

NOT FOR PUBLICATION UNTIL
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ARMED SERVICES COMMITTEE

STATEMENT OF
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BEFORE THE
HOUSE ARMED SERVICES COMMITTEE
SUBCOMMITTEE
ON
MILITARY PERSONNEL
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Mr. Chairman, Secretary Abell and distinguished Members of the Military Personnel Subcommittee, thank you for the privilege to appear before you today on behalf of the Navy Exchange Service Command (NEXCOM), representing its more than 15,000 dedicated worldwide associates. Today, I will give this Subcommittee an overview of the Quality of Life benefits the Navy Exchange provides our total force of military men and women, reservists, retirees, and their families. Serving these great Americans is our mission and our passion.

First, I would like to thank the Subcommittee for your continuing support. Your diligence in protecting this valued non-pay benefit for all our patrons – active duty, retirees, reservists and their family members - is unwavering. I am pleased to report that as a result of legislation this Subcommittee supported, we received the first installment of BRAC Recovery funds for our nonappropriated capital losses during the last round of BRAC. I assure you that these funds will support new capital ventures as intended.

Quality of Life is essential to Navy recruitment, retention, and readiness, and NEXCOM's many programs are an essential part of Navy Quality of Life support. They provide a valuable form of non-pay compensation to our Navy families around the world, no matter where they are located, afloat and ashore. Savings are important to our Navy families, and we have focused our efforts on delivering quality products and services at the best value. We are pleased with the most recent results of our independent market basket surveys administered for all three exchanges by QRS. Navy Exchanges provide an average retail savings of 21.2%, with an additional average 6% savings from sales tax, representing \$415 million in non-pay compensation to our Navy families. In addition, we still supported Navy quality of life by contributing a total of \$64 million to Navy Morale,

Welfare and Recreation (MWR) ashore programs and afloat recreation programs.

Results of our Customer Satisfaction Index (CSI), administered for all the exchanges by CFI, the premier retail intelligence company, continue to confirm the high value our customers place on their Navy Exchange benefit, and they appreciate the improvements we continue to make. NEX CSI results have shown dramatic improvement since the survey was initiated. Starting in 1998, the CSI score was only 61, significantly below that of commercial retailers that averaged about 72. Since then, NEX has implemented aggressive improvement programs in a wide variety of areas. In 2004, NEX reached a world-class level of 77 for worldwide operations. In CONUS, our score is 79. This places NEX in the top tier of retailers in the United States – a remarkable achievement in just six years. We listen to our customers through their input to our CSI, which is very detailed and location specific, to ensure we are meeting their needs and expectations.

We are especially proud that our efforts were recognized by an unbiased survey by Defense Manpower Data Center conducted in 2003. 12,500 active duty Sailors, Soldiers, Airmen and Marines responded, and the results clearly show that NEX is doing a great job serving our customers. In each of the four measures of the web-based survey, Service Members were more satisfied with the merchandise and service they received in the Navy Exchanges, scoring above the DoD median. The survey compared Navy Exchange stores to civilian counterparts and the other Service Exchange Systems. When asked to compare to commercial retailers, 82% said their Navy store was as good, better or much better.

We have had a busy year. Our support of Operation Enduring Freedom and Operation Iraqi Freedom remains a top priority. Over 355 Marines and their families have stayed at

the Navy Lodge Bethesda while being treated at National Naval Medical Center. When there has been a high demand at Walter Reed, we have also assisted the Army with their lodging needs. We donated 4,350 prepaid telephone cards to Bureau of Medicine and Surgery for distribution to injured service personnel returning from Iraq. During the 2004 holiday period, an additional 21,000 prepaid cards were donated to all 27 Navy ships and Coast Guard cutters in theater. In working with our industry partner, AT&T, we are pleased to report a reduction in the cost of calling for shipboard personnel from \$1.00 to \$.50 per minute, of particular importance to those serving in the OIF/OEF region. Our Vending program secured over \$100,000 in donations for Navy Marine Corps Relief Society in support of our Navy and Marine Corps personnel and families. Our Uniform Support Center supports Dover Mortuary with same day turn around service, to provide uniforms for our Sailors and Marines who have made the ultimate sacrifice. We are dedicated to support our Sailors and Marines in the OIF/OEF region and their families at home.

In partnership with other government agencies in support of Executive Order 13149, "Greening the Government Through Federal Fleet and Transportation Efficiency", our Navy Exchange Quarters K Gas Station now offers biodiesel in addition to compressed natural gas and E85, which is 85 percent ethanol/15 percent gasoline. Quarters K is the first and only gas station in DoD and the entire National Capital region to offer all three alternative fuels.

In partnership with the Bureau of Medicine and Surgery (BUMED) and the Navy Environmental Health Center, we support a healthier life style for our Sailors. We are partnering with our name brand food operators to ensure they provide nutritional

information to support Navy's "Get Moving Navy" program. Healthy Alternative nutritional criteria will be included in all future contracts with branded food operators. Healthy Alternatives has already grown to 12 % of our snack sales in vending machines, and it is our goal to increase it substantially. We also continue to promote alcohol awareness and smoking cessation in other partnership efforts with BUMED.

Deployment of our Information Technology Retek Modernization initiative remains at the top of our corporate objectives. The implementation of this state-of-the-art merchandise system, which impacts key functional areas, will drive cost suppression and reduction efforts through improved inventory management and improved efficiency in merchandise ordering and distribution. Our customers will benefit the most as it provides valuable information to our buyers and is key to ensuring we get the right merchandise in the right stores at the right prices and at the right time. We are 28 months into this deployment and have successfully launched Retek's retail software system, having enabled distribution, inventory, shipments, receipts, replenishment, allocations, data warehouse and purchase order management. Retek's Distribution Management application has also been implemented at our Distribution Centers in Norfolk and Rota Spain. Implementation of this module increases efficiency, enhances productivity, improves inventory accuracy and helps ensure full utilization of the distribution center's warehouse space. We are very encouraged with the success so far, and look forward to continuing the rollout in 2005.

This year has not been without significant challenges. The Naval facility in Puerto Rico, including all our business operations on the island, was closed in 2004. In addition, NEXCOM's business operations in Orlando and Pensacola, Florida, sustained severe

damage as a result of four major hurricanes and tropical storms. The total impact has not been fully calculated, but our estimates show that sales trailed behind last year for the same period by about \$11 million. We estimate the total impact to our bottom line to be approximately \$1.4 million.

The silver lining in all these storm clouds was the outstanding performance of our Navy Exchange associates. Many of them, affected by the hurricanes and tropical storms, virtually ignored damage and destruction to their own homes and property, and focused on the task of supporting the Navy and our shipmates in Florida. They shoveled, mopped, hauled, washed, scrubbed, swept, packed, loaded, moved, dried, stocked and did whatever it took, all in the worst conditions, to restore services for our Sailors and their families as quickly as humanly possible. Our Navy Exchange team at NEX Pensacola also worked closely with base officials to support essential mission requirements during and immediately following Hurricane Ivan. They located and secured generators to provide necessary electrical power; shipped tractor trailer loads of ice and drinking water for use by base personnel; secured cellular telephone service for Sailors and their families; provided gasoline and fuels for vehicles required for hurricane cleanup and base security; opened a mobile “mini-mart” truck to provide food, water, sodas and personal hygiene items all across the base; opened a temporary exchange facility to support Navy families who were relocated from their damaged homes; and provided supplies of personal hygiene items to approximately 3,000 displaced NAS Pensacola students. This is but one example of our associates’ commitment. I am extremely proud of what they do to support our mission, and our Sailors and their families each and every day. We could have not provided this level of responsiveness without the strong support of our industry partners.

I would like to thank them for all their efforts, particularly Alltel, Vanguard, Reddy Ice, Citgo Petroleum, Eveready batteries, Porter Cable, American Greetings, Anderson News, Famous Romona Water, Nabisco, Interstate Brands, National Beverage, Pepperidge Farm Bread, Frito Lay, Dixie Egg Co., McKee Foods, Colorado Boxed Beef, Revlon, Eurpac, Bose, Anderson News, American Greeting and Bob Jury and Associates.

Despite the closure of our Roosevelt Roads Exchange and the impact of hurricanes, the Navy Exchange had a record year with total sales from our direct-run operations of \$2.18 billion, an increase of 3.3% over the prior year. Net profit is projected to be \$68 million, which generates \$48 million for ashore MWR programs. Although a slight increase from last year, lost profits from the hurricane's impact combined with unfavorable changes in foreign currency and increased retirement expenses more than exceed this shortfall. The Ships Stores Program generated another \$16 million for afloat recreation programs on \$101 million of net sales.

NEXCOM is a multi-faceted retailer. We operate 433 stores on board 109 Naval installations. These locations are sized and their stock assortments are tailored to serve the diverse population at each individual base. NEXCOM provides a complete assortment of merchandise - softlines, hardlines, and consumables - popular name brand products at a savings, as well as a complete line of private label products with a high level of quality at the best value. In addition our stores include mini-mart gas stations and over 1,200 service operations, which include fast food and family-style restaurants, laundry and dry cleaning shops, barber/beauty salons, photo finishing shops, nail salons, floral shops, tailor and cobbler shops, optical and optometry services, complete vending services and much more. We also operate, in partnership with the Defense Commissary

Agency, eleven NEXMART combined commissary and exchange operations in remote overseas locations. We continue to move toward one stop shopping in response to our customers needs.

Our Ships Store operation is expeditionary, sea-based and provides essential Quality of Life products and services to Sailors and Marines serving on fleet ships and remote areas around the world. Whenever our Sailors are called to sea, our program goes with them. On board we provide retail stores, vending machines, barbershops and laundry facilities to improve the quality of seagoing life. Ships Stores are operated using appropriated funds and generate dividends to support afloat recreation programs that are so vital to building morale and readiness of our Sailors at sea. Our afloat telecommunications program, which provides that vital underway phone link home to our deployed Sailors and Marines, continues to be one of the biggest shipboard morale boosters.

Whether our patrons are on permanent change of station orders, temporary duty, or leisure travel, they can enjoy the hospitality and award winning service of a Navy Lodge at an average savings of 43% compared to commercial lodging. With 3,200 rooms in 43 locations worldwide, our guests are assured of clean, comfortable and affordable accommodations, all available through the convenience of our toll free central reservation number or online through our web page. During the past year, our Navy Lodges answered the call when reservists needed temporary lodging before their units were deployed. The Navy Lodge program is a separate nonappropriated fund entity managed by NEXCOM.

The Navy Uniform program provides authorized uniforms to Navy personnel, both

active and reserve. Additionally, through one of many cooperative efforts with the other military exchange services, we provide in-store uniform support to the other services at many locations. The Uniform Support Center offers a worldwide mail order service and online web store; both are fast, convenient and easy to use. Navy Uniforms are just a phone call away using our 24/7 toll free telephone numbers or few clicks away using the internet, with free standard shipping.

NEXCOM continues to reinvest to update and refresh all our facilities. For 2004 we presented a capital plan totaling \$97.6 million for all our programs. These investments encompass expanded and renovated brick and mortar facilities and equipment as well as computer and point-of-sale systems modernization.

NEXCOM has pursued strong business partnerships. In addition to our industry partners, too numerous to list, we have a strong alliance with DeCA and the other Military Exchanges. We would like to thank all our partners; without whom we could not do the job we do.

The Exchange Services have long engaged in cooperative efforts and will continue to pursue these as they make good business sense. During 2004, we added new lines to our popular Exchange Select label, a joint private label program that offers over 450 quality products, with an average savings of approximately 48% compared to name brands. NEXCOM provided military uniform mail support, distribution support, Visual Rapid Reordering support and merchandising support for the Marine Corps. NEXCOM and AAFES are working to align Retek designs and configurations to facilitate common data schema and leverage backroom costs. Standardization of data provides the most opportunity for future cooperative efforts. While much work still remains in this area, the

benefits are clear.

In 2004, the Navy revitalized our MWR/Navy Exchange Board of Directors, with a focus on balancing the missions and strengthening the partnership of MWR and Navy Exchange. We are committed to supporting the needs of the Navy to benefit our Navy families. We have many small exchanges at remote, isolated and overseas locations that most commercial retailers would not operate. These fact of life operations fulfill a need that would not otherwise be met. The top third of our stores in sales contribute 82.8% of our sales and 82.3% of our profits. Leveraging these top stores, we are able to continue to operate our fact of life locations and still achieve an overall profit, meeting our capitalization and MWR dividend needs while providing savings to our customers.

In working to improve the benefit, we appreciate this Subcommittee's past support in lifting some of the Armed Services Exchange Regulations restricting what we can sell. With current TV restrictions, our Sailors must go off base and spend more, and in many cases incur very high interest rates to finance their purchase. In this era of the Global War on Terrorism, our Sailors are putting their lives on the line every day. They serve their country with the utmost diligence and devotion to duty. We seek your continued support to enhance their purchasing power and merchandise selection.

NEXCOM is an active participant in Department of Defense's Unified Exchange Task Force (UETF) effort to develop a plan for sensible, cost-wise optimization of the three exchanges at a manageable level of risk. At present the Task Force has focused on back room "shared services" integration. We believe this approach addresses the majority of actionable non-store costs, presents lowest manageable risk, is transparent to service members, and continues the current Military Services' Boards of Directors' oversight of

exchange execution and dividend distribution. NEXCOM's direct expenses to date to support UETF are in excess of \$1 million. A detailed compelling business case, a viable governance model and an executable information technology plan are to be delivered.

We are committed to the nineteen operating precepts agreed to by the Services and the Department. First and foremost, exchange integration must result in measurable improvement for each Exchange Service as defined by merchandise selection, merchandise availability, price savings, customer satisfaction and MWR contributions. While we are actively engaged in helping shape the future structure and operations of an integrated exchange, we will continue our primary focus and mission in providing our customers the right products and services at the right price. Serving our Sailors, our retirees and their families will always be our number one priority. This is the covenant we have made to our Navy.

To be a successful retailer we must offer value, quality and good customer service. The measure of our success will be our ability to continue providing quality goods and services at a savings to our Sailors and their families. We must also increase our sales and our profitability, which supports our high level of contribution to MWR. The commitment of our associates and their ability to adapt to changing conditions is the key to our success. They are a dedicated team of professionals who believe in the mission of the Navy Exchange System in support of our Navy and our Sailors. They are true patriots.

In summary, it has been a very busy and challenging year for us. I am pleased to report that our Navy Exchange System remains financially strong and continues to meet the needs of our Sailors and their families around the world every day. Our strong

performance is a direct result of the strong support of our patrons, our dedicated associates, our industry partners, Navy leadership and the support of each of you on the Subcommittee and in Congress. Together we can protect the benefit and maintain the commitment we made to the men and women who have served, and continue to serve, our country so well.

Thank you for the opportunity to address this Subcommittee. I will be pleased to respond to any questions you may have.