

Statement of

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before the

**Subcommittee on Military Personnel**

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

My name is Lloyd Johnson. I'm a member 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 that supply consumer products to military resale activities worldwide. A list of firms serving on the Council is attached (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 many years ago 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. Those services are offered in a more effective manner, or at a lower cost, or both, than all but the very largest manufacturers can provide using their own resources. If that were not the case, the firms belonging to the AFMC would not exist.

Many AFMC firms have been in business since the mid 1940's. Their impact has been felt in terms of better services and lower prices to the military patron 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 on Exhibit 2). Our firms have a total of over 2,800 people working directly in the stores and with the various resale system headquarters, to assure 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 a vital part of the fabric of military life.

It is important to note 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 perspective based on many decades of experience of servicing the military resale system

## **Importance of the Military Resale System**

Mr. Chairman, the AFMC strives to do its part to assure the continuation of the military resale system and the value it provides to our Service members and their families. We hope the information and perspectives presented here will be useful in your review of the military resale system.

The importance of the resale system has continuously been recognized as an extremely valuable benefit for the total forces, including active duty, reserve and Guard, and retirees, and for the central role it plays in recruitment, retention, and morale. Sometimes overlooked is its success in supplying everyday personal needs to deployed forces, many of which are located in war zones.

Our Armed Forces have been on a war footing, not just since September 11 of 2001, but more accurately since 1990. This lengthy period of high operations tempo and personnel turbulence is probably unprecedented in our history and has resulted in intensely stressful working and living conditions for Service members and their families. With this in mind, the case for continuing, as well as striving to improve, the resale system is compelling. Any attempt to diminish its value should be rejected.

## **A System That Works!**

Mr. Chairman, in addition to being a vital compensation benefit and contributor to quality of life, it's worth pointing out that the military system works well! It's honest, effective, efficient, and responsive. Taxpayers, legislators, and leaders from one Administration to another can take considerable comfort from the fact that for more years than we can remember, there have not been any crises or failures that would trigger embarrassment, apologies for mismanagement, or calls for investigations. This

is the result of a deeply ingrained commitment by these agencies to customer service, patron savings, and continued process improvement.

These are not loose judgments. Rather, they are based on scientific surveys of pricing and patron satisfaction and on largely favorable comparisons with outside-the-gate retailers on sales trends, business systems, and asset management. This success would lead one to conclude that the resale agencies could perhaps assume other important tasks as BRAC and troop re-positioning occur during the next few years. Examples might include food service (troop feeding) in overseas areas; expanded lodging (similar to what the Marines and Navy now manage), and selected MWR functions.

While the success of these agencies is in many ways self-generated, it is also a result of steady non-partisan oversight and support from numerous well-informed members of Congress. The members of the Armed Forces Marketing Council thank you for that, as would other segments of the supplier community. But more importantly, given the chance, military members and their families who fully understood your role, would also offer their gratitude.

Having said that, we have some observations and suggestions.

### **Commissaries**

In recent years, Congress has enacted legislation highlighting the importance of Defense commissary stores and ultimately codifying the system into law. The commissary benefit is an important and valued component of non-pay compensation to our service members and their families and is vital to their quality of life. This vital benefit should in no way be diminished, particularly during these turbulent times of base

closures and troop relocations, and of frequent deployments and redeployments of active duty, reserve, and National Guard personnel. To do so would inevitably cause a long-term adverse impact on families and loved ones

In addition, the Defense Commissary Agency (DeCA) can produce evidenced that demonstrates solid progress on several fronts over the last five years.

- Lower operating costs in constant dollars
- Impressive increases in customer satisfaction indexes, one year to the next, and when compared to outside-the-gate supermarket chains.
- Patron savings that now reach the 32% level (vs. average prices on the same items in similar supermarkets), which translates to annual savings of about \$2,500 for a family of four.

It's no wonder that surveys show the commissary benefit to be the number one non-pay benefit offered to military members and their families. The DeCA subsidy should be fully funded every year.

### **Congressional Budget Office Proposal to Consolidate Resale Activities**

The CBO has repeatedly recommended that military commissaries and exchanges be consolidated, prices in commissaries be raised to generate operating funds, or a yearly grocery allowance be provided to active duty personnel. As we have consistently stated in past hearings, there are several significant fallacies with these ideas:

- There is not any conclusive evidence that consolidating the exchanges or establishment of the Shared Services Business Unit will achieve significant savings, either in operating costs or prices to service men and women.

- Increasing the cost of products in commissaries can only be viewed as a reduction in overall military compensation, particularly for those who would not qualify for the allowance (including retirees and most National Guard and reservists), and for those families whose current savings exceed the allowance.
- Active duty Service members will certainly realize this benefit will be lost upon retirement, and Congress could then expect a flood of complaints.
- Completely ignored is the fact that the current \$1 billion commissary subsidy equates to less than one-half the dollar value of the \$2.5 billion savings that are realized when authorized patrons shop in military stores. Looked at another way, purchases by commissary patrons of over \$5 billion would cost over \$7.5 billion at private sector commercial prices.
- CBO ignores the negative impact on the morale of troops and their families.
- CBO ignores the adverse effect on recruitment and retention, especially at a time when these vital functions are experiencing real challenges.

### **Second Destination Transportation (SDT) Funds**

The Congress passed legislation in 2005 that clearly mandated the funding of this function, which assures that American products get shipped to foreign-based exchanges and commissaries at taxpayer expense. This eliminates the need for AAFES, NEXCOM, DeCA, and MCX to either unfairly raise prices to overseas-based troops and families, or for the exchanges to absorb the freight costs and reduce MWR earnings by an unacceptable amount, or for these agencies to shift all their overseas procurement to offshore sources. All of these consequences are simply unacceptable. SDT must be fully funded – it's the right thing to do for quality of life.

## **Relief from ASER Merchandise Restrictions**

The AFMC is most appreciative of the past actions by Congress to alleviate many item and cost restrictions imposed upon the military exchanges, including the lifting of the restriction on projection TV's. Nevertheless, we continue to hold that further lifting of restrictions is needed.

By shopping the resale system, the military patrons are afforded the ability to obtain the products they want and, in most cases need, at the best value and savings. Regularly updated customer satisfaction and patron savings surveys prove this to be the case. Therefore, why not afford Service members the opportunity to receive the best possible prices and provide a truly complete compensation benefit, with virtually no additional burden on taxpayers, by further lifting the current ASER restrictions? Military patrons should not be forced to shop higher priced private sector stores to meet their needs, especially when so many military members and their families are sacrificing so much to defend our freedom.

A case in point, the current restrictions prohibiting exchanges from undertaking new construction or renovation of an exchange facility for the purpose of providing additional space in which to sell furniture, prevents many exchanges from selling any furniture, and severely limits the assortment in remaining exchange stores. In particular, young military families seeking entry-price-point or moderately priced furniture are forced to shop "outside the gate" where mark-ups are usually much higher and interest rates are either very high or deceptively presented. It is the firm belief of this Council that the proper course of action for the military patron is to lift the ban on construction of furniture facilities.



Diamonds are another issue. The current size limitation is unrealistic in today's market. There is clear evidence that many military shoppers would like the opportunity to purchase larger quality diamonds than are now available. The savings to military families versus outside the gate would be very significant. Moreover, expanding the stock assortment will attract more patronage, thereby increasing sales, increasing the dividend contributions to MWR funds, and lowering the MWR burden on taxpayers. The best option is to completely eliminate all jewelry restrictions and let patron demand dictate what is stocked in the stores.

While it is logical to expect that expanding these categories for exchanges will slightly diminish commercial retail sales, the overall impact would be extremely small (less than 1% overall), while the resulting benefit to military patrons would be substantial. At a time when military members are making extraordinary sacrifices for their country, and when the Pentagon is facing serious challenges to recruiting and retention, a simple lifting of these restrictions would be the right course of action.

### **Military Exchange Shared Services**

The Unified Exchange Task Force (UETF), established in May 2003 to develop a plan for consolidation of the military exchange services, has recommended the establishment of a Shared Services Business Unit (SSBU) operated by AAFES. While the proposal for shared services does eliminate some of the inherent risks of total consolidation, operational savings estimates continue to be questioned by the military departments, and by Industry. More importantly, though, there does not appear to be solid evidence that establishment of the SSBU will produce worthwhile benefits to Service members and their families in the form of lower prices, improved merchandise

selection and availability, improved service, or increased contributions in support of MWR activities. Without these, there is no gain in seeking any form of integration or shared services. Additionally, there is no assurance that the following requirements for success will be provided by the proposed SSBU:

- Validated savings in operating costs, either appropriated or nonappropriated
- The establishment of a governance structure acceptable to all military departments
- A standardized or compatible IT structure
- A reasonable implementation cost which could logically and eventually be offset with operating efficiencies.

The establishment of an SSBU, much less total consolidation, is not supported by a compelling business case. The idea seems to have little, if any, support outside of the Office of the Secretary of Defense.

A more prudent and logical approach in the search for operational savings, would be to focus on expanding cooperative efforts between the exchange services.

Examples of current successful initiatives include:

- A common catalog and e-commerce website
- The “Star Card” credit card system
- Private label programs (i.e., “Exchange Select”)
- Distribution services from one Service to another.

Projects with low risk, low implementation costs, and potentially high return on investment could likely be initiated or expanded by agreement among the Services, in

such areas as logistics and non-resale procurement. Other ideas will likely emerge as the Services work together.

### **Base Closures**

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, especially at a time when so many reserves and Guard members have been called up to active duty.

It must be remembered that the purpose of the resale system is to enhance the quality of life of all members of the uniformed services, including retirees, and their families. There is often a tendency to overlook those career Service members who are no longer on active duty.

### **Summary**

Mr. Chairman, the Armed Forces Marketing Council recognizes that there can be no let-up in seeking operational improvements and cost savings in all elements of the military resale system, particularly given the current strain on the Defense budget. Nevertheless, those efforts should not serve to degrade the quality of life of the people who make up our armed forces.

As for the ASER restrictions, we ask that you reconsider the lessening of restrictions on furniture and diamonds in the exchanges, a move which would add value to Service members' compensation with no adverse impact on the budget.

Lastly, we ask that regardless of whether the resale system is considered a core or non-core function, it continues to be a necessary function of the Department of Defense. It is simply too important and vital to be outsourced or downgraded in any way.

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