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HOUSE ARMED SERVICES COMMITTEE

STATEMENT OF
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BEFORE THE
HOUSE ARMED SERVICES COMMITTEE
SUBCOMMITTEE
ON
MILITARY PERSONNEL
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Madame Chairwoman, Mr. Wilson and Distinguished Members of the Subcommittee, Fellow Flag and General Officers and Members of the Senior Executive Service, it is my privilege to represent the Navy Exchange Service Command (NEXCOM) and our 14,000 dedicated associates worldwide. Today I will update you on our programs and how we are improving the quality of life for our Sailors and their families.

Navy Exchanges (NEXs) are a critical non-pay compensation benefit with a quality of life mission – “Provide quality goods and services at a savings and support Navy Morale, Welfare and Recreation (MWR) programs”. Recognizing the importance of quality of life to readiness and retention, senior Navy leadership comprises the MWR/NEX Board of Directors. This Board not only provides oversight but more importantly balances our dual mission of savings to the Sailor and dividends to MWR.

NEXCOM operates 105 Navy Exchange Complexes in 24 States and 11 Countries, which consists of 310 retail outlets, 1,325 service outlets, 161 Ships Stores, and 43 Navy Lodges. We employ over 14,000 associates with annual sales for all programs of approximately \$3 billion. The Navy Exchange program includes retail stores, minimarts, and gas stations. Our service outlets and concessions provide a wide variety of additional services including food, automotive services, barber and beauty shops, optical, floral, laundry, dry-cleaning and tailoring services, as well as personal telephone services, vending and other miscellaneous personalized services. Additionally, local exchanges manage NEXMARTs overseas which provide both the exchange and commissary benefit under one roof. Unlike the commissaries, Navy Exchanges are operated predominantly with nonappropriated funds, receiving limited appropriated fund support primarily for overseas transportation of goods.

Navy Exchange Service Command is dedicated solely to supporting Sailors, retirees, reservists and their families. Their dedication, professionalism and willingness to sacrifice deserve our very best. We must take care of our Sailors, whether they are in port or at sea, and must look after their families when they are deployed. Today, more than ever, Navy is committed to taking care of the families. Families serve as their service members do. Deployments, long separations, recurrent moves are just a few of the challenges our military families face everyday. As a quality of life resource for Navy, NEXCOM works hard to understand those challenges so we can better

accommodate their needs and improve their satisfaction with military life. Spousal satisfaction plays an important factor in the service member's job satisfaction, readiness and retention. In March 2008 Navy spouses were asked what were the ten most used Navy quality of life facilities/services and their perceived importance. Navy Exchanges ranked first with 93% of the spouses reporting using them and 93% citing them as important.

The Exchange Benefit

Today, we are in a challenging retail environment. Commercial retailers are closing stores and bankruptcy filings are increasing. Consumers are changing their buying patterns, delaying large purchases and focusing on consumable and necessity items. Cost escalations for raw materials and transportation have increased product costs. Military members are finding their paychecks being stretched even further to purchase the things they need for their families.

We have made a conscientious effort to respond to our customers' needs during these trying economic times. More than ever, our military families are looking for value and savings. In our customer satisfaction survey, our NEX shoppers cite savings as a major reason for shopping the NEX. They also tell us they want brand name products. Based on their needs, we developed several new pricing strategies last year. Our Best Brands/Best Buys branding initiative offers prestige brands, national mass brands and private brands, all at significant savings. In July 2008, we also implemented our Price Cut Program, providing extraordinary savings on key consumable items important to our military families. These items are typically used on a daily basis by our customers, for example: baby care items, detergents, paper products, health and beauty items and more. Based on a very favorable response from our customers, we will continue the program in 2009. Other programs to help ease the economic impact on our families included an additional 5% bonus on 2008 Federal Stimulus checks/payments, increased use of percentage off scratch promotions, and gasoline promotions.

Our customers can take comfort in the fact they save money every day on the products they purchase from their NEX. We were very pleased with the results of our 2008 market basket survey, conducted semi-annually by an independent research firm.

This year savings are up 3 percentage points from last year, with an average of 23 percent savings, excluding sales tax.

Retailers today are focused on customer segmentation and NEX is no exception. From our customer segmentation initiative, we have a better understanding of our customer demographics. It is a varied customer base with wide ranging incomes and needs. From the data, we can specifically design our merchandise assortment tailored to each store based on its demographics. We want our Sailors and their families to know they have choices at the NEX that will meet their budget. This business strategy is one of our most challenging issues and it is what sets us apart from commercial retailers. A typical retailer will have a niche market, appealing to a certain income level of its shoppers. From the young recruit to the enlisted and officer families to the retirees on a limited income, they all have earned the exchange benefit. I am pleased to report that we have successfully executed this business model, providing not only savings at all income levels but also sustained profits to support Navy's MWR programs.

While the NEX business model is different than commercial retailers, we do rely on industry trends and best business practices to ensure we are giving our customers the best shopping experience.

Internet/on-line shopping is still a growing industry trend. As mass merchants and department stores are in decline, e-commerce is in the growth phase of the retail life cycle. Consumers are looking for a seamless transition from brick and mortar store to their on-line presence. By 2010, experts predict 50% of all retail purchases will be directly influenced by e-commerce sites. We have provided Navy Uniforms via on-line shopping for many years. Building upon that success, we are expanding our Navy merchandise available on-line which provides not only shopping convenience, but offers another outlet for those military personnel, including our Naval Reservists, who do not live near a NEX. Together with the Exchange on-line store, a joint effort among all the military exchanges, we are able to provide added customer service, thereby providing additional savings to all authorized patrons.

Retailers are using alternative media forms to reach the consumer. By 2015, approximately half of all retail e-commerce will be conducted via a personal device. Last year, the NEX weekly sales flyer converted to a digital format, making viewing our

special sales easier and more interactive. When viewing the flyer on-line, customers can search for products based on brand name or category; the flyer also has a zoom feature which allows customers to get a bigger and better view of the item they are interested in purchasing. Additionally, the use of a digital sales flyer helps our environment by reducing the use of paper products. Text messaging is also an important source of communication, especially for those between the ages of 18 and 24. Customers who elect to receive these electronic messages benefit from having timely announcements regarding upcoming sales, special price promotions and special events. NEX has also launched a Facebook page to help better communicate with its customers. The NEX Facebook page features a list of upcoming events, the latest merchandise available for sale in the store, the newest CDs and DVDs being released, promotions and sweepstakes and links to the NEX website and the weekly sales flyer.

Today's shopper is more conscious about the environment. We are offering more green products, intensifying our Energy Star assortments, and working to achieve Energy Star Certified Retailer status in 2009. In an effort to help the Department of Defense and Navy meet its objective of reducing the reliance on petroleum and meet the requirements of Executive Order 13423, NEXCOM has introduced several alternative fuel facilities at Naval installations (E85 and Compressed Natural Gas (CNG)). Customers have the option of purchasing reusable NEX green shopping bags instead of using plastic bags.

Aligned with Navy's conservation goals, nearly every facet of the Navy Exchange System is involved in conserving our natural resources for the future. NEX vending was one of the first military exchange programs to install energy efficient vending machine technology capable of reducing energy consumed by about one third. NEX Distribution Centers have replaced their high intensity discharge fixtures with new lighting fixtures that have a higher lamp life for half the cost. Several NEXs have completed energy retrofits, which include installing power factor correction devices on air conditioning units and devices on light fixtures to reduce voltage and lighting levels. The Ship's Store Program has introduced Ozone washing technology to the fleet as a way to save energy and cut down on the amount of chemicals used in shipboard laundries. The Navy Lodge Program has several programs in place that emphasize the importance of water and energy conservation. As part of each Naval installation, NEXs worldwide also

participate in various recycling and environment protection programs. Base clean-up efforts, tree planting initiatives and education programs are just part of what NEXs do to support the Navy, its customers and the community to help protect the environment.

Consumer interest in personal privacy and safeguarding personal information is paramount. A number of commercial retailers have experienced personal privacy breaches, leading to stricter Payment Card Industry (PCI) requirements. The PCI standards were developed by the credit card industry to protect sensitive cardholder data from unauthorized use or compromise. These standards apply to all merchants and service providers that save, process or transmit cardholder data. This past year the Navy Exchange demonstrated full compliance with all PCI security requirements. Our exchange customers can be assured that credit card data is strictly controlled and our procedures fully meet today's security requirements.

Since 1999, we have asked our customers to rate their NEX in a variety of areas including merchandise selection, customer service, store environment, problem resolution and more. The survey is conducted by an independent research firm used by many commercial retailers. Over the past years, we have seen a steady increase in our overall score, culminating with a high score of 80 in 2007. I am very pleased to report that we maintained our score of 80 in 2008. At 80, our customer satisfaction ranks among the upper tier of retailers in the U.S.

In today's uncertain retail environment, our financial position remains strong with year over year improvements in sales and profit. For 2008, NEX total annual sales of \$2.6 billion will generate an estimated \$57 million in profit to support Navy's Quality of Life programs. Seventy percent of the profit is contributed to MWR and the remaining amount is used for store expansions and remodels. NEX carries no bank debt, and our balance sheet is strong. Our forecast shows modest improvements in both sales and profits over the next few years. This requires continuous attention to the daily details of our supply chain and store operations. In addition, our Ship's Store Program generated \$68 million in sales and \$10 million in profit to support afloat Quality of Life programs.

Our capitalization program also remains strong. NEX's programmed capital spend for 2008 was \$85 million for major construction, minor construction and equipment, and information technology. Future year major projects are focused on consolidation and

operational efficiency to support infrastructure reduction, improve exchange financial results and improve patron store experience. We are working to improve our small and medium sized stores which are experiencing significant sales growth and patron demand.

Deployed Support

The Navy is a seagoing service. Our Sailors routinely deploy overseas aboard warships and on the ground in support of combat and expeditionary operations. The Navy Exchange supports our shipboard Sailors by providing free shipboard telephone calls for ships deployed overseas during the winter holidays and for Sailors serving ashore in the CENTCOM theater of operations. Through our Ship's Store Program, all Ship's Stores maintain an assortment of health and comfort items to support assigned crewmembers. On any given day, 40% of the Fleet is deployed with full deployment loads, and 50% of the Fleet are at sea on various operations. The Navy Exchange strives to be agile and flexible to meet the needs of our warfighters and their families.

Our Navy Exchanges in Bahrain and Djibouti continue to support our warfighters serving in critical locations. Customer satisfaction ranks high at both locations. Through December 2008, sales at NEX Bahrain have increased 17% from the previous year, while NEX Djibouti sales have increased 62% from the previous year. Last year NEX Bahrain opened a GNC Retail Nutrition Center to support the nutritional needs of our warfighters. We also expanded our service departments, barber shop, laundry and dry cleaning and photo finishing based on customer feedback. Our retail promotion offerings and product assortments also increased. By maximizing our supply chain, we were able to increase our merchandise in stock availability. With the return of families to Bahrain later this year, we are working hard to adjust our merchandise assortment to focus more on family needs. We have also expanded our assortment and personal service offerings at NEX Djibouti and maximized our in stock capabilities through supply chain initiatives. We opened a small mart in the Djibouti housing area and received approval for an expansion of the Main Exchange to start in 2010.

Wounded Warrior Support

Our Wounded Warriors have made great sacrifices and we want them to know they have our steadfast support. They are proud to wear the military uniform, and we have developed tailoring techniques to meet their many needs. We are working with the

Wounded Warrior Project and Hiring Heroes Program in concert with the Department of Rehabilitation Services. These programs reach out and provide specialized assistance to injured service members. NEX participated in two Wounded Warrior Project fairs in 2008. Through partnering with MWR and our vendors, we have provided many events targeted toward our Wounded Warriors. One example is the New Balance Wounded Service Member Care program. Each service member that returns ill or injured from Operation Iraqi Freedom (OIF) and Operation Enduring Freedom (OEF) receives a free pair of New Balance athletic shoes to aid in their recovery. Nintendo donated popular Wii video game systems as therapeutic devices to Naval Medical Centers as part of an ongoing partnership to help the wounded in the recovery process. Smith and Hawken donated a beautiful garden bench to National Naval Medical Center Bethesda. Eurpac donated new DVD titles to update Bethesda Naval Hospital's video library. We will continue to focus on our warriors' specialized needs wherever we can.

Working Together to Deliver the Benefit

We continue to partner with Navy, the other military resale activities, the Army Air Force Exchange Service (AAFES), the Marine Corps Exchange (MCX), the Coast Guard Exchange (CGES), the Defense Commissary Agency (DeCA), the Morale, Welfare and Recreation (MWR) entities, as well as our commercial industry partners, to leverage our combined efforts to better serve our military families.

This past year the military exchanges have focused on finding ways to leverage our combined spending through joint procurement efforts. This initiative consisted of establishing seven different commodity councils, with representatives from each exchange, to analyze various areas where the three exchanges can agree on procurement of similar supplies and services. Our joint efforts resulted in over a dozen contracts, thereby reducing overhead expenses by approximately \$5.5 million. We continue to identify additional areas where our cooperative efforts can have a financial benefit or increase customer satisfaction for our dedicated military members.

Many of our exchanges are collocated with commissaries, providing one stop shopping, saving our military families both time and money. While the commissaries and exchanges have different operating models, we have the same mission to serve our

military families. We are working together to promote the benefit and seek ways we can do more joint initiatives.

Working with industry, last year we rolled out a new supply chain solution in the tobacco, food and confections departments for all CONUS locations. The result has been streamlined assortments, increased deliveries, controlled inventory levels, all of which generated more sales and, more importantly, improved customer service.

This past year was an exciting time for the Navy Uniform program. The Navy Exchange is an integral partner in the deployment of new Navy Uniforms. Working with the Defense Logistics Agency, as well as the Chief of Naval Operations staff, the Navy Exchange completed the rollout of the new Physical Training Uniform and began the rollout of the new Service Uniform in 2008. In 2009 we began the rollout of the new Navy Working Uniform. These new uniform programs comprise the largest uniform transformation in Naval history.

Keeping in touch with family at home is important to our Sailors. Last year, our Sailors' phone calls from Navy ships totaled 15 million calling minutes. During 2008, NEXCOM donated 56,000 phone cards to military members, of which 31,000 were distributed to underway units during the holiday season. This special holiday event provided Sailor, Marine and Coast Guard members who were shipboard deployed a \$10 prepaid phone card. NEXCOM has been providing these free cards since 2001. Additionally, NEXCOM has teamed with MWR, Commander, Navy Installations Command, and Navy Hospitals to install free WiFi internet service in Navy Gateway Inns & Suites, MWR activities, NEX Food Courts, and Naval Hospitals in Portsmouth, VA and San Diego, CA.

We continue to partner with the Navy community and support various initiatives. We developed an on-line textbook store business model to serve the changing needs of Navy students. As the Navy continues to enhance their Navy Professional Reading Program, NEX has an active role. NEX procures and distributes books to ships and commands globally, and offers the books in stores and on-line at 35-45% off publishers' list prices. We have also partnered with Navy to help get important messages out. We allow space in our NEX flyers to provide information on financial classes, predatory lending, motorcycle safety, alcohol deglamorization, and Military One Source. In support of the

Navy's motorcycle safety initiatives, we expanded our merchandise selection to carry motorcycle safety gear. These are just a few examples of how we support Navy's mission in many ways.

Our support to Navy families goes beyond providing retail merchandise and services. Navy family members represent about twenty seven percent of our associates worldwide. We continue to promote our existing military family member continuity program to allow spouses to develop a NEX career as they follow their military sponsor from assignment to assignment. Navy Lodges support families on permanent change of station orders, as well as their leisure needs, providing quality lodging with many amenities, including kitchenettes. To meet the needs of our military families who have pets, Navy Lodges have implemented a new pet policy offering pet friendly rooms. In Naples, Italy, we have worked with local utility companies so our customers can pay their bills through the Navy Exchange. This provides our military families the convenience of paying with U.S. dollars. NEX provides school lunches for DoD schools in Italy (Naples and Sigonella); Spain (Rota); and Japan (Yokosuka, Sasebo, and Atsugi). Additionally, through the support of our industry partners, we host celebrity visits at our installations. These include book signings by well known authors and popular figures from the sports and entertainment world. Last year, the Jonas Brothers paid a visit to NEX Oceana, VA taking the time to personally meet hundreds of Navy family members. With our industry partners, we also sponsor Customer Appreciation Days at our overseas locations. These events provide entertainment as well as promotional opportunities for the families stationed away from home. Last year we held such events in Guantanamo Bay, Cuba and Naples, Italy. Our stores work with the local commands to offer many other events, including homecoming events, health and safety awareness classes, vehicle maintenance classes for deployed spouses, and joint events with our MWR partners; all designed to help make life a little easier and enjoyable for our families, wherever they are located.

Our relationship and support of MWR goes much further than dividends. We are truly partners in delivering Navy Quality of Life, working together to complement our operations and seeking cross-organizational efficiencies in the delivery of our programs.

Mission Focused

The success of our programs is due to the dedication and commitment of our NEX associates. NEXCOM is a diverse workforce. Minorities increased from 61.3% to 64.8% in the last year. We exceeded Navy's goals for hiring associates with disabilities. Keeping in line with Navy's Human Capital Strategy, we have expanded many of our associate programs. During 2008, we introduced five new investment options to the 401K plan and replaced two underperforming plans. To further help our associates, we improved the 401K plan provisions by eliminating the 90-day wait to initiate a new loan, and extended the repayment period on loans to obtain a primary residence. To focus on the health and well being of our associates we issued "Guides to Preventive Health Care." We also provide leadership development courses and support higher education through our tuition partnership program. Two hundred twenty five associates have graduated from our Executive Skills Development program since 2000. These graduates maintained a retention rate of about 90% and at least two thirds have been promoted to more senior positions. During 2009, we are implementing flexible spending accounts for qualified medical or dependent care expenses. We are taking care of our associates who are vital to our continued success.

Our commercial industry partners, who supply many of our goods and services, are not only businessmen but they are Patriots in their own right. Everyday they give us their utmost effort to make sure our military customers get the products they deserve and desire. We are always on the leading edge when it comes to our products and services and we are eternally grateful to industry for their hard work.

We also appreciate the efforts of our Military Coalition partners like the Armed Forces Marketing Council, the American Logistics Association, the Fleet Reserve Association, National Military Family Association, and many other Coalition members who work hard to make sure our valuable forms of non-pay compensation are protected. This relationship between the exchanges, suppliers and association advocates functions as a fine-tuned instrument. It is the ultimate example of teamwork in action.

Madame Chairwoman and Distinguished Members of the Subcommittee, we appreciate this Subcommittee's superb support of our Sailors and their families. On their behalf, I thank you.

In closing, I would like to reiterate that the Navy Exchange Service Command is a military organization, laser focused on our mission to support Navy readiness, recruitment and retention. Our customers have unique needs and our retail exchange system is unlike any other retailer's. We recognize the dedication and sacrifice our Sailors and their families make everyday. We, in turn, are there for them everyday and are dedicated to provide the utmost support and respect they have earned.