%
Austria Post AG	2% – 7%
Posten AB	(1)% – 7%
Canada Post	2% – 4%

The Corporation has also lagged behind other Posts with regards to innovation, increased productivity and infrastructure renewal.

Postal investment* and renewal in other countries Major projects of the last decade

Country	Expenditure (\$ million – CDN)	Timeframe
United States	\$31,000	1998 – 2007
France	\$5,400	2004
Germany	\$5,000	1998
United Kingdom	\$4,600	2007
Norway	\$1,600	2004
Switzerland	\$1,200	2002 – 2003
Netherlands	\$1,000	1998
Australia	\$600	2000
Austria	\$500	2000
Denmark	\$400	2005 – 2006

* Includes investment in postal plants, technology, delivery, sort, and material-handling equipment.

Postal systems in Europe and the United States have undergone significant transformation and made great strides in integrating information technology systems with operational processes. Germany, for example, has implemented fully automated sequencing of its letter mail – saving 60 minutes per day on each delivery route. Canada Post employees still sort mail by hand to each address. This process takes between 1.5 and two hours of a letter carrier’s morning each day. Saving 60 minutes of manual labour each day per delivery route would amount to approximately \$200 million in annual cost savings for Canada Post.

3.3 CLOSING OUR FUNDING GAP

We estimate that the Postal Transformation program will cost approximately \$2.5 billion, of which \$1.9 billion is capital. Our estimates are still being refined as we complete our request for proposals process. We are required to plan for future years and enter into long-term financial commitments now. The nature of the investments – constructing buildings and making large purchases of machinery across the network – creates very long lead times and therefore requires this kind of planning.

In its report for Canada Post, TDSI concluded that: “Generating sufficient cash to fund the Postal Transformation will be a significant challenge for Canada Post Corporation.” But it is both necessary and possible. Based on current estimates, without any of the changes being recommended in this submission, Canada Post will have to borrow in the range of \$1 billion to \$2 billion to augment internally generated cash.

We can fund more of our investment internally if we gain some flexibility to manage. Our ability to predict how much we will need to borrow in the future and how much we can generate internally is limited.

- First, our revenue stream is difficult to predict. As discussed earlier, our core businesses are under attack and we are limited in our ability to respond through price.
- Second, the volatility of our cash flow is made worse by our requirements around our pension funding.
- Third, we have borrowing restrictions that do not match our current investment requirements.

3.3.1 Revenue Certainty Through Pricing

Although many of Canada Post's prices have been deregulated over the years as the postal market has become increasingly competitive, the price of a stamp for a basic letter is still regulated. Pricing is a key tool for any company to manage its revenue stream and specifically for Canada Post to be able to protect service.

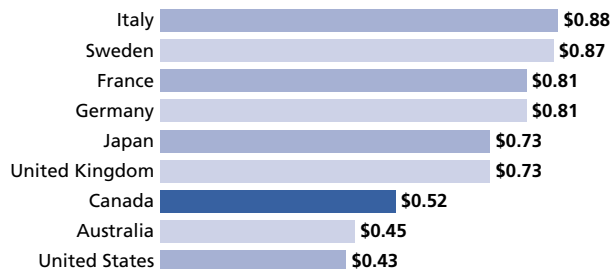
The company was given the authority to propose pricing regulations. The *Canada Post Corporation Act* regulations were amended in 2000 to include a price cap formula for the basic domestic letter rate, which is the amount charged to mail a regular-sized letter up to 30 grams. That price cap formula limited increases in the basic letter rate to two-thirds of the Consumer Price Index (CPI) – a broad measure of inflation, or the cost of living, that is published by Statistics Canada. If the CPI rose three per cent, then Canada Post could increase the domestic letter rate by two-thirds of that amount, or by two per cent. This was not a formula linked to the reality of our cost structure.

The CPI has risen 14.5 per cent since 2002; the price of a basic stamp in this country has only gone up eight per cent, or four cents. The TDSI report states that: "The basic letter rate price cap of two-thirds inflation limits revenue generation and the ability of Canada Post Corporation to recover operating costs." Had the domestic letter rate increased at full inflation since 1982, the price of a stamp in Canada today would be \$0.65 versus \$0.52. The Corporation would have collected an additional \$500 million since the price-cap formula was implemented.

This formula has succeeded in keeping the basic domestic letter rate low in Canada compared to other countries. Among major industrialized nations, Canada's basic domestic letter rate is consistently among the least expensive.

Basic letter rate (\$CDN)

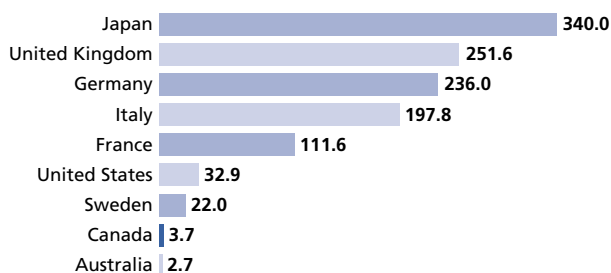
As of June 1, 2008



Canada Post is proud that it offers its customers outstanding service at affordable prices. Keeping prices low is an impressive achievement. Canada's low population density and large land mass means the delivery costs in this country are much higher than some other countries such as Japan, Germany and France. Yet the domestic letter rate charged in smaller countries, such as Italy, is almost 70 per cent higher than in Canada.

Population density

Population per km²



We continue to offer a low rate even while rising costs for labour, fuel and transportation, along with other business challenges, have eroded profit margins. Fuel prices alone have risen more than 30 per cent in 2008,

putting significant pressure on Canada Post, which relies on the country's largest and most intricate transportation network of more than 12,000 vehicles to transport and deliver the mail across 170 million kilometres each year. Annual transportation costs for the company are estimated at half a billion dollars.

While the Corporation works diligently to keep postage rates as low as possible, the reality is that pricing must also be reasonably adjusted in a timely way to reflect changing business realities. We recognize that, given competition in all segments of our business, we must be prudent with pricing. There is a limit to how high prices can go without causing customers to switch to competing companies or substitute products. We have the research capacity and customer outreach to understand these trends. The Corporation also understands that financial objectives cannot be met solely through price actions; cost control and reduction must be part of the plan.

Increased competition has led to products and prices being effectively deregulated in Canada. Today, market competition in the form of virtually free electronic substitutes serves as an effective regulator for pricing. Competition in the marketplace, customer intelligence and knowledge of market elasticity disciplines Canada Post's pricing strategy. In fact, many business customers have indicated that their main concern is that they receive adequate notice regarding changes to postage rates.

In June 2008, Canada Post announced its intention to increase the price for the basic domestic letter rate by two cents in each of the following three years – 2009, 2010 and 2011. These increases, which would raise the price of a stamp from \$0.52 today to \$0.58 by 2011, are necessary to help Canada Post manage escalating fuel prices and other cost pressures, including the decline in mail volume per address. Even with these increases, Canadians will

likely still enjoy one of the lowest domestic basic letter rates in the developed world.

Pricing is a basic business and operational matter. Management, supported by customer focus, market intelligence and research results, is best placed to make recommendations on pricing to the Board of Directors.

Recommendation #4

Through the Canada Post Corporation Act, Parliament gave Canada Post regulatory responsibility for pricing. As such, it is only in exceptional circumstances that the Governor in Council should be required to exercise its right to veto any proposed pricing changes.

To ensure that pricing changes more closely reflect Canada Post's costs of doing business and contribute to the sustainability of the postal service, it is recommended that:

- ***Consistent with the regulation published by Canada Post in the Canada Gazette in June 2008, the current price-cap formula be removed as the mechanism for establishing the price of the domestic basic letter rate in Canada.***
- ***Through the regulatory process established in the Canada Post Corporation Act, Canada Post's Board of Directors, on the recommendation of management, should have the discretion to set rates for all regulated products, while providing users with reasonable notice.***
- ***The Government of Canada retain its ability to disallow rate increases, but this be exercised only in exceptional circumstances.***

3.3.2 More Effective Use of Available Cash – The Problem of the Pension Solvency Calculation

Canada Post has the largest pension plan among Crown corporations at \$15 billion in assets – ranking ahead of Ontario Hydro and Quebec Hydro. The pension plan is indeed one of the largest in Canada and is forecast to double to about \$30 billion by 2017. Since inception, the plan has met its investment objectives and has consistently earned returns above the median of other pension plans. It is fully funded on a going-concern basis. However, with the structure and size of the pension plan relative to Canada Post, the volatility of returns and discount rates result in significant fluctuations in required plan contributions and expenses.

Canada Post's pension is regulated under the federal *Pension Benefits Standards Act*. This legislation applies to all entities falling under the legislative authority of Parliament and to any business that is largely an inter-provincial undertaking, including shipping, railways, airlines, telecommunications and broadcasting.

The pension plan is subject to various actuarial valuations for different reasons, including determination of required funding and expenses to be recorded on a going-concern and on a solvency basis. With the current surplus of 10%, Canada Post's pension plan is more than fully funded on a going-concern basis, which indicates that on a long-term basis, pension assets exceed future obligations to be paid to pensioners.

But the rule relating to the solvency calculation poses a problem for Canada Post as it creates a significant and unpredictable drain, diverting cash that could be used for operating requirements and investment priorities. The solvency-basis valuation considers whether Canada Post would have enough money to purchase annuities to cover its existing pension liabilities should it be wound up. Since Canada Post cannot be wound up without an Act of Parliament, the likelihood of this occurring is remote. The pension solvency calculation is therefore theoretical, arguably not necessary, and potentially harmful to the Corporation's ability to manage its cash.

The calculation of solvency is based on current market conditions and interest rates that can fluctuate substantially. For example, even a 0.1 per cent change in interest rates can cause a change to the solvency valuation of more than \$230 million. In March 2008, we saw a \$200 million fluctuation in the solvency calculation over a two-day period.

When we are required to file a solvency valuation and the pension plan is in a solvency deficit, the Corporation has to begin injecting funds into the pension plan even in periods where the pension is fully funded on a going-concern basis.

As such, it requires the Corporation to put theoretical pension considerations ahead of current operational requirements. This rule draws much-needed cash away from capital investment requirements. Between 2003 and 2006, Canada Post made a total of \$669 million in solvency payments to its pension fund to meet this theoretical solvency rule.

There is precedence in other jurisdictions within Canada for providing exemptions from funding pension solvency deficits for organizations of similar status as Canada Post. The Government of Ontario allows pension plans to exclude future automatic indexation from the solvency liability calculation. In Alberta, Crown corporations are generally exempt from solvency valuation calculations. The Quebec government provides a similar exclusion to municipalities, universities and transit commissions. And, Nova Scotia has legislation that grants municipalities an exemption to fund solvency deficits that are less than 15 per cent of a solvency liability.

Recommendation #5

As long as Canada Post's pension remains fully funded on a going-concern basis, and to ensure that cash funds are available to protect service by investing in infrastructure and technology, it is recommended that:

- ***The pension solvency rules governing Canada Post be changed to allow for an exemption from funding solvency deficits; or***
- ***As long as Canada Post is majority owned by the Government of Canada, that the Government provide a guarantee or promissory note that, in the unlikely event that Canada Post is wound up (through legislation) and a solvency deficit exists at that time, the Government will fund any deficit. This does not require any cash outlay by the Government, but would allow Canada Post to preserve its cash for essential investments.***

Relief from the solvency calculation could free up approximately \$360 million based on current estimates.

3.3.3 Access to Capital Markets

With pricing flexibility and the ability to conserve cash through relief from the pension solvency calculation, we can reduce the borrowing required to fund Postal Transformation.

Extending the limit on how much Canada Post can borrow in the capital markets remains critical. Currently, the amount that Canada Post can borrow in the market is capped at \$300 million, subject to the approval of the Minister of Finance. This amount is not aligned with our current requirements. Under the *Financial Administration Act*, to increase this limit requires an Act of Parliament. Approval by the Minister of Finance is also required on the specific terms and conditions of borrowing. The processes to gain the required approvals can be long and cumbersome, and curtail Canada Post's ability to be responsive. The Board of Directors, cognizant of its fiduciary role, should have purview over this. It relates directly to the company's ability to meet its mandate and strategic imperatives – key aspects of the Board's role.

Access to outside capital is a critical step to making the investments necessary to ensure the continuation of service by renewing the physical infrastructure, equipment and technology. It also has ancillary benefits. It brings additional discipline to ensure the right investments are made – those that generate the highest return. It puts us on an equal footing with our competitors. It encourages the innovation and strategic drive necessary to guarantee service and operational excellence. Most importantly, it provides a new factor to help change the culture of Canada Post, a necessary step if we are to be the competitive, customer-focused enterprise to which we aspire.

Recommendation #6

The Board and management of Canada Post are eager to have an opportunity, through our Corporate Plans and other discussions, to describe our investment needs to the Government. Once the Shareholder understands our investment requirements, and the various approaches to financing them, it is recommended that:

- *Canada Post's borrowing limit be increased to a level commensurate with the company's requirements for capital. The correct limit should be set by considering the company's ability to generate funds internally, including through other mechanisms that might result from this review that would free up funds for these investments.*
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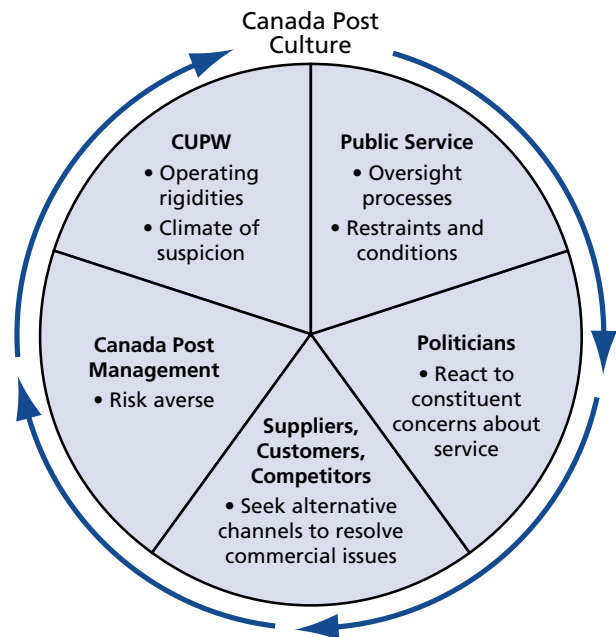
4. WE NEED TO CHANGE OUR CULTURE

Canada Post is determined to successfully execute Postal Transformation. The cost savings and service improvements that will result make this essential for our future. But this investment alone will not be enough to secure our long-term success. To do so requires a change in our culture.

The culture at Canada Post has been shaped over the past 40 years by a number of internal and external forces: unions, federal public servants, political representatives, suppliers, customers, competitors, and Canada Post management. The results are both a great company with numerous achievements and much potential and, at the same time, one that is held back by the weight of the operating rigidities and heavy oversight processes it faces every day.

Each one of these forces will need to change or be changed if a new culture – one that can enable our future success – is to emerge.

We at Canada Post must take responsibility for this change. We have started to make progress through our last round of collective bargaining and our employee engagement initiatives. But we need both our own efforts and pressures from outside the company to break through the barriers we face. In this section of our submission, we will describe the mutually reinforcing cultural dynamics at play as well as the measures required to open a path for positive change.



4.1 OPERATING RIGIDITIES MAKE IT DIFFICULT TO PROVIDE GREAT SERVICE

Canada Post values all its employees – from those who work in the plants, depots and retail outlets across the country, to letter carriers, salespeople and management. Our people directly ensure that the mail gets delivered to 14 million points of call each day. Our success as a socially responsible, customer-driven and financially sound enterprise rests with our employees.

But full and complete engagement of our people in the success of Canada Post is hampered by numerous operating rigidities perpetuated through complex and stifling collective agreements that have developed as a result of more than 40 years of very public negotiation and arbitration processes. The collective agreement with our operating employees has its roots in the days when we operated mainly as a monopoly in a protected market. This agreement can no longer enable our success, given the pressure we face from competitors with much more flexible agreements that give them an immediate and significant operating advantage.

Our four bargaining agents – the Canadian Union of Postal Workers (CUPW), the Association of Postal Officials of Canada, the Public Service Alliance of Canada/Union of Postal Communications Employees, and the Canadian Postmasters and Assistants Association – represent 73,500 employees (including temporary, casual and term employees) under five collective agreements. The CUPW – the largest union – represents 56,000 employees in two separate bargaining units that cover employees responsible for mail processing, collection, delivery and retail, as well as Rural and Suburban Mail Carriers (RSMCs) who deliver mail in rural and suburban areas.

The CUPW's constitution and policies provide a clear indication of the union's attitude towards management and its approach to labour relations. The constitution states: "Within the trade union movement, the union wants to promote and strengthen a militant and combative front with which to oppose any form of collaboration with management and government serving management's interest... The union rejects completely the logic of 'belt-tightening' and 'shared responsibility' for the economic crisis of our present system."

The CUPW's *raison d'être* is job creation. In order to create and protect the most jobs possible, its focus in any round of collective bargaining is to add provisions for more leave and practices that increase the number of people required in our operations.

The union has been very successful. The CUPW agreement – at 553 pages in length, including 56 articles and 34 appendices – is one of the most complex, rigid and constraining collective agreements in all of North America. The article used for resolving disputes between parties is 25 pages long and contains 106 clauses. This is unheard of in other collective agreements.

The CUPW agreement is very inwardly focused. It has no view to the customer, service or quality. It contains a substantial number of cumbersome and inefficient restrictions. These restrictions can both limit the quality of our service and our ability to implement change, and they shape the culture on the floor of our facilities. For example:

- **Individual work measurements** – Canada Post cannot measure the work of an individual to determine productivity. Canada Post can only measure the work of a group to obtain an objective evaluation. This makes it very difficult to manage unproductive employees.
- **Seniority** – This is the determining factor for staffing at retail counters, rather than by the more appropriate standard of measuring an individual's suitability for working directly with the public. In addition, frequent movements due to bidding based on seniority create training and team-building challenges.

-
- **Technological change** – Canada Post is required to give 120-days notice prior to implementing any technological changes. Anything can be deemed a technological change. In a recent CUPW bulletin, the union stated: “Article 29 in the urban operations collective agreement contains the best language on technological change found in any collective agreement in North America and possibly the world. What is important about the language in the urban operations agreement is that changes in work processes are covered, whether or not they result from the introduction of new equipment.”

Such restrictive work rules make it almost impossible for the Corporation to improve customer service or productivity. Our productivity gap compared to others in our sector is large.

Employees are also encouraged to complain and grieve even the smallest things. For example, a manager moving a piece of equipment that is supposed to be moved by an employee can result in a grievance. Some other instances: the wrong person picking up a piece of mail that has fallen off of a machine belt can create a grievance, as can someone considered to be working too quickly. Shop stewards are paid to investigate and prepare grievances to be submitted on behalf of employees.

The technical complexity of the collective agreement rules and protocols is further compounded by their interpretation by selected arbitrators. Several arbitrator rulings have overturned the company's ability to responsibly deal with employee disciplinary actions involving serious breaches of conduct. These instances include cases of individuals uttering threats to customers, and employees

convicted of theft – who were subsequently ordered reinstated. Such outcomes challenge the assurance and security needed by customers that Canada Post can be entrusted with their business.

The time and processes required to deal with grievances and manage other complaints are very onerous. More than 20,000 grievances were filed in 2007 alone. These contributed to a total of more than 32,000 grievances still pending at the end of the year. The quantity of grievances makes it difficult for management to discern the real issues from the very minute ones.

The exploitation of what originated as legitimate complaint processes and the rigidity in our operating culture create a cultural wedge between management and many of the operating employees so critical to the company's success.

4.2 LINK TO OTHER CULTURAL CHALLENGES

The impact of the CUPW's approach goes beyond the company.

The CUPW fights very publicly against any change or potential change in the way in which we deliver service – it wants the postal service to remain the same as it was 40 years ago. It uses the Internet, public demonstrations and write-in campaigns to elected officials, the Minister responsible for Canada Post, and municipalities across the country to make frequent, public, unfounded accusations that the company is trying to reduce service or close post offices simply to create fear among the public and elected representatives. Using external platforms, the union creates an environment of suspicion that permeates our relationship with Canadians, federal public servants and politicians.

Numerous government officials in many departments are empowered to “oversee” and “challenge” almost any activity that Canada Post is undertaking in the course of normal, day-to-day business (such as pricing, contracts, network changes) as well as longer-term corporate matters (such as investments, suppliers and financing). They use the suspicion created by the union as a platform to position themselves as “protecting the public good.” The questions they ask and processes they impose, however, merely serve to slow the company down and impede ordinary business.

CUPW’s activities also result in unnecessary concern by Canadians that their postal service is at risk. They cause Canadians to doubt Canada Post’s dedication to its service commitment. Politicians, representing Canadians, want to ensure their constituents are receiving good postal service without disruption. But the climate of suspicion emanating from both the union and the public service have led to concerns among Ministers and Members of Parliament over the years that Canada Post should be approached with caution. This frequently puts the Minister responsible for Canada Post in the difficult position of balancing the pressure to intervene and the need to respect the Crown corporation arm’s-length relationship.

Whenever outside stakeholders observe that the Shareholder is willing to make inquiries or potentially get involved in the day-to-day operations of the company, they are encouraged to use the same channels to improve their own positions. Customers lobby for better rates than Canada Post is willing or able to provide them. Contractors lobby for preferential treatment outside regular commercial practice. Unions will lobby for those things that they were not able to get at the bargaining table. Historically, such efforts have been successful and have therefore persisted.

All of these forces are stifling the capacity of Canada Post to continue to provide the high level of service Canadians expect and deserve as they inevitably come to bear on the management culture at the company. They cause management to become very risk-averse and concerned about the impression an initiative might have in the public domain as opposed to what the best decision might be. They quash the capacity to be nimble and respond effectively to the competitive and technological changes the company is facing.

4.3 HOW TO BREAK THROUGH

Both the internal and external factors affecting our culture need to be addressed. We at Canada Post are ready and eager to address these issues. We will continue to try to change the operating rigidity of our collective agreement through the bargaining process, and to improve employee engagement.

But we cannot turn back the clock on the past 40 years on our own. We need support from our Shareholder to create real change within the company, and to adjust some of the processes and attitudes behind them that hold us back from success.

It is in this context that we are recommending three things that we believe can help change the strong cultural forces affecting the company:

- setting the right environment for collective bargaining;
- introducing a tool to accelerate employee engagement;
- empowering the Board of Directors to drive cultural change.

4.3.1 Setting the Right Environment for Collective Bargaining

Canada Post is committed to maintaining a professional and effective relationship with all of its unions. Given the number of employees represented by the CUPW, changes to the CUPW collective agreement are of foremost importance. Canada Post has not endured a strike or lock-out with its largest union in a decade. On May 3, 2007, the company signed an agreement with the CUPW that runs until January 1, 2011.

This was an important achievement. We are proud that we were able to successfully bargain for the inclusion of the CUPW membership in our corporate team incentive – our “bonus” based on achieving key business results. Until this round of bargaining, the CUPW had always resisted the idea of member participation in such a plan. This was an important first step in bringing employees’ attention to the importance of the company’s service, customer value, engagement and financial targets, and the role they have to play in achieving these targets. All of these are measured to determine whether or not an incentive is paid.

Our Postal Transformation plan is aimed at seizing part of the one-time opportunity in coming years to reduce our workforce and achieve labour cost reductions through attrition, retirements and improved technology – without anyone losing their job. But, beyond Postal Transformation, we must look to make further changes in our operating processes currently restricted by our collective agreement.

Sustainable change at Canada Post is only possible if we can modernize our collective agreements and reconcile them with customer- and market-driven terms. The C.D. Howe Institute came to a similar conclusion in a 2007 report, stating that, “...adopting policies that would capitulate to union (not employee) concerns about maintaining historical employment and wage levels would risk seriously undermining reform benefits.”

Post offices in foreign jurisdictions have also undertaken reforms to their collective agreements in recent years. In Australia, labour reforms in the postal system included wage improvements that were directly linked to modernization and productivity targets. This approach resulted in labour productivity rising by 20 per cent over the last five years. And as Australia Post has modernized, its full-time workforce has been reduced in favour of a greater reliance on part-time and contract employees. Today, Australia Post’s labour costs as a percentage of total revenue stands at 46 per cent compared to 63.8 per cent at Canada Post. Similar labour reforms have been undertaken in Austria, Sweden and Germany.

Addressing productivity Postal sector labour reform in other countries

Company	Labour-Related Reforms
Australia Post	Increased use of part-time and contract labour
Royal Mail	Introduction of flexible work practices to address coverage of absences and sharing of duties; increased automation
Austria Post AG	40% of workforce is part-time
Deutsche Post AG	Reduction in paid breaks; standardized delivery jobs, allowing for greater use of part-time delivery force
Post Danmark A/S	Use of delivery teams; automation of route sequencing
TNT	Standardized delivery jobs, allowing for greater use of part-time delivery force

But implementing labour change is not easy. We want to honour our people's job security provisions but we need their commitment to help us improve productivity levels at Canada Post. This collective agreement cannot be made competitive through another round of normal collective bargaining. New approaches need to be brought to bear to create the right environment for this to occur. As in other countries, government support will be critical to any labour reforms at Canada Post.

Recommendation #7

It is recommended that the Government of Canada undertake the following:

- ***To begin to break down the operating rigidity that constrains Canada Post, a third party should be appointed to review the CUPW collective agreement to lay out what changes would be required for the company to move toward a more competitive situation. Transparency is an important tool to change culture. Therefore, this report should be put in the public domain so that the distance between what is permissible under this agreement, and what is necessary to be successful in the future, is an important consideration of the upcoming round of collective bargaining.***
- ***The Government should publicly show support for change in the lead-up to the next round of bargaining. It may be useful to look to models that have been successful at breaking down operating rigidities in other sectors or Posts.***

It will also be essential for the Government to underline that the next round of bargaining must contribute to the continuation of excellent postal service but also to long-term financial self-sustainability.

4.3.2 A Tool to Accelerate Employee Engagement

Employee connectivity to the values, vision and goals of Canada Post is critical for success. Employee engagement can serve as an important force in changing a company's culture. Fostering and sustaining such engagement is a collective responsibility of both the company and its employees.

Canada Post is proud that it has been able to sustain healthy wages and benefits for its employees for decades. Canada Post's employees have access to an extensive health-care plan, wide-ranging dental coverage – including orthodontic services – a broad vision and hearing care plan, two retirement-planning options, and life and disability insurance. Canada Post's benefits programs rank among the most generous plans in Canada.

Overall, employee wages and benefits drive almost 70 per cent of Canada Post's costs. The emerging challenge is to be able to financially sustain such benefits in the face of the operational rigidities that prevent us from making the necessary changes to return us to a healthy financial state. The best protection of anyone's job security, wages and benefits is a successful Canada Post.

Information and openness to discussion will gradually change the attitudes supporting our internal culture. For this reason, employee engagement is a central focus of our plans. Our goal is to become one of Canada's employers of choice – capable of attracting and retaining motivated, talented people in a wide range of fields. The Corporation has taken a number of steps to improve engagement levels, including:

- Developing a Corporate Team Incentive bonus that is paid each year provided Canada Post meets defined business targets, such as service, customer value, engagement and financial measures.
- Creating an open dialogue with employees at all levels – getting executives out of their offices and onto the shop floors of the company.
- Focusing on a workplace improvement culture founded on the principles of fairness and respect.
- Focusing on workplace health and safety to reduce accidents.

Introducing an employee share ownership plan at Canada Post would augment these efforts by providing a tool to help employees focus on the connection between what they do every day and the earnings of the company. Under the *Canada Post Corporation Act*, employees can own up to 10 per cent of shares in Canada Post. Such shares would be non-voting and therefore would not dilute the ownership control of the Government.

Share ownership helps change attitudes and front-line work culture and encourages enhanced productivity. It moves the employee beyond being a passive participant to being an engaged owner – transforming the culture of the organization in the process.

“Ownership is indispensable because it is what tips the balance of the conventional employment equation. ... When employees own a stake, the attitude of a company changes – and so does its bottom line. ... employee ownership transforms this dynamic because it gives everyone in the company a direct and visible interest in the longer-term success of the business. ”

“Equity: Why Employee Ownership is Good for Business”

Harvard Business School Press, 2005

Many private-sector companies currently offer employee share ownership plans as a matter of competitive practice. In Canada, both UPS and FedEx offer forms of employee share ownership incentive programs. Since 2001, Canada Post's subsidiary – Purolator Courier – has offered similar programs with resounding success. Besides their economic returns, such programs support the evolution of a partnership culture between management and employees.

Recommendation #8:

With a view to providing Canada Post with the tools needed to improve employee engagement and change our internal operating culture, it is recommended that the Government of Canada provide its final approval for Canada Post to activate an employee share ownership plan.

4.3.3 Empowering the Board of Directors to Drive Cultural Change

Canada Post is proud to be one of the largest Canadian Crown corporations wholly owned by the federal government. The Government of Canada's decision in 1978 to transform the Post Office Department was based on the need to improve the quality of service, management capability and labour relations within Canada's mail system. The Crown corporation model was intended to make Canada Post more nimble than a government department and allow it to provide quality services on a financially self-sustaining basis.

However, there is still a considerable number of oversight processes that Canada Post is subject to, many as a result of the suspicion discussed earlier. These not only restrain our ability to compete and respond to our customers in a timely manner but also serve to reinforce the internal management culture of risk aversion.

Under the requirements of the *Financial Administration Act*, Canada Post is required to develop and submit a five-year corporate plan and one-year capital budget each year for government approval. It is also required to seek approval for certain commercial transactions (restricted transactions), such as the creation of a subsidiary or the acquisition of shares, and to seek approval for borrowing. The processes underlying these approvals have become unduly lengthy – approval of corporate plans can take over a year and up to 18 months, well past the start of the applicable fiscal year. Restricted transactions can take as long as six months and in some cases are approved with so many conditions as to restrict Canada Post's ability to manage them.

These processes and policies limit Canada Post's capacity to be a nimble, responsible and responsive company – and they support the culture of suspicion and inertia that can undermine an otherwise successful future.

"To be effective in a highly competitive and changing marketplace, CPC needs a clear mandate with the ability to make sound and relatively quick decisions to adjust its plans and initiatives as conditions develop. Approval process delays and political directives that adversely affect financial performance hinder CPC's abilities to compete, fulfill its mandate and be self-sustaining."

*"Canada Post in the 21st Century"
Conference Board of Canada, 2007*

As the sole shareholder, the Government of Canada appoints the members of the Board of Directors and the Chairman of the Board. In doing so, it exerts considerable influence over the strategic direction of Canada Post. The Board is accountable to the Shareholder for carrying out the Government's expectations of the Corporation. The President and Chief Executive Officer (CEO) is in turn accountable to the Board for achieving the corporate targets it sets and for all of the company's activities.

The Board of Directors of Canada Post takes its role as the representative of the Shareholder very seriously. It is, in no way, trying to replace the important role of the Shareholder. The Board is committed to an open dialogue with the Government to ensure it understands the direction and objectives that it has for Canada Post and can ensure that these are carried out by management.

The Board has responsibility for transforming the directions given by the Minister responsible for Canada Post into reality. But the current level of process and oversight is impairing the Board's ability to do so. Lengthy bureaucratic processes overlaid on matters where the expertise lies with management and the Board (for example, pricing, acquisitions, joint ventures, cost reduction measures, product changes, contracts with third parties) slow the company down or, in some cases, prevent it from taking advantage of opportunities in the marketplace. Over time, this has reinforced a management culture of risk-aversion and apprehension, and is holding the company back from success.

The recommendations we are making are meant to bring discipline to some of the external cultural forces at play. Clarifying and strengthening the mandate of the Board of Directors is essential to achieving future goals and modernizing the postal system.

Other Posts have taken steps in this regard. In New Zealand and Australia, the postal operators' Board of Directors appoints the chief executive officer. In Australia, steps have been taken to make the post office's Board of Directors more business-minded and independent. In the Netherlands and Germany, there is significant or majority ownership by the public of the postal system and shares of the Post are traded on stock exchanges. Actions taken in foreign jurisdictions, while not all applicable to the Crown corporation model, demonstrate a concerted effort to distance the operations of the postal system from the restraints of bureaucratic influence and provide exemplary governance. The result has been better service, stronger financial results, greater collaboration with employees and lower costs.

There exists a widely accepted set of private-sector practices that help to ensure that publicly traded companies are governed by independent Boards of Directors, whose primary concern is the effective running of the business and providing a return on investment to shareholders. These include: annual election of Board members by the shareholders, a majority of independent directors, and giving the Board the power to hire and fire as well as set targets for and compensate the CEO. Some of these private-sector best practices can be adopted in a commercial Crown corporation context.

Recommendation #9:

In order to both help change our culture and ensure the wishes of the Shareholder are carried out:

- ***Members of Canada Post's Board of Directors should be appointed based on strong business, executive and directorship experience. Highly qualified Board members will be best equipped to meet the expectations of the Shareholder. The Nominating Committee of the Board understands the professional qualifications and skills necessary for a Director to help guide the company forward. The committee is also equipped to run timely and professional processes to seek out Directors with a view to complementary skills and continuity. Its recommendations should therefore play a dominant role in the selection of Board members by the Shareholder.***

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- *The Board of Directors is best placed to represent the Shareholder in ensuring that the President and CEO is well qualified and is executing on plans consistent with the Shareholder's expectations of the company. Therefore, the Board of Directors should appoint Canada Post's President and CEO, set his/her performance targets and evaluation criteria, and determine appropriate compensation.*
 - *Timely access to capital markets will be essential for the completion of our Postal Transformation plan. Moreover, having external lenders will help bring additional discipline to the execution of the plan and balance against cultural factors that might otherwise impede its success. The Board of Directors should have the authority to access capital markets, where required, to fund the company's infrastructure requirements.*
 - *We understand the need for Shareholder approval of certain transactions. However, current government approval processes are not time sensitive. Moreover, the Board is better equipped than those currently leading these approval processes to assure the Shareholder that transactions such as acquisitions and joint ventures are worthwhile, appropriate and well structured. Therefore, a more workable approach would be for transactions of a certain value (up to \$250 million) to be approved by the Board. The Governor in Council should have the opportunity to examine any transaction over \$250 million and if, after 60 days, no objection is expressed, the company should be free to proceed.*
 - *Dividend payments are an essential expression of return to the Shareholder for capital invested. However, during periods of low profitability or significant capital reinvestment, dividends may not be the most prudent use of a company's cash. It is currently the case that dividend payments are within the discretion of the Board. There is nevertheless an unrealistic expectation of annual dividends regardless of our financial circumstances. This is not practical. Therefore, the discretion of the Board in paying dividends should be reiterated.*
 - *Corporate plans and budgets are essential annual documents to align management and all employees around the objectives of the company in any year and over a multiple-year horizon. This alignment is essential to engaging all of our people in the success of the company and overcoming the culture of operating rigidity described earlier. In order to ensure these plans are approved in a timely fashion, corporate plans should be deemed approved 60 days after they are formally submitted, if no other approval or refusal has been provided in that time.*
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CONCLUSION

Canada Post welcomes the Strategic Review as an important opportunity to reaffirm our enduring commitment of service to Canadians and to present our vision of what is necessary to allow us to meet that commitment as a modern, efficient company. As we have laid out in this submission, our vision is to continue to provide Canadians with world-class service, to be an employer of choice, to contribute as a socially responsible company, and to be financially self-sustainable. To do so requires that we respond to the evolving needs of our customers and the market forces around us.

Despite the perception of Canada Post as a monopoly, much of the revenue that sustains our operations comes from sectors that are intensely competitive. This requires us to be responsive and innovative. We have not stood still in recent years. We have taken measures to improve our service, reduce our costs and improve our customer focus. We never forget our obligation to provide efficient, reliable service to every Canadian and every business in this country – against a backdrop of an expanding delivery network, decreasing revenue from each point of call, and the aging and outdated state of our infrastructure. But investments are now required in our network, technology and product offering if we are to remain relevant.

Canada Post is proud of the achievements we have made – but we, as a company and each of our 72,500 people, can do more. We need to change the culture at Canada Post in order to achieve our vision. Our efforts alone are not sufficient to realize the change required. Action by the Government is required now to ensure that the challenges we face can be overcome. Without profound, immediate change, the reliability that Canadians expect of us and the profitability that has allowed us to sustain postal services are at risk.

We are confident that the recommendations we have put forward in this submission, when taken together, will allow Canada Post to fulfill its enduring service promise to Canadians and meet its requirement to be financially self-sustainable well into the future.