

Statement of

Lloyd Johnson

Chairman

Armed Forces Marketing Council

before the

Subcommittee on Military Personnel

Committee on Armed Services

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Mr. Chairman and members of the Subcommittee on Military Personnel:

My name is Lloyd Johnson, Chairman of the Armed Forces Marketing Council (AFMC). The Council was incorporated in April 1969 as a non-profit business league, composed of firms representing manufacturers who supply consumer products to military resale activities worldwide. (A list of firms serving on the Council is in **Exhibit 1.**)

The AFMC mission is as follows:

- Promote unity of effort through a cooperative working relationship among the Congress, the military, and the industry.
- Provide a forum for addressing industry issues.
- Encourage worldwide availability of quality consumer products at the best possible prices and value.
- Encourage continued congressional support and funding of the resale system.
- Assist in maintaining the resale system as an integral part of military life.
- Promote awareness of sales and marketing agency services to the military resale system.

Council firms subscribe to a code of ethics requiring that each member firm maintain the highest level of integrity and professional conduct, critical to the continuation of successful service to the Armed Forces and American manufacturers.

Military sales and marketing agencies, comprised largely of small, privately held businesses, were formed in response to the need by manufacturers for efficient, specialized sales representation to this unique, worldwide military resale market. These

firms have developed marketing and merchandising programs specifically tailored to the military resale system, and those services are offered at a lower cost to manufacturers than those same manufacturers could provide using their own resources. If that were not the case, the firms belonging to the AFMC would not exist.

In fact, many AFMC firms have been in business since the mid 1940's, which has clearly resulted in better services and lower prices to the military patron for many, many years on a wide range of goods. Through the link they form between the resale system and the manufacturers, they have also encouraged the continuous availability of the complete array of consumer products normally available to the civilian market.

AFMC firms represent over 400 manufacturers, both large and small. (A representative sampling is at **Exhibit 2**.) Our firms have a total of over 2,800 people working directly in the stores and with the various headquarters, side by side with our military partners, to make sure that the right products are on the shelf in the right quantities and at low prices. By so doing, they have played a significant role in helping the resale system become part of the fabric of military life. In fact, surveys have confirmed that commissaries are the #1 non-pay benefit to military families, even surpassing health care.

It is important to convey to you, the members of the Military Personnel Subcommittee, that the AFMC members see themselves as:

- “Stakeholders” in the military resale system
- Interested in and concerned about the continued viability and health of the resale system

- Having a perspective based on many decades of experience in servicing the military resale system

Mr. Chairman, as always, the AFMC is keenly interested in doing its part to assure the continuation of the military resale system and the current value it provides to our Service members and their families. We hope the information and perspectives offered today will be of use to you in your review of the resale system.

The importance of the military resale system to the Armed Forces community including active duty, National Guard, reserves, and retirees, cannot be overstated. It plays a critical role in recruitment, retention, and readiness. This is especially true when you consider that the United States relies on a volunteer force that is only modestly compensated and operates in extremely dangerous locations around the world in the war on terrorism. Add to that the intensely stressful conditions under which our Armed Forces have been working for the past three and a half years, and the case for continuing important benefit programs is compelling. In fact, any effort to diminish the availability and value of the resale benefit seems indefensible to the members of the AFMC.

Commissaries

In recent years, Congress has enacted legislation highlighting the importance of Defense commissary stores, including codification of the system into law. The Principal Deputy Undersecretary of Defense (Personnel and Readiness), The Honorable Charles Abell, in testimony before this subcommittee on March 16 of this year said, “The

commissary benefit is an important and valued component of non-pay military compensation and it is vital to the quality of life of all our Service members.”

The Armed Forces Marketing Council fully subscribes to that position and firmly believes that this vital benefit should in no way be diminished, particularly during the current turbulent times for the military establishment. I’m speaking of the ongoing conflicts in Iraq (OIF) and Afghanistan (OEF); and the related deployments and redeployments of active duty, reserve, and National Guard personnel in support of those operations; and the forthcoming base closures and troop realignments.

Contracting Out Commissary Workforce

DeCA is in the throes of a thorough reengineering process designed to develop a flexible workforce and improve the efficiency and effectiveness of the agency. At the same time, the agency is about to begin the conversion of its workforce to the NSPS. These are solid business strategies that require time and careful focus to implement.

Of course, customer service must be maintained while these efforts to streamline operations are conducted, which will be a real challenge in the face of uncertainties presented by BRAC and other forced relocations of military personnel. Unfortunately, at the same time DeCA is also being required by DoD to perform in-depth studies on contracting out parts of its workforce under the A-76 process. This not only overlaps with DeCA’s ongoing business efficiency initiatives, it also costs a great deal in terms of time distractions and money, detracts from employee morale, and presents enormous challenges in terms of managing an agency that could end up having multiple contractors win awards for separate sections of the workforce. It is important to note

that no supermarket chain in America contracts out more functions than DeCA already does, and any more moves in that direction will result in an unmanageable business.

Mr. Chairman, it is reasonably conceivable that upon the completion of the reengineering process and the implementation of the NSPS, the productivity and cost effectiveness of the reengineered DeCA workforce will be greater than a privatized workforce.

It is also the view of the AFMC that the ongoing directive to conduct piecemeal contracting out of the DeCA workforce will ultimately lead to efforts to privatize the entire operation of commissaries. It has repeatedly been demonstrated that this would result in degradation of the value of the benefit, and thus a reduction in military non-pay compensation. This flies in the face of Mr. Abell's statement quoted earlier.

Therefore, on behalf of the AFMC, we respectfully request that Congress direct the Department of Defense to provide DeCA with temporary relief from the requirement to conduct competitive outsourcing of its individual store employees for at least five more years. DeCA is not broken -- it is efficient, productive, and effective, and the ongoing internal re-engineering will make it even more so.

Congressional Budget Office Proposal to Consolidate Resale Activities

The CBO this past February published its recommendation that military commissaries and exchanges be consolidated, prices in commissaries be raised by ten percent, and a grocery allowance of \$500 per year be provided for those eligible to receive cost allowances for food. There are several major problems with this proposal:

- There is no reliable way to predict that appropriated funds would be saved. During the next few years, DeCA will be re-engineering, and they will face store closure uncertainties caused by BRAC and the relocation of troops and families from overseas to domestic locations, developments that by themselves may create significant savings.
- The number of people that would qualify for the proposed \$500 grocery allowance now, may be very different from the number in the future.
- Increasing the cost of products in commissaries by 10% is tantamount to a significant reduction in overall compensation, especially for those patrons who would not qualify for the \$500 allowance (including retirees and most National Guard and reservists), and for those families that exceed the “average size” on which the allowance is presumably based.
- Active duty Service members will certainly realize that they will be losers upon retirement. Commissaries are part of their retirement package.
- Completely ignored is the fact that the current commissary subsidy equates to less than one half the dollar value of savings realized when authorized patrons shop in military stores. Simply put, purchases by commissary patrons of \$5.1 billion would cost over \$7.3 billion at private sector commercial prices (without even considering civilian sales taxes). This benefit is already delivered at a very efficient cost!
- There is not yet any conclusive evidence that consolidating the exchanges will save \$200 million in operating costs.

- Not even addressed is the likely negative impact on the morale of troops and their families when retention is a major challenge.

Relief from ASER Merchandise Restrictions

The AFMC is most appreciative of the past actions by this subcommittee to alleviate the item and cost restrictions imposed upon the military exchanges. However, we believe that further lifting of restrictions is needed. While the House of Representatives opted to remove the restrictions on projection TV's, the Senate did not agree. As a result, exchanges cannot offer patrons the latest technology in projection TV's, and more importantly the opportunity for them to buy the most affordable large screen TV's on the market (see **Exhibit 3**). All of this is occurring at a time when in-home entertainment devices are in very high demand, especially by people that are in the age bracket of most military families. Consequently, these military patrons are forced to go outside the exchange system, where they pay higher prices (by 6% to 19%), higher credit costs (by 7% to 20%), AND sales taxes. On relatively high-ticket purchases, these percentage increases end up costing military consumers a huge amount of dollars.

The AFMC also believes the current cost price limitation of \$3,500 for TV's should be abolished to allow the exchanges to react quickly if new technologies in this rapidly changing consumer electronics category bring high-demand new products to the market that we cannot predict at this moment in time. Historically, the government's reaction has been slow to respond to these technology changes, putting the exchanges in a difficult position to respond to consumer demand.

As regards furniture, the current restrictions prohibit exchanges from selling any one piece of furniture with a cost price over \$900 (the House increased this to \$1,100 but the Senate did not concur), and from initiating any capital construction for building or renovating facilities for the purpose of offering anything other than what is now a very limited selection on most bases. Documented customer satisfaction surveys show that furniture is a category that most patrons want to see improved in most exchanges. Having access to a reasonable selection of furniture is a lot like projection TV's -- military patrons are currently forced to shop outside the gate, where prices are higher, credit rates are MUCH HIGHER, and sales taxes are imposed on normal household goods that are relatively high ticket purchases even at exchange prices.

And while savings to military patrons is the primary concern, it's also true that the increased sales by exchanges on these important categories would provide significantly more dividends to support on-base MWR activities, thereby reducing reliance on appropriated funds.

While it's true that expanding these categories for exchanges would take some sales away from commercial retailers, the overall impact would be MINIMAL versus the resulting benefit to military patrons, especially during a time when military members are making extraordinary sacrifices for their country, and when the Pentagon is not meeting its recruitment and retention goals. Also, so called "Mom & Pop" stores would not be affected, because these types of retailers now play an insignificant AND FAST DECLINING role in the TV and furniture categories. Additionally, military sales in exchanges are historically only 1% or 2% of outside retail sales of the national chains

for entire categories. And in this case, the AFMC is suggesting that these two categories be expanded only a limited amount beyond whatever already exists.

Military Exchange Shared Services

In May 2003, the Deputy Secretary of Defense mandated total consolidation of the three military exchange services – AAFES, NEXCOM, and MCX – and established the Unified Exchange Task Force (UETF) to develop and implement an execution plan. In July 2004, total consolidation was shelved in favor of establishing a system of “Shared Services” requiring the three exchange organizations to combine five functional areas: human resources, finance and accounting, information technology, logistics, and non-resale procurement (equipment and fixtures, used in store operations, but not for resale).

The decision to scale back the UETF effort to development of a shared services type operation is welcome and serves to eliminate some of the inherent risks from total consolidation; however, the move is by no means a panacea – it must be carefully and diligently carried out, and must comply with certain prerequisites:

- A business case analysis that supports shared service implementation
- The development of an executable plan
- The establishment of a workable governance structure
- A standardized IT structure
- Standard chart of accounts
- Optimized distribution in CONUS and overseas
- A reasonable implementation cost

Further, the integration of the five exchange functional areas should above all result in measurable gains for the patron through better merchandise selection and availability, lower prices, and increased contributions to MWR support. Failing those achievements there is no need to undertake the cost and risks of any form of integration.

Base Closures

Title 10, in defining the “purpose” of the retail systems, stats in part, “The defense commissary system and the exchange system are intended to enhance the quality of life of members of the uniformed services, retired members, and dependants of such members. . .”

The AFMC recognizes that it may not be feasible to retain military resale facilities at all closed bases; however, we firmly believe that every effort should be put forth to retain those facilities whenever and wherever possible, particularly at those locations where there is a sizeable population of reserve, National Guard, and retired Service members.

Summary

Mr. Chairman, the Armed Forces Marketing Council recognizes and supports the need to seek operational improvements and cost savings in all elements of the military resale system. Nevertheless, those efforts should not become an end in themselves, such that service to the military community is degraded in any way. We further respectfully seek your support in continuing to lift the ASER restrictions to allow

expansion of the merchandise selection in exchanges, and thus increase the military non-pay compensation value with no cost to the government.

We have voiced our position in past years, but it bears repeating. The resale system ***is a core function*** of DoD, and its impact on quality of life contributes directly to recruitment, readiness, and retention. The resale system, when viewed in terms of the total defense budget, represents a minor cost for a highly valued benefit for the people of the Armed Forces. In view of the incredible sacrifices of these men and women in the war against terrorism and in favor of democracy in the world, it's unconscionable to consider any move that threatens to degrade their benefits and non-pay compensation.

Thank you, Mr. Chairman and members of the Military Personnel Subcommittee for your steadfastness in assuring the best possible quality of life for our Service members and for your support of the military resale system. I appreciate the opportunity to appear before you today and stand ready to receive your questions.