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**TESTIMONY OF
KENNETH J. KRIEG
UNDER SECRETARY OF DEFENSE
(ACQUISITION, TECHNOLOGY & LOGISTICS)
BEFORE
HOUSE ARMED SERVICES COMMITTEE**

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**Overview of the Department of Defense
Prime Vendor Program**

**The Honorable Kenneth J. Krieg
Under Secretary of Defense
(Acquisition, Technology and Logistics)**

Chairman Hunter, Representative Skelton and Members of the Committee:

Thank you for the opportunity to appear before you and discuss the status of the Department of Defense's Prime Vendor Program. I welcome this opportunity because I know you are committed, as I am, to providing our soldiers, sailors, airmen, and marines with the best logistics support this nation is able to provide. It is our obligation as leaders, decision makers, and policy developers to provide our warfighters with the tools, procedures, and systems that they need to be successful today and in the future. At the same time, we must be faithful stewards of the resources you provide us to accomplish these goals and ensure the taxpayers are receiving the best value for their money, in terms of outcomes and cost. In that vein, today I will summarize our current logistics posture and discuss the critical role played by the Defense Logistics Agency (DLA) and its programs, including Prime Vendor, to provide world class logistics support.

I would like to take just a few minutes to recognize the efforts of our DoD logisticians. Most recently, our civilian and uniformed logisticians have successfully supported complex military operations, humanitarian relief associated with the Tsunami, the Pakistan earthquake, and the humanitarian relief along our own Gulf Coast. This group of dedicated and professional logisticians is the only group in the world that could

have successfully undertaken these efforts. With the help of this Committee, the nation has crafted a world-class military logistics system, and our men and women are recognized as such. I am proud to be joined today by the man responsible for leading this agency, VADM Keith Lippert. DLA logisticians have played a critical role in all these support efforts, for example, including providing over 5.1 million meal kits and bottled water hurricane victims through their subsistence Prime Vendor while simultaneously providing ongoing support to our forces deployed in Iraq and Afghanistan. In fact, a recent Joint Staff assessment rated DLA's support of our warfighters as excellent.

VADM Lippert will discuss the details of DLA's Prime Vendor Program, but I would like to note for the record their importance to our overall logistics capability. For years, the Department and this Committee have sought lessons from the private sector for use in the public sector. The Prime Vendor Program is an example of just that. The overall purpose of the Prime Vendor Program is to streamline supply chain management, lower overall cost to the government, and improve service to our warfighting customers.

This program allows military customers to buy commercial products directly from a list of pre-established commercial distributors. The distributors are selected ahead of time through a competition run by DLA. The prices listed include a guarantee of fast delivery and reflects the collective purchasing power of the Department of Defense.

The program uses private vendors and combines commercial best practices and information technology to provide a structure for improved customer support.

Current DoD Logistics Performance and Structure

We are on a clear path to achieve world-class logistics capability and to maintain our comparative advantage in power projection and sustainment. I am working with the Office of Management and Budget and the Government Accountability Office to aggressively address those Government Accountability Office High Risk Areas under my purview – including Supply Chain Management. In the past 60 days, our staffs have formalized plans with appropriate objectives, milestones, and metrics to reduce risks in these areas critical to DoD. In addition, we are reviewing our supply chain efforts as part of our Quadrennial Defense Review (QDR). As part of our Quadrennial Defense Review (QDR), the Secretary directed General Duncan McNabb and me to lead a review of our acquisition and other business processes to ensure they are capable of meeting customer needs. We are including improved supply chain business practices as part of strategy development.

As part of these efforts, we are pursuing leading-edge commercial procurement practices through initiatives to integrate supply procurement; we are actively developing an integrated logistics transformation strategy; and we are improving our support to deployed forces to include improved supply availability, reduced re-supply times, and smaller, more agile operational supply lines. The current state of DoD logistics is strong. In terms of our core business, to project and sustain US military power, we continue to demonstrate outstanding performance under the most severe conditions. While supporting engaged forces in Afghanistan and Iraq, we executed the largest humanitarian airlift since the Berlin airlift in support of Tsunami relief. Most recently in support of

other local and federal authorities, the DoD and National Guard deployed 68,000 troops and 400 aircraft to our own Gulf Coast. Those personnel and equipment, along with the Coast Guard, rescued 49,000 people, evacuated 26,000 people, and treated 22,000 patients while airlifting 51 million pounds of relief supplies. I am proud of our logisticians and their accomplishments.

Simultaneously with current operations, we are improving our business processes that support those operations. Thanks in part to continued resource support from the Congress, we are realizing historically high materiel availability to meet warfighter needs with historically low backorders and cost recovery rates. In fact, DLA reduced its recovery rate to less than 15%. To further enhance support to forces deployed in Iraq and Afghanistan, we stood up a forward deployed DLA warehouse in Kuwait, and under the auspices of the partnership between DLA and the United States Transportation Command, the designated Distribution Process Owner, we have established a joint distribution operations center. Combined, these efforts have significantly reduced warfighter wait time by over 50 percent for critical Army parts, and reduced transportation costs by over \$400M by reducing reliance on air transportation into theater.

When we look at the DoD supply chains, we all realize we are dealing with a big business. The DoD logistics workforce is just over 1 million personnel (active duty, reserve, and civilian), managing an inventory valued at approximately \$77B. We estimate our peacetime logistics costs to be approximately \$100B per year, with a capital investment of approximately \$60B over the FY06 President's Budget 5-year plan.

To appropriately manage that business, we are committed to employing best-in-class supply chains and supply chain practices. For items such as food, pharmaceuticals, medical supplies, and common shop materials, we use commercial supply chains today under the Prime Vendor Program. Our experience with the Prime Vendor Program has been an overall success. These programs provide overall best value to the taxpayer and outstanding support to the warfighter.

Prime Vendor is a commercial best practice – like our commercial counterparts, under prime vendor, DoD procures inventory at the time of need rather than holding inventory just in case. Prime Vendor frees up DoD resources in terms of both personnel and infrastructure so those resources can be applied to our warfighting mission. Under these programs, DoD holds limited inventory, and is generally realizing 24-48 hour response times. For example, our pharmaceutical Prime Vendor Program saved us \$177 million in reduced wholesale inventory. In addition, DoD hospitals saved over \$167 million in hospital level inventory, DoD holding costs, and in the prices of pharmaceuticals. Most importantly, our customers received their deliveries in less than 48 hours. Our Subsistence Prime Vendor Program reduced inventory by \$70 million while DoD reduced depot workload by \$7.9 million, and response time to customers improved by more than 75 percent.

Of course, we are committed to ensuring that competitive cost for items is part of the best value equation; that is why recent reports of overcharging are so disconcerting. These overcharges occurred during DLA's original, or "first generation," Food Service Equipment contract, which was awarded in 1999. The contractor responsible for these

charges was not competitive in the 2005 second generation and is no longer part of the Prime Vendor Program. VADM Lippert will address the anomalies in the program that were raised in the recent news article and DLA's actions to preclude any valid pricing discrepancies. However, we firmly believe DoD continues to get best value from these programs; our challenge is to continue to make the make the program more effective over time.

I do want to emphasize that while we are focused on the significant transformation taking place in the overall logistics support to our forces, we are also committed to finding and fixing any isolated problems in our procurement and logistics programs, such as those identified with our Prime Vendor Program. Let me assure you that we have established procedures to prevent future overcharges. Prime Vendor contract management now involves a quarterly and annual review and uses a program to select random samples for price validation. This process includes obtaining refunds where appropriate.

Conclusion

In summary, again I thank you Mr. Chairman for the opportunity to testify today on the important issues associated with DoD supply chain and logistics. I hope my testimony has provided you with a solid understanding of our progress in this area and our willingness to work with other national-level stakeholders to continue to improve our effectiveness, efficiency, and accountability. I believe our strategic actions are fully responsive to the needs of the taxpayers, observations of GAO and OMB, and the intent of this Committee. I look forward to continuing to work with you to improve our

processes and request your continued assistance in providing our military forces with the logistics support they need and deserve.

Thank you and I would be happy to answer any questions you and the Members of the Committee may have.