

From the Chairman

JULY 2015



Focusing on the Three Cs: Customers, Change, and Costs

We should all be proud of our accomplishments in Fiscal Year 2015. We had excellent operating earnings, we're on track with our FedEx Express profit improvement plan, and we took big steps to fill gaps in our portfolio through acquisitions.

As a result of your hard work, FY15 became a transformative year for FedEx. Congratulations and thank you for a job well done. We're poised for continued success on nearly all fronts.

But remember, when things look so good, it's actually a time for greater diligence. FedEx can never really relax. Feeling complacent has been the road to ruin for many big, well-known companies. Think Borders, Kodak, and Blockbuster in the U.S., or Eaton department stores in Canada. These companies failed to keep up with what was happening around them. They lost focus on customers' needs, marketplace changes, or cost management. We have a great corporate strategy and outstanding execution, but it's up to **all** of us to make sure FedEx is constantly vigilant in three critical areas: customer focus, change management, and cost control.

Customers

As companies get bigger, they often concentrate on growth at the expense of improved customer service. Have you ever been put on hold a long time by a company and wondered why they didn't hire more service reps to answer calls promptly? Have you ever had to deal with a company's bureaucracy and still not get your problem solved? As a customer, you feel as if you're not the company's top priority.

Many times, large companies become consumed with internal or external matters that arise because of growth and success such as insider politics, union demands, outdated policies, and non-productive legacy operations.

For example, almost the entire airline industry in the United States went bankrupt after deregulation in 1978 with most carriers virtually ignoring customer needs, while allowing costs to bloat despite new competition and lowered ticket prices. Some legendary carriers like Eastern and Pan Am were liquidated, with the loss of thousands of jobs.

Customers pay all our salaries and all our bills: a simple fact that is, incredibly, often forgotten within big companies.

Throughout the 70's and 80's, the U.S. auto industry failed to listen to their customers' demand for more efficient and reliable cars. As a result, Asian and German companies that met that demand became major competitors within the U.S., and GM and Chrysler had to be restructured in 2009 by the U.S. government.

Powerhouse computer companies Univac, RCA, Burroughs, Wang, and Digital Equipment completely misjudged the PC revolution and faded into oblivion.

Like the famous brands above, many companies fail because they cannot adjust to changing markets or new technology.

At FedEx, we make the customer the center of everything we do. We try to keep our customer focus sharp through our People-Service-Profit philosophy that guides our actions and through clear messaging and measurements that tell us how we're doing:

- The Purple Promise informs each of us that we must strive to make every FedEx experience outstanding;
- The Service Quality Index (SQI) measures the efforts of our entire company against what customers say is most important to them — on-time deliveries, pickup reliability, damage claims, instant tracking, and other satisfaction indicators; and
- Quality Driven Management (QDM) provides a system for meeting our customers' needs, finding the causes of problems, and revamping processes to deliver better service, reduce waste, and lower costs.

People-Service-Profit commits FedEx to maintaining an appropriate balance of these three interwoven and essential interests: satisfied customers, motivated team members, and adequate profits to fund future operations and compensate shareowners and lenders. The Purple Promise, SQI, and QDM unite us in the way we manage and operate FedEx by providing a common language we use daily with each other, whether we're in Manchester, Mumbai, Montreal, or Memphis.

The Purple Promise, SQI, and QDM provide clear guidance on how to consistently improve customer satisfaction.

At FedEx we don't sell widgets or microchips. We sell great service, which is always defined by the customer — not us! Customers pay all our salaries and all our bills: a simple fact that is, incredibly, often forgotten within big companies.

Change

The famous Roman philosopher Marcus Aurelius said it centuries ago — the only constant in life is change. When circumstances change, so must FedEx. And that can be challenging.

Companies often fail to change or even recognize the need to do so. They don't respond quickly and decisively to evolving customer needs and expectations. They may ignore new trends in their industry or fail to keep up with the latest technology. Ironically, doing the same things in the same ways eventually and always causes failure, even if those things originally brought success. This has always been the case and is even more true today. Why? Because we live in a time when market and technological forces are reshaping businesses at an unprecedented pace.

History shows that innovation and change are at the heart of human progress and business success or failure.

One of the great strengths of FedEx has been our ability to change. In the 80's, we were gaining more international customers, so we acquired Flying Tigers to obtain strong Asian air routes. In the late 90's, customers told us we needed an economical ground service for goods that didn't need the fastest possible delivery. We acquired Caliber System, which included the RPS ground business. RPS evolved into FedEx Ground, now a highly profitable and expanding operating company that has highly differentiated service compared to the competition.

More recently we've made a number of acquisitions, once again to fulfill our customers' ever-changing expectations.

In response to growing e-commerce, we acquired GENCO and Bongo International to create more comprehensive supply chain solutions. GENCO specializes in product life cycle solutions and is a leader in reverse logistics — the handling of returns as well as repair, repackaging, or properly disposing of goods. Bongo International expands our cross-border e-commerce portfolio. Now part of FedEx Trade Networks, it calculates duties and taxes and provides international payment options and other services for online shoppers. Bongo helps retailers and e-tailers efficiently reach and serve international consumers in more than 200 countries.

Our recent offer to buy TNT Express, if approved, will quickly broaden our portfolio of solutions particularly in Europe. Customers of both FedEx and TNT will benefit from our unmatched global network.

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On the technology front, our history has been one of innovation in response to changing markets and customer demands. We were the first to offer online shipment tracking when customers needed greater visibility into the shipment timeline. Six years ago, we rolled out SenseAware to help customers monitor shipments that were temperature sensitive or required special handling such as medicine or flowers. More recently, in response to the needs of customers on the go, we developed FedEx Delivery Manager to help recipients customize deliveries. Customers can specify times and addresses, designate a hold at a FedEx location, sign electronically for the delivery in advance, or request a vacation hold, among other choices. Delivery Manager received a CIO Magazine Award last year.

Costs

As companies grow, there’s a tendency to add more staff, more bureaucracy — and expenses often rise faster than revenues. Costs can easily become unwieldy, especially after mergers and acquisitions. That’s why FedEx must regularly scrutinize our systems and processes to avoid complexity, redundant work, and cost creep. It’s why we have a very disciplined corporate development and integration plan to deal with each company we buy.

We constantly monitor our costs in all aspects of FedEx. Three years ago, we began a profit improvement plan (PIP) to create a more streamlined, efficient FedEx Express that better served customers in a slower-growth global environment. The PIP is on track for FedEx Express to exit FY16 with \$1.6 billion in additional operating profit from the FY13 baseline.

FedEx Ground is merging the SmartPost operation into a more efficient common network and management structure. Similarly FedEx Freight in 2011 combined separate regional and national networks into a unique single pickup provider of both priority and economy shipping options.

In the IT realm, we needed to migrate to cloud-based computing to better support our businesses and quickly meet new customer needs. That was a big challenge considering we had thousands of legacy applications and interfaces built over the past 35 years. Accordingly we launched Project Renewal, a multi-year effort by operating companies and IT to simplify and modernize our technology, thus saving money and increasing speed-to-market for enhanced services. By changing to a cloud-based architecture, we’ll be able to shorten development time and move ideas much faster from the drawing board to launch. Happier customers at less cost! For example, “Workbench” is an IT solution which has revolutionized the FedEx aircraft maintenance process. It combines

team members’ knowledge with automated processes for aircraft maintenance, engineering, and material management to help us make safe and reliable decisions every day. Workbench allowed us to retire a cumbersome and costly legacy system while improving aircraft reliability and enhancing our ability to keep the Purple Promise.

In many areas, Project Renewal is starting to pay big dividends. We’ll continue to revamp our technology to lower expenses while staying responsive to the legions of tech-savvy customers who want every convenience at their fingertips on their mobile devices and helping team members do their jobs more effectively and efficiently.

QDM, innovation, and improved technology are the keys to controlling costs. If we apply QDM to our processes, we’ll continue to make them better, cheaper, and faster. As we note repeatedly, **great quality costs less** long-term, not more. Just look at the huge savings these Quality Action Teams netted for FedEx last year:

- A flight operations team now makes flight documents in near real time instead of the old process that took 45 days, for a total annual savings of \$2.5 million.
- A team in Asia replaced a complex manual with an automated system saving \$2 million a year.
- A night-sort operations team began using a new type of container instead of bulk trucks. The result: \$3 million a year in savings.

Three teams and savings of \$7.5 million per year! I urge you to use QDM like these teammates did to systematically examine your work processes. QDM collaboration will help you achieve your organization’s goals in the most economical way possible.

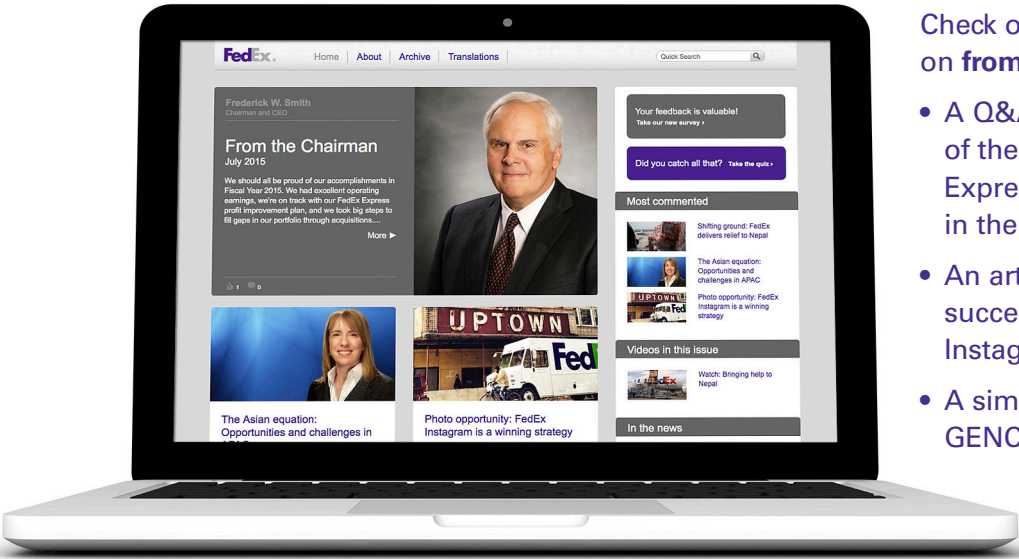
As we begin Fiscal Year 2016, it’s important to take pride in our accomplishments, but recognize at the same time that success can be fleeting. In large companies, big problems can slowly and insidiously develop when 1) the focus turns inward versus constant attention to customer needs; 2) necessary change is difficult or impossible; and 3) costs rise faster than revenues. We have always effectively managed FedEx to avoid these pitfalls.

If we continue to do so, the future for all of us is bright indeed.

Frederick W. Smith

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Chairman and CEO

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