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STATEMENT OF  
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BEFORE THE  
HOUSE ARMED SERVICES COMMITTEE  
SUBCOMMITTEE  
ON  
MILITARY PERSONNEL  
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Mr. Chairman and distinguished members of the Subcommittee, I am pleased to appear before you today, representing more than 14,000 dedicated associates, to provide an update on our Navy Exchange (NEX) Program. It has been a very challenging and busy year, but one that has brought us much fulfillment in supporting our Sailors, retirees, reservists and their family members

### **Integral Part of Navy Quality of Life**

Navy Exchange plays a vital role within Navy. Chief of Naval Operations, Admiral Mike Mullen has said, “I am convinced that family readiness is tied directly to combat readiness. Our families serve as we serve...I firmly believe that we recruit a Sailor, but retain a family.” Last year, Secretary of the Navy reported Navy has met its recruiting goals in each of the last six years, noting a key to this achievement has been Department of Navy’s aggressive program to enhance quality of service and quality of life.

Enhancing Navy family support is Navy Exchange’s single mission. Success in our mission goes beyond satisfied customers in our stores. Navy’s ability to sustain a ready and able military force; to attract and retain qualified individuals, to help families cope with deployments, separations and moves; to fulfill basic requirements regardless of location, and to sustain Morale, Welfare and Recreation (MWR) programs are all measures of our success. We are committed to ensuring Navy Exchange meets Navy’s demonstrated requirement.

By its nature, Navy is a forward-deployed force with units worldwide. Our goal is to provide our Navy Family quality products and services at a savings, no matter where they are located, in a responsible, cost-effective manner. To that end, the Navy Exchange System has evolved a diverse portfolio of stores. Some of our bases are located in large

metropolitan areas with high costs-of-living, making Navy Exchanges all the more important to family budgets. In those areas, we have large stores offering a full range of merchandise and services. These stores represent one-third of our total store portfolio, and more importantly represent 89 percent of our total exchange operating profits. The remaining stores are smaller, some overseas and some in isolated, remote locations. Our overseas stores are particularly important because they are a piece of home to our Sailors and their families serving outside the continental United States. In some cases, these locations are small and expensive to operate, but the need for them is critical. They are “fact-of-life” operations. Leveraging this unique portfolio of stores allows us to support all locations yet remain profitable as a system. It is this unique portfolio that differentiates us from our sister exchanges.

Navy Exchanges are an integral part of local and regional command structures enhancing quality of life and family support. They operate as a department of the base or installation, within the chain of command. Commanding Officers are responsible for enabling the mission of the Navy Exchange and ensuring the products, services and support provided are responsive in meeting the needs of the local Navy Family.

Meeting demonstrated MWR requirement also plays a role in the quality of life for Navy’s forces. During 2005, NEX provided \$51.6 million directly to Navy’s Morale, Welfare and Recreation Programs. It is important to note that 100 percent of profits from Navy Exchange are returned to our shareholders, our Sailors and their families, in the form of support to MWR or in new and improved facilities. We recognize that NEX revenue is truly Sailors’ money and we are committed to being good stewards of their funds, maximizing total value for our shareholders.

## **Meeting the Mission Today**

Meeting our mission to Navy means taking care of our Sailors - delivering the products and services they want at a savings in quality facilities as well as sustaining MWR Programs. It is a carefully balanced model. Maximizing savings to our Sailors and their families directly impacts our bottom line, and our contribution to MWR Programs. Within Navy, a single MWR/NEX Board of Directors oversees both programs to ensure proper balance.

We perform various surveys annually to measure our performance in returning value to our Navy Family. Market Basket Surveys are performed twice a year by an independent retail intelligence firm, QRS. Approximately 400 items are surveyed from 34 different departments in 8 major markets. Our Market Basket savings have been over 20 percent since early 2004, with our latest survey in August 2005 showing Sailors save an average of 21.9 percent at the cash register. These savings reflect the merchandise velocity of a typical Navy Family but do not reflect additional state sales tax savings. Saving our Navy Family money is very important to us; it is the key component of their exchange benefit.

Customer satisfaction is also important to us. An internal Customer Satisfaction Survey by an independent intelligence retail firm, CFI Group, is performed annually. Our Customer Satisfaction Index (CSI) rates the satisfaction of our Navy Family with multiple aspects of our Navy Exchange Enterprise including products and services offerings. Our 2005 score was 78, up one point from 2004 - a statistically significant increase. Since we began using CSI in 1998, we have seen a steady increase from our

initial survey in 1998 with a score of 61. CSI not only provides a metric for customer satisfaction, it also provides valuable detailed business intelligence for improving our value to our Navy Family.

The Department of Defense “August 2005 Status of Forces Survey of Active-Duty Members” shows Navy personnel have the highest satisfaction with their Exchange Service. Sailors cited higher satisfaction in all areas, including merchandise quality, service quality and cost of items. These results are consistent with the 2003 Status of Forces Survey.

### **A Unique Retailer**

Like many commercial retail organizations we provide merchandise and services to our customers. However, no single retailer has the depth of services and breadth of merchandise Navy Exchanges provide. NEX has a unique retail strategy. We are a combination of many types of retailers – discount stores, mass merchants, department stores, category killers and convenience stores. We are a combination of many services – lodging, telecommunications, barber/beauty shops, food operations, gas stations, automotive repair, dry cleaning, photo service, florist shops, vending and more. Exchanges are the only retailer to sell hardlines, consumables and apparel at three price points. We do this because unlike commercial retailers, we do not serve a niche customer – although we serve a niche market on Navy Installations. As a non-pay military benefit, we must serve and satisfy all our customers – in every life stage from single Sailor to retiree; single, married and single-parent families; every ethnic group, and a wide range of income levels; all with different needs. Balancing these factors to achieve a high level of satisfaction is the foundation of our retail strategy.

Navy's seagoing forces confront a highly dynamic environment that is extremely complex and fluid. Our Ships Store Program is completely aligned to our forward deployed forces, both afloat and ashore at remote locations, to provide quality of life retail, barber and laundry services. On an average day, more than 30 percent of the fleet will be deployed. NEX is deployed with them to provide essential retail goods at a savings, improve morale and generate dividends to support shipboard MWR Programs that together underwrite strong unit cohesion, team morale, readiness and effectiveness.

Our Afloat Telecommunications Program provides that vital underway phone link home to our deployed Sailors and Marines and continues to be one of the biggest shipboard morale boosters. The price reduction implemented in November 2004 lowered the cost of shipboard calling from \$1.00 per minute to \$.50 per minute, resulting in a 37 percent increase in minutes used during 2005 for a total of more than 14.5 million minutes. During this past year, we have been busy upgrading our shipboard personal calling equipment to ensure compatibility with Navy's current satellite architecture. This will ensure the continuation of this valued benefit to our afloat Sailors.

Our Navy Lodge Program celebrated its 35<sup>th</sup> Anniversary continuing its mission to provide affordable temporary lodging to all military members and their families. This year, the program saved Sailors and their families 40 percent compared to commercial lodging rates. In 2005, we assisted military members injured in OIF and their families providing 3,500 room nights. The Navy Lodge Program's Guest Satisfaction rating is at an all time high of 95.4 percent with an occupancy rate of 79 percent, both well above industry averages. During 2005, we renovated over 20 percent of our guest rooms, continuing our commitment to providing the best facilities for our Sailors and their

families. We are planning to replace over 100 rooms with new construction at the Navy Lodge Norfolk. The Navy Lodge Program is funded through self-generated revenues and continues to be a valued benefit to our active duty and reserve Sailors, retirees, and their families.

NEX is much more to our Navy Family than a store; it is part of the fabric of each base we serve. Our patrons shop at NEX because it reflects who they are as members of the Navy Family. Our Navy Exchange in San Diego recently received a letter from the daughter of one of our loyal customers. Addressed to all the “Employees of 32<sup>nd</sup> Street Navy Exchange”, she said, “Quite often going to work is just another day to clock in, do the job then clock out. However, you are different. You have genuine caring attitudes. Since 1963, my Mother has been going to the Navy Exchange at least once a week. Every Saturday, she would get her hair done and then shop at the exchange. For close to 5 years, I have been blessed by being able to watch the interaction between her and all of you. She always looked forward to those Saturday mornings. It wasn’t just to get her hair done or go shopping, she also loved chatting with the employees. You let her know how special she was.” All our customers are special. They are young Sailors returning home from deployment. They are spouses and children coping with the deployment of a loved one. They are families living overseas. They are retirees who have served their country with great pride. They are all part of our Navy Family we so proudly serve.

### **Strong Financial Position**

I am pleased to report that the Navy Exchange System is financially healthy and strong. During 2005, we had very strong sales performance. A commercial best practice measure of sales performance is comparable, or same-store sales. During 2005, NEX

same-stores sales increased 5.1 percent, compared to a 3.9 percent increase reported for industry. Particularly noteworthy were our record sales during this past holiday season, 8.6 percent same-store increase versus 3.5 percent reported for industry. Over the past 5 years, we have sustained same-store sales increases, averaging 5.0 percent annually compared to commercial growth of 4.4 percent annually. Significantly, we continue to exceed the commercial growth rate despite a declining active duty population. These increases validate the importance of Exchanges in the lives of our Navy Family.

Our preliminary 2005 system-wide net profits were \$65 million with an additional \$10.8 million generated from our Ships Store program. We face the same challenges as many other companies in the commercial sector today: rising health care costs; rising fuel and energy costs; and rising construction costs; all of which have an impact on NEX system profitability. However, despite all the challenges, we continue to meet our mission to Navy, delivering best value to Navy Family.

During 2005, Navy Exchange Service Command (NEXCOM) was selected as one of four Navy commands to receive official recognition from the Office of Government Ethics for excellence in our Standards of Conduct Program. NEXCOM underwent extensive review of its government ethics program, including its financial disclosure reporting systems, gift processing, ethics advice and counsel for Commanders and associates, and post-government employment advice. The award is affirmation of NEXCOM's commitment to ethics and values.

### **Another Dimension to our Mission**

In the aftermath of the hurricanes last year, the work and dedication of our NEX associates and industry partners in the Gulf region were exceptional. We worked side-by-side with base Commanding Officers to open as many facilities as possible in the days following the storm to meet the need for emergency supplies. In many cases, NEX was first on the scene with much needed water, batteries, gasoline, health and comfort items, and food. NEX received and filled hundreds of orders coming directly from afloat and ashore Navy units in support of Navy's Recovery and Humanitarian Relief Effort. An all out effort was conducted to reopen NEX main stores, mini-marts, gas stations and Navy Lodges so military members devastated by the hurricane had the necessities of life. Navy Exchange facilities in Pensacola and Whiting Field, Florida as well as Meridian, Pascagoula, Gulfport and Stennis, Mississippi were able to open once power had been restored in the area. Navy Exchange's New Orleans and Belle Chasse, Louisiana also reopened within a week of the storms' passing. When the need arose at Joint Reserve Base New Orleans to support military members engaged in recovery and relief efforts, we responded by opening a "Fleet Store" stocked with basic items such as drinks, food items, health and comfort items, uniforms and undergarments within weeks. Our dedicated associates from the area, many having lost homes themselves, and NEX volunteers from all over the country unselfishly worked long hours to ensure NEX support of Navy readiness and military humanitarian relief support efforts.

The storm disrupted gasoline distribution throughout the United States as a number of refineries were closed or damaged. NEX, along with our industry partners, worked diligently to ensure Navy Exchange gas pumps were functioning. In the immediate

aftermath of the storm, all NEX gas stations were providing service to government, military and relief efforts.

Within days of the storm, pay phones were operational on Navy and Coast Guard bases in New Orleans, Louisiana; Gulfport and Pascagoula, Mississippi; and Mobile, Alabama. NEX's cellular provider, T-Mobile, made phones available in Gulfport so military members could make free phone calls home. They also provided free internet service for military members stationed at New Orleans. Working with our industry partner, AT&T, free prepaid phone cards were distributed to displaced families, the injured brought aboard the USNS Comfort for treatments, and to Sailors aboard the many Navy ships deployed for recovery and relief efforts. In all, 6,500 free prepaid phone cards were given in support of the many people affected by the storm.

Recognizing the need to support the many military personnel working on recovery and relief efforts, our NEX team quickly responded with six Mobile Retail Facilities (MRFs). These "Navy Exchanges on Wheels" were stocked with food and comfort items, reaching troops wherever they were, no matter their size, including 18 National Guard units, and the 82<sup>nd</sup> Airborne Division. These daily missions covered over 5,000 miles from Gulfport, Mississippi to Lake Charles, Louisiana, even reaching as far as Key West, Florida in the aftermath of another hurricane there. With the support of Department of Defense, our MRFs were able to provide 30,000 free health and comfort kits to our military members in the region. The comfort kits included basic health, comfort and convenience items such as a toothbrush, shampoo, socks and underwear as well as a NEX gift card and a prepaid cell phone.

I had the opportunity to personally visit the area and observe first hand the hard work

and dedication of our active duty, reserve troops, and National Guard units, as well as our own NEX associates. Their efforts were relentless and the troops' appreciation for the health and comfort items provided was overwhelming.

The response to the hurricanes was truly a partnering effort – Navy, NEXCOM and our industry partners. I wish to publicly thank our industry partners for their support. Their quick response and cooperation were vital to our capability to provide disaster relief support so badly needed. Several industry members donated much needed consumer goods and food items in support of military members and other authorized patrons. One supplier offered large quantities of flashlights and batteries. Another supplier offered two truckloads – about 4,200 cases – of drinking water in specially manufactured 12 ounce cans. Other suppliers offered such varied items as cereal in individual serving sizes, beef jerky, nuts, pretzels, muffins, cookies, and other consumables. NEXCOM worked in tandem with Navy leadership to ensure these much-needed consumer goods could be accepted in accordance with current laws and directives. When all was said and done, almost \$90,000 worth of items was provided on behalf of our personnel in the region. Through these efforts, we have shown the value of being a small, agile organization that can quickly respond to any situation. I have never been more proud of everyone involved in the relief effort.

### **Positioning for the Future**

As we move forward, NEX is positioning itself to meet the challenges of the future. We will operate in the most efficient manner possible, because increased efficiency results in greater benefits and value returned to our Service Families.

We continue to deploy information technology modernization initiatives implementing commercial best business practices, and we are encouraged with the results we are achieving. For example, improved in-stock positions were a significant contributing factor to our increased sales over the past year. The year 2006 will be a transition, as we complete our merchandise modernization implementation and are able to retire old legacy systems. Over 75 percent of our business applications will be commercial-off-the shelf, supporting our position as a state-of-the-art global retailer.

As we look to the future, we know the value of partnering – with industry, MWR, and with our sister exchanges. We have engaged our industry partners to improve our supply chain management. We are working with MWR to develop a single food service strategy for Navy that satisfies emerging operating requirements, leverages technology and commercial best practices, optimizes financial resources and meets stakeholder requirements and expectations. We have been formally engaged with our sister exchanges in cooperative efforts for six years and will continue to pursue joint initiatives that make sound business sense. The Exchanges continue to expand their successful joint private label programs that had combined sales of \$73.3 million last year. Highlights of other cooperative efforts include Exchange Catalog and e-commerce, Military Star Card, unofficial telecommunications and joint contracting, to name a few. The Exchanges recognize that future efforts must have a more disciplined, programmatic approach to drive more robust results. To that end, we have initiated work on consolidating non-resale procurement through combined Commodity Councils, and are taking a close look at consolidated distribution opportunities.

We have heard concerns regarding our ability to face the challenges in the future – base closures, force reductions and increasing commercial competition. NEX has a proven record of success in not only sustaining our system, but also improving performance, as we have faced all these same challenges in the past. We are confident the foundation we are building today will help us continue our strong performance in the future and improve the value of the exchange benefit for Navy.

### **NEXCOM's 60<sup>th</sup> Birthday**

The Navy Exchange System will celebrate its 60<sup>th</sup> birthday on April 1, 2006. Navy Exchanges have come a long way since the days when bumboats sold their wares to Sailors aboard Naval vessels in the 1800s. However, the underlying philosophy of stewardship of Navy Exchange System has not changed – we exist solely to support our Navy Family. The success of the Navy Exchange System over the years is due primarily to our dedicated associates who serve our Sailors everyday. All of us in the Navy Exchange System share the same commitment - to provide our customers the best value at their Navy Exchange and enhance their Navy quality of life.

Over the years, this Subcommittee has shown commitment to the programs that support our Navy Family. Your contributions have greatly enhanced the quality of life for our Sailors, retirees, reservists and their families. In particular, I would like to thank the Panel for lifting the restrictions on projection televisions last year. Our sales for projection televisions through mid-February 2006 were \$8.5 million, exceeding our expectations and generating considerable customer excitement and satisfaction. This tells our military customers that their Exchange has something for everyone, including the latest technology at low prices. We greatly appreciate your support.

In conclusion, I am pleased to report the Navy Exchange System is financially healthy, supporting Navy in taking care of our Sailors and their families. It is our job; one we have proudly done well and will continue to do so into the future.