Report on
Plan to Obtain Budget Neutrality
for the
Defense Commissary System
and the Military Exchange System

May 2016

Report to Congress
in accordance with section 651 of the
National Defense Authorization Act
for Fiscal Year 2016 (P.L. 114-92)

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This report is submitted consistent with section 651 of the National Defense Authorization Act for Fiscal Year 2016 (P.L. 114-92) which requires the Secretary of Defense submit to the Committees on Armed Services of the Senate and the House of Representatives a report setting forth a comprehensive plan to achieve by October 1, 2018, budget-neutrality in the delivery of commissary and exchange benefits while meeting specified benchmarks. This report addresses a plan to optimize defense resale, alternatives to achieving budget neutrality, and measures of the desirability or success of proposed or attempted changes to the Defense Commissary and Military Exchange systems.

On behalf of the Secretary of Defense, I am pleased to provide our Report on the Plan to Obtain Budget Neutrality for the Defense Commissary System and the Military Exchange System pursuant to section 651 of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2016. The Department remains committed to preserving the quality of life benefits – including savings, services, convenience, and Morale, Welfare, and Recreation (MWR) dividends – provided by the Defense commissary and exchange systems for Service members, retirees, and their families. At the same time, the Department acknowledges that fiscal constraints require creative thinking and constant examination of opportunities for improved efficiency.

To that end, the Department has developed a comprehensive plan required by section 651 to achieve budgetary savings by October 1, 2018, without diminishing commissary and exchange benefits. The plan calls for consideration of optimization measures, including the establishment of consistent business practices across the Defense Resale Enterprise; the implementation of variable pricing in the defense commissaries, beginning with pilot programs authorized by the NDAA for FY2016; the introduction of private label products in the commissaries; the improvement of commissary store operations; and the conversion of the commissary system to a nonappropriated fund entity.

Based on the work conducted by the Military Compensation and Retirement Modernization Commission (MCRMC) and the Boston Consulting Group (BCG), the Department believes that these measures can reduce Resale Enterprise reliance on appropriated funds by roughly $2 billion over a five-year period. A new Defense Resale Business Optimization Board (DRBOB), comprised of the Defense resale executives and the Deputy Chief Management Officer (DCMO), has been tasked to lead the implementation effort.

The DRBOB will conduct a business case analysis to measure the success of each potential efficiency initiative against a benefits baseline of patron savings, customer satisfaction, and contributions to MWR programs. The DRBOB will give particular emphasis to the assessment of proposals to optimize and increase commonality among back-office processes and systems, such as those associated with finance and distribution, to increase efficiencies and savings. However, none of these measures will be adopted unless the analysis shows a favorable return on investment.

Even if the Department is able to achieve all of the potential savings forecast by MCRMC and BCG, however, the defense commissaries will fall $1.5 billion short of the savings required to produce budget neutrality in FY 2019. For this reason, the Department has also examined other alternative approaches to achieving budget neutrality.

First, the Department is critically assessing the privatization of all or portion(s) of the commissary system. Initial conversations with interested business entities informed the Department of private sector willingness to engage, which is leading to more thorough market analysis, including a formal Request for Information that we expect to issue in May. But preliminary information now available indicates that although this avenue is worth pursuing it is unlikely to achieve budget neutrality by FY 2019.

Second, the Department considered the possibility of across-the-board commissary price increases and store closures to achieve the additional $1.5 billion in annual savings needed to achieve budget neutrality by October 1, 2018. The Department determined that such changes would undermine the commissary benefit and reduce exchange system patronage, significantly diminishing resale benefits to Service members, retirees, their families, and the military Services. Moreover, it appears that no alternative short of shutting down the commissary system would achieve the goal of budget neutrality. As a result, the Department has rejected these alternatives.

The Department appreciates the flexibility provided in section 651 and in additional legislative proposals now pending before Congress. Under the leadership of the Under Secretary of Defense for Personnel and Readiness, the DCMO, and the DRBOB, the Department will continue to implement these new authorities to optimize resale system practices, exploit synergies, and employ fact-based business analysis to drive down appropriated funding while maintaining the quality of life and resale benefits that patrons receive today.

Peter Levine
Acting Under Secretary of Defense for Personnel and Readiness

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INTRODUCTION

The Department of Defense (DoD) is committed to preserving the quality of life benefits provided by the Defense commissary and exchange systems for service members, retirees, and their families. This includes the patron savings, service, and convenience delivered by the commissaries and exchanges as well as the Morale, Welfare, and Recreation (MWR) dividends provided by the exchanges.

The Department will focus its efforts on changes that will enable the Defense Resale Enterprise to improve business practices and maximize its efficiencies while delivering patron benefits at levels equal to or better than currently provided at reduced cost to the taxpayer.

The Department is dedicated to establishing benefit measures and baselines, optimizing resale system practices, reengineering business methods, exploiting synergies, and employing fact-based business analysis and decision-making across the Defense commissary and exchange systems.

The Department also recommends statutory changes that would free the commissary system to adopt best commercial practices and operate in a more business-like manner without reducing the benefits provided to authorized patrons. The Department believes that, with some legislative relief, it will be possible to maintain current benefits and still achieve efficiencies that result in meaningful savings for the taxpayer.

This report is submitted in accordance and consistent with section 651 of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2016 (Public Law 114-92) (see Appendix A).

Background: The underlying rationale behind what has evolved into the current Defense Resale Enterprise can be traced back to the earliest days of standing armies the world over.[1] While basic food and clothing requirements of military forces were normally satisfied by the appropriate organizational authorities, discretionary, personal convenience and comfort items tended to be offered for sale only by third party business entities. Because they dealt with having to meet specific volumetric requirements, than what official channels were forced to accommodate to ensure mission effectiveness.

During America's Revolutionary War, a system of vendors, or sutlers, evolved that was officially acknowledged and authorized by Congress and the War Department to provide sundries to soldiers, above and beyond the staples that were provided by official means.[2] These merchants effectively provided leisure items and services that soldiers desired, adjacent to their battlefield locations. Eventually, sutlers gave way to a system of post traders as the young nation extended its network of frontier posts further westward. These traders continued to be officially sanctioned, private merchants who offered their wares on a for-profit basis throughout the system

[1] Army and Air Force Exchange Service, "History," www.aafes.com/about-exchange/history-mission/ (accessed December 10, 2015).
[2] Army and Air Force Exchange Service, "One Hundred Years of Service: A History of the Army and Air Force Exchange Service 1895-1995," 1994, 1.

of fixed outposts. Finally, in July of 1895, after several large scale corruption scandals and other questionable ethical practices came to light and invited intense scrutiny on the handling of post traders across the nation, Army General Order Number 46 was issued that directed post commanders to establish post exchanges wherever it was deemed practicable.[3] These post exchanges were operated as nonappropriated fund (NAF) activities that existed solely for the benefit of the troops and their families, with excess revenues going directly to morale and quality of life programs on the posts themselves. Following the establishment of the Department of the Air Force in 1947, it was decided to operate the exchanges of the Army and the Air Force on a joint basis, and the Army and Air Force Exchange Service (AAFES) was organized in 1948.[4]

The evolution of the present Navy Exchange (NEX) system and the Marine Corps Exchanges (MCX) paralleled in many ways that of the Army. So-called "bum boats" served Navy ships early in our nation's history, in much the same way sutlers served Army posts, providing convenience items to ship-based personnel. Navy ships' stores became full-fledged governmental activities in 1909 (with the adoption of legislation preceding the present-day title 10, United States Code, chapter 651). Navy shore-based exchanges came under the governance of the Department of the Navy in 1923. Both systems were consolidated under the Navy Ships' Stores Office in 1946 and 1947. The first Marine Corps post exchange was established in 1897; in 1912 the last Marine post trader was replaced by an exchange.[5]

Remarkably, the same basic operating tenets of the early post exchange system continue today. The separate exchange systems, however, have evolved from those early models to become much more business-focused and efficient.

The commissary system, as a benefit, traces its own lineage back to 1825 when Army officers at specified posts could make purchases for their personal use, paying at-cost prices for goods from commissary department storehouses. By 1841, officers could also purchase items for members of their immediate families.[6] This authority was again broadened in 1867 to enlisted personnel and their families, and subsequently to retirees as early as 1879.[7] During the first half of the twentieth century, the military services each developed their own commissary systems operating under the same, overall rubric of providing grocery items "at cost" as a way to supplement the pay benefit of patrons.

On March 31, 1989, Congress directed the Department to conduct "a comprehensive, unrestrained study of the military commissary system" to "strive toward developing policies that move the system forward in an orderly and consistent manner" while examining "options for ensuring a viable commissary program." In response, the "DoD Study of the Military Commissary System," known as the Jones Commission Report, was submitted to Congress on December 18, 1989. As a result of the report and recommendations of the Jones Commission,

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[3] Army and Air Force Exchange Service, "One Hundred Years of Service: A History of the Army and Air Force Exchange Service 1895-1995," 1994, 18.
[4] Military Compensation Background Papers, 7th ed., November 2011.
[5] Ibid.
[6] Defense Commissary Agency, "History of US Military Commissaries," www.commissaries.com/history.cfm, accessedwww.commissaries.com/history.cfm (accessed December 10, 2015).
[7] Ibid., (accessed December 14, 2015.).

DoD Directive 5105.55, dated November 9, 1990, established the Defense Commissary Agency (DeCA) to operate all commissary functions of the individual services to ensure uniform commissary practices and policies for the armed forces. DeCA became operational on October 1, 1991.[8] Just as with the exchange system, the basic tenet of the commissary operating concept has remained relatively constant to this day. Commissaries still sell groceries to patrons at cost, plus a Congressionally-mandated five percent surcharge added to offset capital expenditures.

Commissaries are subsidized through annual appropriations. Until 1985, the general provisions of the annual DoD appropriations acts contained language precluding the use of appropriated funds (APF) for certain commissary store operating expenses, including commercial transportation in the United States, utilities in the contiguous United States (CONUS), operating equipment and supplies, and store losses through shrinkage, spoilage, and pilferage of merchandise. In 1984, these prohibitions were codified at title 10, United States Code, section 2484.[9]

In 2000 Congress provided that the commissary system's operating expenses should be funded with APF[10] and that surcharge funds[11] may be used to pay for infrastructure expenses. The revision specifically required APF to be used to pay salaries, utilities, and communications expenses; to purchase operating supplies and services; to pay second destination transportation (SDT) costs within or outside the United States; and to pay any costs relating to above-store-level management of the commissary system. At the same time, Congress required the sales price of merchandise sold in, at, or by a commissary be adjusted to cover the cost of first-destination transportation in the United States and the actual or estimated cost for shrinkage, spoilage, and pilferage.[12]

This operating model allows DeCA to provide products at prices that DeCA has estimated to be, on average, approximately 30 percent below local commercial grocers, measured globally. Commissaries remain an important non-pay benefit for today's military, contributing to the financial health and readiness of many military families.[13]

While both the exchange and commissary systems grew out of a distinct, mission-based need to provide goods and services in locations where commercial sources were either inconvenient or impractical, as commercial retail stores have proliferated, the Defense Resale Enterprise has evolved into a significant income and quality of life benefit to service members, retirees, and their families that is still tied to the greater military mission through dividend contributions to MWR and enhancement of the overall sense of community within the military.

The value of these benefits is demonstrated by commissary usage between February 1, 2015, and January 31, 2016, encompassing over 88 million shopper visits to commissary stores. The

[8] Military Compensation Background Papers, 7th ed., November 2011.
[9] Ibid.
[10] Title 10, United States Code, section 2483.
[11] Title 10, United States Code, section 2484(h).
[12] Title 10, United States Code, section 2484(e).
[13] Defense Commissary Agency, "History of US Military Commissaries," www.commissaries.com/history.cfm, (accessed December 10, 2015).

DeCA implemented identification (ID) card scanning worldwide on January 9, 2014, fulfilling DoD requirements to validate commissary patronage.

Usage based on categories of patrons by military service, status, and grade are depicted in the tables below (percentages may not add up to 100 percent due to rounding).

Commissary Usage (By Service, Status)

Percentage of Transactions[1]

	USA	USAF	USN	USMC	DoD[5]	Uniformed Services[6]	Other[7]	Total
Active Duty[2]	19.5%	16.2%	9.4%	4.8%	0.0%	0.5%	0.0%	**50.4%**
Guard / Reserve	1.7%	1.7%	0.6%	0.2%	0.0%	0.0%	0.0%	**4.2%**
Retired[3]	13.0%	14.1%	9.3%	2.0%	0.0%	0.5%	0.0%	**38.8%**
DoD	1.7%	0.8%	0.6%	0.2%	1.3%	0.0%	0.0%	**4.6%**
Other[4]	1.0%	0.3%	0.2%	0.2%	0.0%	0.0%	0.3%	**2.1%**
Total	**36.9%**	**33.1%**	**20.1%**	**7.3%**	**1.3%**	**1.0%**	**0.3%**	**100.0%**

[1] Transactions for commissary eligible shoppers, including sponsors and dependents, at all commissaries
[2] Includes Active Duty, Active Guard/Reserve (representing 2.4 percent of all transactions), and Cadets
[3] Includes "Gray Area Retirees" (representing 1.6 percent of all transactions), who are reserve retirees not yet eligible for retired pay
[4] Includes disabled veterans, foreign military, Medal of Honor recipients, others not classified as Active Duty, Guard or Reserve, Retired, or DoD
[5] Includes DoD civil service employees, contract employees, NAF employees, and beneficiaries primarily in locations outside the United States
[6] Includes members of the Coast Guard, US Public Health Service, and National Oceanic and Atmospheric Administration (NOAA)
[7] Includes disabled veterans and other Government employees not classified as USA, USAF, USN, USMC, DoD, or Uniformed Services

Commissary Usage (By Grade, Service)

Percentage of Transactions[1]

	USA	USAF	USN	USMC	DoD[3]	Uniformed Services[4]	Other[5]	Total
E1-E3	2.0%	2.0%	1.2%	0.8%	0.0%	0.0%	0.0%	**6.1%**
E4-E6	14.3%	12.9%	8.4%	2.8%	0.0%	0.4%	0.0%	**38.8%**
E7-E9	9.4%	10.1%	5.0%	1.8%	0.0%	0.2%	0.0%	**26.5%**
W1-W3	1.1%	0.0%	0.1%	0.2%	0.0%	0.1%	0.0%	**1.5%**
W4-W5	0.5%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	**0.7%**
O1-O3	2.2%	2.0%	1.2%	0.5%	0.0%	0.1%	0.0%	**6.0%**
O4-O5	3.1%	3.3%	2.0%	0.6%	0.0%	0.1%	0.0%	**9.1%**
O6	0.9%	0.8%	0.7%	0.1%	0.0%	0.1%	0.0%	**2.5%**
O7+	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	**0.2%**
Other[2]	3.3%	1.9%	1.3%	0.4%	1.3%	0.0%	0.3%	**8.6%**
Total	**36.9%**	**33.1%**	**20.1%**	**7.3%**	**1.3%**	**1.0%**	**0.3%**	**100.0%**

[1] Transactions for commissary eligible shoppers, including sponsors and dependents, at all commissaries
[2] Includes all grades not specific to the military rank structure (e.g., General Schedule (GS), Wage Grade (WG))
[3] Includes DoD civil service employees, contract employees, NAF employees, and beneficiaries primarily in locations outside the United States
[4] Includes members of the Coast Guard, US Public Health Service, and National Oceanic and Atmospheric Administration (NOAA)
[5] Includes disabled veterans and other Government employees not classified as USA, USAF, USN, USMC, DoD, or Uniformed Services

For the purpose of understanding active duty commissary usage, a better method is to measure household usage. Sponsors (service member) and dependents (family members) represent the total household; therefore, if any member of the household shops during a specified period, the household is considered a commissary user. Households are measured using the number of sponsors. The data below represents 12 months of scanned ID cards at more than 240 commissaries between February 1, 2015, and January 31, 2016. The active duty member status is as of January 31, 2016. At the end of the measurement period, there were approximately 1.58 million eligible active duty households. Of the eligible households, 1.26 million or 79.9 percent shopped in the commissary at least one time during the period.

Commissary Usage (Active Duty Summary)			
Number of Households			
Status	Eligible	Shopped	Utilization
Active Duty[1]	1,579,550	1,262,661	79.9%

[1]Active Duty includes Active Duty, Active Guard/Reserve and Cadets.

Commissary Usage (By Active Duty, Grade)											
Number of Households											
Grade	E1-E3	E4-E6	E7-E9	W1-W3	W4-W5	O1-O3	O4-O5	O6	O7+	Other[1]	Total
Eligible	341,335	736,464	163,075	19,452	4,997	146,610	90,299	14,970	1,105	61,243	**1,579,550**
Shopped	222,686	633,345	139,307	16,976	4,166	127,759	77,367	12,687	1,020	27,348	**1,262,661**
Utilization	**65.2%**	**86.0%**	**85.4%**	**87.3%**	**83.4%**	**87.1%**	**85.7%**	**84.7%**	**92.3%**	**44.7%**	**79.9%**

[1] Other includes all unknown grades such as survivors and members on Transitional Assistance Management Program (TAMP). TAMP provides 180 days of benefits to eligible service members and their families who are separating from service. During this period, the Service Member holds the last known status (Active Duty); however, the member no longer holds a rank/grade and, therefore, is categorized as other. This is a process with members continuously entering and exiting the program.

Congressional Oversight: Numerous oversight and special Congressional hearings have been held since 1949 with respect to the existence, operation, and benefit of the commissary and exchange systems. Hearings held in 1953, 1957, 1970, 1972, and 1979, for example, all supported the conclusion that the Defense Resale Enterprise is a privilege that members of the armed forces and their families have come to expect and rely upon and that such personnel regard the system as an important benefit accruing to service membership. In 1972, a House Armed Services Committee special subcommittee on recruiting and retention came to the independent conclusion that commissary stores are a vital factor in the retention of military personnel and encourage enlistments.[14] The Defense Resale Enterprise is governed by title 10, United States Code, chapters 54, 147 and 651 as well as section 2643.

Defense Oversight: The Under Secretary of Defense for Personnel and Readiness oversees the operation of the commissary and exchange systems and provides policy guidance through Department of Defense Instruction (DoDI) 1330.17, *DoD Commissary Program*, DoDI 1330.09, *Armed Services Exchange Policy*, and DoDI 1330.21, *Armed Services Exchange Regulations*. In addition, several key governing bodies monitor commissary and exchange operations. These governance bodies include the Defense Business Council and the Deputy's Management Action Group, as well as the individual resale system boards of directors and the Executive Resale Board. The Military Services represent their members' interests, as well as their state of readiness, through all of these.

Prior Studies: Over the past 30 years, the Defense Resale Enterprise has been the subject of frequent studies seeking efficiencies, improvements or cost savings. Appendix C summarizes select studies from this period, focusing on those studies which recommended change or consolidation. Although these recommendations were rejected they informed the Department's work on the initiatives and actions discussed in this report.

Definitions: Several terms used within this report are defined below to ensure consistent interpretation or understanding.

[14] Military Compensation Background Papers, 7th ed., November 2011.

Defense Resale Enterprise: The Defense Resale Enterprise is comprised of the DeCA, the AAFES, the NEX, and the MCX. NEX is managed by the Navy Exchange Service Command (NEXCOM) and MCX is managed and operated by the Business and Support Services Division, HQMC. The Defense Resale Enterprise is also referred to as an ecosystem because of the synergies and interrelationships between the different components.

The foundations for this ecosystem are the main commissary and exchange stores. Additionally, the exchange systems also operate thousands of smaller retail outlets, providing a wide range of services such as convenience stores, gas stations, barber and beauty shops, florists, optical shops, auto repair, car washes, vending, residential services, lunches for military schools, financial services, repair/installation services, rental services, food operations, theaters, credit programs, bottled water plants, and bakeries.[15] Over time, exchanges have also assumed responsibility for military uniform stores, book stores, package/class six stores, and personal phone and telecommunication services for service members around the world.[16] Exchanges also support small retail outlets on Navy ships and tactical field exchanges, provide services through embedded Marines in combat zones, and, when called upon, assist with disaster recovery and other emergency response missions.[17] In addition, NEXCOM operates the Navy's permanent change of station housing solution (Navy Lodges) and its uniform research, design and distribution program, sharing across the enterprise a common IT infrastructure, staff support and other resources. Similarly, the MCX shares support staff and other resources with the Marine Corps' MWR; Warfighter and Family Services; and Child, Youth and Teen programs. The exchanges also provide an e-commerce option through their online shopping websites for eligible patrons.

Exchange System: When used in this report, this term refers collectively to the three military exchanges (AAFES, NEX, and MCX) as a single unit.

Budget Neutrality: While at least two meanings are found within the context of the President's budget, the Department interprets "budget neutrality," as used in section 651 of the NDAA for FY2016 in requiring this report, to mean that, in a given year, the Defense budget request will not seek Congress' appropriation of funds directly to the Defense Resale Enterprise. This includes the subsidy for DeCA's operating expenses (see title 10, United States Code, section 2483) and appropriations to cover SDT costs (for shipping familiar goods to overseas and remote locations) for the Defense Resale Enterprise as a whole (in accordance with title 10, United States Code, section 2643) and to cover utility costs for the exchange system overseas and at remote and isolated locations.

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[15] Armed Services Exchange Regulations, DoDI 1330.21 (2005), Enclosure 3, 13-14.
[16] Ibid.
[17] Report of the Military Compensation and Retirement Modernization Commission, Final Report, January 2015, 141.

Outsourcing: The transfer of a support function, traditionally performed by an in-house organization to an outside service provider. Outsourcing occurs in both the public and private sectors. While the outsourcing firm or government organization continues to provide appropriate oversight, the vendor is typically granted extensive flexibility regarding how the work is performed. In successful outsourcing arrangements, the vendor utilized new technologies and business practices to improve service delivery and/or reduce support costs. Vendors are usually selected as a result of a competition among qualified bidders.[18]

Privatization: A subset of outsourcing which applies only to the public sector. Privatization actions may involve not only the contracting out of support functions, but also the transfer of facilities, equipment, and other government assets to private (i.e., non-Government) vendors. Government organizations often outsource support functions without privatizing public assets.[19]

Discount Savings Agreement: The provision of agreed-upon levels of savings to all eligible or authorized patrons based on contractual agreement with one or more private sector businesses that have stores within a given proximity of one or more military installations. This agreement presumes the Department's closure of affected commissaries and/or exchanges, or of one or more of the commissary and/or exchange systems.

Catalysts for New Assessment: There are several drivers for once again assessing the Department's approach for the Defense Resale Enterprise.

First, the Budget Control Act of 2011 established a new and challenging fiscal environment for the Department by placing binding limits or "caps" on annual appropriations bills covering discretionary programs, including defense, beginning in 2013. DoD's projected reductions through 2021 of $547 billion over ten years required the Department to examine every part of its budget and make difficult funding trade-offs. The Department's initial proposal included a $1 billion (or 71 percent) cut to the annual DeCA budget phased in over the course of the FYDP. While Congress disagreed with the Department's position, rejected legislative proposals, and restored DeCA's funding, the new fiscal environment continues to drive a need for greater efficiency in all parts of the defense budget.

Second, the Military Compensation and Retirement Modernization Committee (MCRMC) was established, as required by subtitle H of the NDAA for FY2013, to conduct a review of the military compensation and retirement systems (including the military exchanges and commissaries) and to make recommendations on their modernization. The commission's final report, released in January 2015, recommended the creation of a single Defense Resale Activity (DeRA), new efficiencies in back-office operations and support functions of the commissaries

[18] Defense Science Board, "Report of the Defense Science Board Task Force on Outsourcing and Privatization,," August 1996, 21
[19] Defense Science Board, "Report of the Defense Science Board Task Force on Outsourcing and Privatization,," August 1996, 21

and exchanges, and statutory changes to enable the commissaries and exchanges to achieve needed efficiencies. An independent review, directed by section 634 of the Carl Levin and Howard P. "Buck" McKeon NDAA for FY2015, augmented with a Departmental objective to assess consolidation, and conducted by the Boston Consulting Group (BCG), arrived at similar recommendations. The Department supported the recommendations to look for efficiencies in back-office operations and support functions and for new statutory flexibilities, but did not agree that consolidating the four separate systems would preserve or enhance the benefits for the Service members and improve cost-effectiveness without disrupting the current command structures and operational integration of the exchanges within their respective military services.

Third, section 651 of the NDAA for FY2016 authorized the Department to establish pilot programs in the commissaries and exchanges, including pilots under which commissary prices would be established in response to market conditions, with the objective of achieving budget neutrality by October 2018 without a reduction in existing benefits to commissary patrons. This new objective puts significant pressure on the Defense Resale Enterprise to rapidly assess and adjust its operating and labor models, if appropriate and justified by return on investment; define business optimizations and potential collaborative solutions to further efficiencies and savings toward budget neutrality; and weigh entering into wholesale competition with the private sector, all while maintaining the strong relationships it has with its industry partners.

These external catalysts, coupled with the review of past studies (see Appendix C) on the Defense Resale Enterprise and current commercial retail environmental factors, have created a combination of conditions that makes a reexamination of the Defense Resale Enterprise extremely timely, with the potential for positive change.

PLAN TO OPTIMIZE DEFENSE RESALE

Leveraging the work done by the MCRMC and the independent evaluation conducted by the BCG (pursuant to section 634 of the Carl Levin and Howard P. "Buck" McKeon NDAA for FY2015) in their "Military Resale Study" of July 2015, the Department is developing a plan to identify and analyze initiatives, when supported by solid business cases, that will optimize the way the collective Defense Resale Enterprise delivers goods and services to its patrons.

These initiatives include: the establishment of a new Defense Resale Business Optimization Board (DRBOB) to drive optimization measures; the establishment of consistent business practices across the Defense Resale Enterprise; the implementation of flexible pricing in the defense commissaries, beginning with pilot programs authorized by the NDAA for FY2016; the introduction of private label products in the commissaries; the improvement of commissary store operations; and the conversion of the commissary system to a nonappropriated fund (NAF) entity. The Department recognizes that making the pilot program permanent and converting the commissary system to NAF funding would require new legislation. Each of these initiatives is described in greater detail in Section 1 below.

Section 651 of the NDAA for FY2016 directs the Department to develop a comprehensive plan to achieve budget neutrality in the delivery of commissary and exchange benefits by October 1, 2018, without a reduction in savings to commissary patrons or other benefits provided by the commissary and exchange systems. On the basis of estimates included in the BCG and MCRMC reports, the Department has concluded that the initiatives planned by the Department should be able to achieve APF reductions of at least $300 million per year beginning in FY2019, and roughly $2.0 billion over a five-year period, without a reduction in patron savings, MWR dividends, or customer service. On that basis, these initiatives have been included in the Future Years Defense Program (FYDP). Of course, the actual savings achieved may vary depending on the nature, scope, timing, and outcomes of the specific initiatives undertaken. The Department's decisions to move forward with an individual initiative, savings forecasted, and initiative outcomes, including savings generated, will be grounded in and documented by a detailed business case analysis.

The anticipated FY2019 savings would fall $1.5 billion short of the savings required to produce budget neutrality, which would require the elimination of both the commissary subsidy of $1.4 billion and the $0.4 billion in APF received by the military exchanges.

The Department examined alternative approaches, including privatization of the commissary system and the use of discount savings agreements with local grocery stores, to achieving an additional $1.5 billion in savings by October 1, 2018. As described in Section 1 below, the Department does not believe that either approach could replicate the range of benefits, level of savings, and geographic reach provided by the Defense commissary system and achieve budget neutrality. Despite this, the Department is continuing its investigation of full or partial privatization based on private sector interest and on the possibility that it may reduce the requirement for APF support.

For these reasons, the Department concludes that it would not be possible to make the Defense Resale Enterprise budget neutral by October 1, 2018, without drastically increasing commissary prices and closing commissary stores. Either action would significantly reduce the benefit available to commissary patrons, and would adversely impact the customer base of the military exchange system, reducing the availability of dividends for morale, welfare, and recreation activities as well. It would also require dramatic reductions in the commissary and exchange workforce, which is made up, in large part, of military family members.

The extent of store closures or price increase that would be required to achieve budget neutrality is assessed in Section 2, below. The Department does not recommend such drastic changes in the commissary benefit and would not implement them unless required by law.

Section 3 below discusses the measurement of patron benefits, and Section 4 discusses certain other factors considered by the Department in developing its Defense resale optimization plan.

SECTION 1: DOD INITIATIVES

On the basis of the MCRMC report, the BCG recommendations, and the direction provided in the NDAA for FY2016, the Department proposes to undertake the following initiatives to improve the efficiency of the defense resale system and drive savings in appropriated funds without a reduction in benefits:

Defense Resale Business Optimization Board (DRBOB): One of the first steps the Department took as part of its effort to preserve the benefit, maintain MWR contribution levels, and reduce the overall burden on the taxpayer was to establish a body solely focused on optimizing operations within and among the commissary and exchange systems. The DRBOB is tasked to identify optimization opportunities, collect data, model performance, perform risk assessments, and conduct business case analyses in support of ensuring the continuity of contributions to MWR programs and sustaining the commissary and exchange system benefit for all authorized patrons while reducing the level of APF support to the Defense Resale Enterprise.

The DRBOB is the successor to the Cooperative Efforts Board (CEB). The CEB was originally established in 2000 as a strategic planning and action committee to develop proposals to improve the efficiency and effectiveness across the exchange systems. The Board was expanded to include DeCA in 2009. Although a significant number of savings and revenue-generating opportunities were implemented as a result of the CEB's work, the DRBOB was created to increase visibility of these efforts and to formalize the identification, planning, and execution cycle of endeavors across the entire Defense Resale Enterprise. The DRBOB will work with the individual resale corporate boards, the Executive Resale Board, the Defense Business Council, and the Deputy's Management Action Group to advance its agenda.

The DRBOB will pursue operational efficiencies, optimize and promote collaborative solutions and consistent business practices based on sound business cases, and garner savings wherever practicable, all while delivering patron benefits at levels equal to or better than currently provided. The DRBOB has the authority to recommend process improvements across the resale enterprise, solidifying and unifying the ecosystem. It is this body that will develop the comprehensive plan based on sound business analysis and realistic goals.

DRBOB will work to share and capitalize on best practices, technology solutions, and labor management expertise to enable the commissary to operate on a more business-like platform, consistent with the exchange systems. These optimizations will make it possible for the entire ecosystem to leverage best business practices and gain potential efficiencies in some common functional areas. The DRBOB will also be the Department's mechanism for identifying, analyzing, and proposing any pilots (either through existing governance or directly, if within DRBOB members' authorities) for the Secretary pursuant to the authority of section 651(e)(1) of the NDAA for FY2016, and for planning, guiding implementation, and reviewing results of such pilots.

Establishment of Consistent Business Practices: The concept upon which the DRBOB was founded is the idea of capitalizing on efficiencies that result from a more cohesive, coherent approach to Defense resale business operations. A significant portion of the Department's plan to optimize the Defense Resale Enterprise is based upon leveraging the best of breed elements that one or more of the systems might share.

Expansion of collaborative solutions to achieve efficiencies and savings among the exchanges and—to the extent currently authorized and rational— the commissary system will further optimize the Defense Resale Enterprise.

In particular, back-office services, such as finance and accounting, could be further optimized through the convergence to common information technologies, joint procurement and logistics, and cooperative operations supporting processes (such as NAF human resources and pricing) based on solid business cases.

The MCRMC report recommended a consolidated Defense Resale Enterprise, encompassing the exchange and commissary systems under a single organization, the DeRA. Under this single organization, back-office operations and support functions would be treated as shared services. Based on the information it had, the study found that doing so would help sustain benefits and assist in reducing the APF subsidy, as well as provide a more flexible and cooperative organization with fewer overlaps and redundancies.[20]

Similarly, the BCG recommended a consolidation of the entire Defense Resale Enterprise that included a merger of back-office functions to form a shared services business unit as the

[20] Report of the Military Compensation and Retirement Modernization Commission, Final Report, January 2015, 149. Previous studies made similar recommendations. Following the merger of the four separate service commissary operations into DeCA, Defense officials examined a shared services model which was thought to be a more prudent approach than the consolidation of the exchanges. Although reports from the second Jones Commission, Logistics Management Institute, Government Accountability Office (GAO), and SRA International backed full integration, the department decided that the risks, challenges, and costs involved with a consolidation of the exchanges were deemed to meaningfully outweigh the benefits. The Unified Exchange Task Force recommended a shared services business unit (SSBU) for the exchanges to use common functional areas to reduce cost and leverage information, as well as core businesses to be more competitive, focus on customer value creation, improve operating effectiveness, and improve management of the portfolio, but after careful consideration the Department again rejected the recommendation.

foundation for the first implementation stage. It also suggested that an exchange shared services business unit could be leveraged during a NAF conversion for DeCA.[21]

The Department did not agree that consolidating the four separate entities would preserve or enhance the benefits for the service members and improve cost-effectiveness without disrupting the current command structures and operational integration of the exchanges within their respective military services. However, the Department believes that benefits identified by MCRMC and BCG could still be achieved by consolidating back-office systems and processes without the need for merger or consolidation of the commissary and exchange systems. The DRBOB has been directed to move forward with appropriate business case analyses as necessary predicates to decisions with regard to the merger or consolidation of back-office systems and processes.

The Department expects the DRBOB to pursue other business opportunities and efficiencies as well. For example, one effort that spans the Defense Resale Enterprise is the expansion of the Exchange Credit Program to the commissary system. The MILITARY STAR credit card is offered by the Exchange Credit Program, which was formally established by Congress in 1979 as a mechanism to protect service members from predatory lending practices.[22] The card features no annual fees, no late or over-limit fees, and competitive interest rates to assist members with safely building credit while increasing their purchasing power. System-wide benefits of the program include the United States Government's avoidance of merchant fees associated with the retail processing of other credit cards, and the fact that earnings accrued by the Exchange Credit Program are passed back to the military community as dividend contributions to MWR and quality of life programs.[23] While this action alone would not have a direct effect on reducing the commissary system's APF requirements, it would continue to promote responsible credit use, strengthen the Defense Resale Enterprise, and expand the system-wide benefits cited earlier. However, if the commissary or exchange systems receive revenue from credit program earnings and leverage legislative flexibilities to apply its share to the payment of operating expenses (rather than to contributions to MWR and quality of life programs), then this effort could reduce the APF requirements.

Cooperative efforts among the three exchange systems are also expected to continue and increase as more efficiency opportunities are identified. Expansion of the exchange systems' online retail channel to all honorably discharged veterans is another system modification that has the potential to enhance the benefit provided by the Defense Resale Enterprise. By extending this privilege to the nearly 18 million living veterans who have contributed to the defense of our nation, the exchange systems will continue to honor their service while enhancing the quality of life benefits of our current service members and their families. Revenues from online sales would contribute to the earnings that go directly toward supporting MWR programs in support of the greater military community. Even with only modest adoption by the veteran community, the exchange system could realize meaningful additional annual dividend contributions. Expansion

[21] Boston Consulting Group, "Military Resale Study," July 10, 2015, 174.
[22] Exchange Credit Program. "MyECP: About ECP," myecp.com/HtmlPages/AE_AboutECP, (accessed December 14, 2015).
[23] Ibid.

of the online benefit is a low-risk, low-cost opportunity that requires no APF from the exchange system and can generate meaningful incremental sales and earnings for the entire military community.

Flexible Pricing: The Department plans to use the authority provided in section 651 of the NDAA for FY2016 to establish pilots providing the flexibility to set commissary prices in response to market conditions and customer demand, as long as the baseline level of savings to the customer is maintained. The DRBOB will play a key role in designing the different pricing constructs to be tested.

Current Pricing Strategies: Currently, the components of the Defense Resale Enterprise employ various pricing strategies based on their respective business models and legislative constraints (or enabling legislation). The exchange systems, which operate under fewer restrictions using a NAF business model, have dedicated pricing staffs that employ different approaches depending upon the product. For example, market-based pricing is used by AAFES for wine, beer, spirits, non-alcoholic beverages, all of which are price surveyed. For products under the exchanges' private label program, pricing is based on setting a target margin based on the competitive landscape. The exchanges are in some cases constrained by minimum advertised prices set by the vendor (e.g., Apple and its products). The Navy Exchange generally conducts pricing on a system-wide basis using competitive data collected from a variety of sources such as Nielsen and NPD, which results in price consistency across the system. This strategy ensures that military members—whose pay scale is independent of location—are not penalized for receiving orders to transfer to a high cost-of-living duty station. The MCX overall pricing strategy ensures that the buyers consider not only retail pricing at competitors outside the gate, but also the critically important value proposition to all authorized patrons. The MCX also conducts local competitive shops on key consumables categories and institutes regionally synchronized pricing strategies, where possible.

The commissary system, on the other hand, must operate using a cost-plus a five percent surcharge as established by title 10, United States Code, section 2484, but which is inconsistent with a free-market economy. While this model is straightforward and allows DeCA to provide discounted groceries to service members, it also constrains DeCA from operating like its commercial counterparts. This strategy means that DeCA effectively suffers a net loss on each transaction because there is no margin generated to apply to operating expenses that incrementally accrue with each item sold. Consequently, under this model, higher sales volume necessitates a larger APF subsidy. The commercial grocery sector, on the other hand, generally sets prices based on various factors including consumer willingness to pay, competitive intensity, and category roles.[24]

The Department will continue to use the pricing strategies employed by the exchange systems, but must expand its marketing mix practices and processes with respect to pricing, product features and positioning, channel decisions, and promotion to the commissary system to take advantage of proposed legislative flexibilities that could allow DeCA to explore alternate pricing models and operate more like commercial grocers.

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[24] Boston Consulting Group, "Military Resale Study," July 10, 2015, 22.

Flexible Pricing Pilots: Pursuant to the authority of section 651 of the NDAA for FY2016, the Department anticipates conducting two variable pricing pilot programs within DeCA as an exception to the requirement of title 10, United States Code, section 2484(e) that goods sold in the commissary be priced to "…recoup the actual product cost of the item."

Flexible pricing, a strategy in which the price of a good or service may vary based on region, sales location, date, or other factors, is the framework used by commercial grocers. By setting prices independently of cost, prices can be adjusted to achieve optimal balances between sales volume and income per unit sold. This alternative strategy should enable DeCA to achieve a reduction in APF requirements by creating a profit (or reduced loss) margin on its sales.

As it begins to create an improved margin, DeCA will work to maintain a consistent market basket discount in each region and will not jeopardize the overall benefit currently provided to patrons. Rather, DeCA will seek to expand margins by:

- Negotiating improved product costs from suppliers (i.e., lowering the current cost of goods sold (COGS));[25] and

- Introducing quality private label products,[26] which have a higher gross margin and lower retail price, providing savings both to DeCA and to DeCA patrons.

In order to assess DeCA's ability to expand margins without changing the overall benefit provided to patrons, the Department, through the DRBOB, plans to conduct two simultaneous variable-pricing pilots: 1) a **Category-Based Pilot**, in which the commissaries will hold prices constant in one or more categories of goods while reducing product costs to create a margin and reduce APF requirements; and 2) a **Store-Based Pilot**, in which we will adjust product prices up or down within a store while maintaining a consistent overall savings, based on market basket measurement. The intent of both pilots is to maintain the current level of savings provided to patrons today. Other than the normal market based price fluctuations, the category-based pilot is

[25] Because DeCA is required to set prices at cost-plus five percent, all products generate the same five percent margin. Cost-plus pricing currently prevents DeCA from fully capturing the margin benefits from reducing COGS. Under cost-plus pricing, any reduction in DeCA's COGS would have to be passed directly to the patron. Reducing COGS would actually reduce the surcharge collected because DeCA's prices would be lower. As a result, reducing COGS would not lessen APF needs, but rather increase them. Boston Consulting Group, "Military Resale Study," July 10, 2015, 90. Thus, while managing COGS is a key driver of profitability for private sector grocers, this practice is currently largely irrelevant for DeCA. Boston Consulting Group, "Military Resale Study," July 10, 2015, 36.

[26] By obtaining the authority to apply variable pricing, DeCA would be able to implement private label within their stores. Virtually all private sector grocers offer private label (or store brand) products that are priced lower than national brands but often offer equivalent quality. Private label typically provides grocers with a much higher margin for the retailer (often as high as 40-50 percent margin in some categories). With variable pricing, DeCA could set the price for such products in a manner that preserves or enhances the patron benefit while creating a margin and thus improving their bottom line. Private label now makes up roughly 19 percent of all grocery sales in the US private sector, and commissary patrons have expressed willingness to consider private label products in commissaries for many categories. Boston Consulting Group, "Military Resale Study," July 10, 2015, 10.

not meant to raise or lower current prices in commissaries. The store-based test will entail the adjustment up or down of prices on individual products to achieve a level of savings on all items in the commissary when compared to local competitors.

Category-Based Pilot: In the category-based pilot, DeCA will choose a subset of categories and begin the process for improving existing product cost. DeCA will identify a subset of its existing categories with potential for improving product cost, and then begin negotiating for the lower cost with suppliers and introducing private label products. Once the lower product cost has been negotiated, those lower cost goods would be distributed throughout DeCA stores enterprise wide. To demonstrate the margin expansion potential, DeCA would hold current prices constant on the products for which lower COGS have been negotiated.

Because of the large number of categories involved, it is impractical to conduct all COGS negotiations prior to the commencement of the pilot. Consequently, DeCA will commence negotiations with those categories selected based upon their potential for COGS savings as well as ease of execution. The overall COGS opportunity will be driven by size of the category and early category analysis, however, supply chain considerations and anticipated negotiation challenges could become priority selection factors. DeCA will negotiate the other categories in subsequent waves. It is estimated a three-month period will be required to complete the rollout of each wave. The rollout of all categories is expected to be completed within 18 months; however, an initial analysis as to the success of the pilot should be available within six to nine months.

The category-based pilot will also require DeCA to institute a number of other business model improvements. First, it will require DeCA to conduct a category optimization exercise to define the new assortment for the category and identify those brands considered as likely candidates for COGS negotiations. Second, in determining the anticipated assortment, DeCA will reserve shelf space for the introduction of private label products into the category assortment. It should be noted that while variable pricing is a condition precedent to the economically-viable introduction of a private label, DeCA already has the legislative authority (title 10, United States Code, section 2484(f)) to deploy a private label. In other words, it is variable pricing that makes a private label offering attractive from a revenue generation perspective.

It is important to note that testing the potential for lowered product cost must be done by orienting around an entire category. Orienting around categories will enable DeCA to leverage its full volume in negotiations and/or in launching private label products. It would not be possible to test lower cost of goods in a subset of stores as there would not be negotiating leverage for DeCA unless it is entering discussions with suppliers on the full volume of a product.

The category-based pilot is expected to allow DeCA to begin generating revenue to be applied against the APF subsidy rapidly. The metrics for success will be maintained savings levels and increased margins, which will be tracked by store and category.

As a subset of the category-based pilot, DeCA intends to evaluate the potential for bringing vendor stocking in-house using nonappropriated fund employees. This pilot subset will be limited to several stores. The measure of success for this subset will be in-stock status and sales impact against similar control commissaries.

Store-Based Pilot: The store-based pilot will focus on changing price levels of categories and items in a handful of sample markets to create a margin and reduce APF needs while maintaining competitive prices and the overall savings level. This will enable DeCA to account for product affinities (i.e., product purchasing patterns, linkages, and cross-sell opportunities in order to increase sales and revenues) and basket impacts of price changes when evaluating the tests. Meanwhile, moving towards a more consistent discount across categories could improve overall price perception, leading to increases in store traffic / sales and the associated product margin.

In the store-based pilot, DeCA will identify a limited number of stores that vary in size, demographics, and geography. Ideally, each pilot store should be at least 2 hours away from another commissary to limit cross-shopping during the pilot.

In this pilot, DeCA will adjust prices to provide a more consistent discount (e.g., increase one product or category by five percent above current prices, but decrease a different product or category five percent below current prices) and ensure the net impact balances to a basket neutral position. At the same time, the assortment and COGS negotiation changes from the category tests will impact these stores, increasing margin.

If DeCA validates that it can adjust product prices up / down while maintaining basket discount, this pilot will be expanded to other stores in a phased approach until all stores enterprise-wide are included.

Success will be measured against the goals of maintaining basket savings while improving traffic, same store sales, and patron price perception (e.g., Customer Care, Service, and Support scores).

Overall, the category and store-based pilots will enable DeCA to gain full insight into variable pricing, including generating revenue to offset appropriated requirements and to learn more about patron sensitivity to pricing. All of these efforts will support the broader transformation and enable DeCA to achieve its long-term goals of a reduction in appropriations and maintenance of the benefit. DRBOB will also assess secondary and tertiary impacts of these pilots on the broader resale enterprise.

The full realization of these goals will require that the flexible pricing authority provided on a pilot basis by the NDAA for FY2016 be made permanent. The Department has made a legislative proposal that would provide such permanent authority.

Privatization: Since the 1920s, commissary system privatization has been a topic of discussion and debate (i.e., questioning why the military is involved in the grocery business) that seems to resurface based on prevailing economic climate and political sentiment.

There are likely infinite permutations for wholly or partially contracting the commissary system to the private sector, all, some, or none of which may yield results that are deemed positive in terms of taxpayer burden. While the Department works through the possibilities in search of the right answer for both beneficiaries and taxpayers, it is important to note that the Department does have experience with privatization.

First, throughout its history, DeCA has examined opportunities to reduce both unit costs and total cost of operations through the competitive outsourcing of specialized commissary sections, such as delicatessens and bakeries.[27] Recent additions of sushi bars in stores (through contract) have expanded commissaries' reach and appeal particularly to younger generations that favor the grocerant concept (i.e., selling ready-to-eat and heat-n-eat fresh prepared food) and fresher, healthier options. Additionally, since its formation in the 1990s, DeCA has privatized its distribution system, relying on a commercial system of brokers and distributors to supply its stores. It contracts at least 30 percent of its store-based operations, including the functions of receiving, storage, shelf-stocking, and custodial duties. Even those who perform the bagging function at the checkouts are self-employed contractors.[28]

Second, the Army conducted an Office of Management and Budget (OMB) Circular A-76 study during 1983-1984 at the commissaries at Yuma Proving Ground, Arizona, and at Fort Leonard Wood, Missouri, to determine if private contractors could run the stores more cost effectively than the Department. A contract went into effect on 1 December 1983 at Yuma Proving Ground for the operation of the front end, grocery, meat, produce, and warehouse functions. The contract ended unsuccessfully just ten months later when the contractor admitted it could not provide everything requested and could not meet the standards required by the contract. This test was considered to be proof at the time that some portions of the commissary could not be contracted out.[29] The Fort Leonard Wood contract never went into effect because the bids exceeded the costs of running the store in-house.

The conclusion generally reached by the past debates and studies was that privatization (more broadly than sections within individual stores) was not an effective method of reducing the Department's budget for several reasons. Nonetheless, the debate continues.

The Case for Status Quo: DeCA provides a benefit to members of the uniformed services in the form of savings, proximity, and consistency that the traditionally low-margin commercial grocery sector, which must operate for profit, might find it difficult to sustain. The benefit provided by the commissaries encourages people to reenlist, thereby preserving a well-trained, dedicated military; ensuring training investments are well-spent; and saving the expense of retraining the majority of the force every few years. More importantly, the savings,

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[27] Dr Peter D. Skirbunt and Kevin L. Robinson, The Illustrated History of American Military Commissaries, Vol. 2, (US Government Printing Office, 2008), 472

[28] Resale and MWR Center for Research, "Costs and Benefits of the Department of Defense Resale System," December 2012, 68

[29] Dr Peter D. Skirbunt and Kevin L. Robinson, The Illustrated History of American Military Commissaries, Vol. 1, (US Government Printing Office, 2008), 339-340

proximity, and consistency of the commissaries encourage spouses, whose opinions may be a deciding factor in reenlistment decisions.[30]

DeCA is required to operate where the service members are, even when it would not be economically beneficial from a commercial standpoint. More than two-thirds of the commissaries serve military populations living in locations that are not profitable for private sector grocers; these commissaries are made possible (for DeCA) by the appropriated fund subsidy and by operating efficiencies and volumes of the large stateside stores. Over 40 percent of DeCA's appropriated budget provides commissary service in overseas and remote locations.

The economic case for privatization may be strongest in the case of larger, more profitable, stateside stores. However, if only some of the commissary stores were privatized, a substantial APF subsidy would still be required to service the military mission and authorized patrons in those remote and overseas areas. Additionally, if not all stores were privatized, the savings at remaining stores would decrease due to DeCA's reduced buying power. For example, without the US operations, the reduced volume of goods purchased (from $5.5 billion to less than $1 billion) would result in DeCA doing business with wholesalers instead of directly with the manufacturers as today. This change would cause a 20 percent increase in the price of goods to commissary patrons. DeCA's operating costs would also increase, as industry store level support for such items as merchandising and shelf stocking would be lost. This would increase DeCA's store level costs by five percent of sales. Other drawbacks to operating commissaries only overseas could result in the loss of employment income for military families (36.6 percent of DeCA employees are military spouses or other family members); necessitate the termination of over $220 million in service and supply contracts, including many with small business and AbilityOne (as administered by non-profit agencies, SourceAmerica (SA) and the National Industries for the Blind (NIB)); and the loss of ancillary industry support, valued at almost $250 million annually.

The Case for Change: Pursuant to section 651 of the NDAA for FY2016, the Department has reached out to relevant private sector entities to gauge interest in taking on the privatization of the defense commissaries.

The Department contacted the chief executive officers of 10 major private-sector grocery chains, distributors, and retailers to determine their willingness to discuss both privatization and discount savings. Four companies agreed to preliminary discussions, during which their management teams all expressed interest and corporate ability to manage and/or operate all or parts of the commissary system. One of the four declined further discussion after the initial contact; however, the other three affirmed their interest in pursuing the matter in greater depth.

During February and March 2016, the Department engaged with the three companies using a standardized set of questions to gauge interest and willingness to participate (see Appendix D). Although privatization of the exchanges was mentioned, the focus of the engagement was on opportunities for the commissary system primarily due to the need to address budget neutrality

[30] Dr Peter D. Skirbunt and Kevin L. Robinson, The Illustrated History of American Military Commissaries, Vol. 2, (US Government Printing Office, 2008), 523

and secondarily to the expertise of the three companies (i.e., grocery retail management, operations, and supply chain). Each of the companies also indicated a willingness to provide eligible beneficiaries with a discount savings program, although specific savings percentages were not discussed.

Each entity emphasized its commitment to the military and an understanding of the need to operate in locations where the troops are, particularly remote and overseas locations. Continued support of the military was a common theme of conversation - some of the ways that they currently provide support is through military distribution operations and the preferential hiring of veterans and family members.

Each of the three commercial entities had a different vision of privatization. One proposed taking on management and store operations in support of only those locations proximate to their own existing grocery stores. While it already preferentially hires veterans and military family members, its executives were less interested in absorbing the whole of a commissary's workforce (in the case of closure), would hire individually if there were local vacancies, and would probably not welcome unionization. Another said it would leverage its existing distribution network and partnerships, but would likely continue the use of the on-base commissaries, including their workforces, if a reasonable leasing agreement could be arranged as part of a privatization contract. All of the companies articulated interest in supporting both US based and international commissaries. And, two were clearly interested in being the sole distributor for all of the commissary system worldwide. Each company demonstrated flexibility in its operating model that will allow it to adapt to market fluctuations such as deployments, base realignments and closures, and development of new missions and locations.

From these conversations, the Department confirmed, among other things, that:

1. Privatization is in fact not an all-or-nothing proposition. Substantive wedges of functionality, management, or operations could be carved out of the whole to increase efficiency and effectiveness and to possibly achieve savings in APF.
2. The companies that might be interested in supporting privatization are not of a single sector, size, or reach. In order to privatize as much as possible, the Department would need definitive scope, requirements, benchmarks, and performance standards in its contracts to ensure continued savings, proximity, and consistency across the providers and across the system.
3. These companies each offered other capabilities, such as loyalty programs and analytics, that are nascent or not of much use (given the legislated operating model) in the Defense commissary system. In a less constrained business model, these capabilities drive up revenues and customer satisfaction.
4. There are many costs that these companies would incur in providing the Department's commissary system (or aspects thereof) that are not currently borne by the Department but which must be factored into the equation; some of these are insurance (e.g., property, liability) and taxes (i.e., federal, state, and local corporate taxes).
5. These companies expressed concern with the constraints inherent in government contracting and in the legislation that governs the Defense Resale Enterprise that serve as barriers to doing business more efficiently in the operation of the commissaries.

6. Continued dialogue with these companies and others is necessary to fully assess how and what to privatize, the earnestness of the companies, and the likelihood of delivering 30 percent savings in an industry that routinely averages 25-28 percent gross margins. Compounding that likelihood will be whether these companies can garner board and stockholder support for taking on any or all of the commissary system without some subsidy from the Government.

To the last point, the Department is continuing its due diligence on privatization through the pending publication of a request for information from industry. The request for information will break down the commissary system by organization, function, and region, enabling respondents to identify which (if not all) they could corporately take on and under what conditions. The responses may in turn lead to the development of a focused privatization plan and one or more requests for proposal.

Beyond privatization, the three companies indicated that they would consider some form of a discount savings program (such as that currently offered voluntarily by Home Depot across the US) if the Defense commissary system was to be shuttered. It was noted however, that compelling price structures are already in place in the private sector that could be far below the national average and close to the commissary's price structure. They noted that a discount savings program would drive up patronage, which in turn might increase the need for subsidization.

As a final note, community support and outreach are common objectives for each of the three commercial entities with which the Department spoke. All indicated that they would extend their support to the military community, and promised to consider whether portions of military-based revenues might be returned to the Department as dividends in support of MWR and quality of life programs.

Conversion of the Commissary System to Nonappropriated Fund Entity: While increasing the commonality of the processes and technology and possibly achieving more cooperative initiatives with the exchange systems will produce some savings, it will not be practical for the commissaries to make use of such common processes and technologies as long as the Defense commissary system continues to be an appropriated fund entity. Because the laws governing APF and NAF require fundamentally different business processes, there will continue to be strict limits on the ability of the Defense Resale Enterprise to adopt common business systems and processes as long as these different funding models continue to apply. For this reason, the Department submitted a legislative proposal that would authorize the conversion of the commissary system to a NAF entity, if the alternative pricing strategy is successful.

It is important to note that there are a number of NAF implementation models that are under consideration. These models are not discussed in depth in this report and much is still to be learned about the pros and cons, costs and benefits of each. Nonetheless, the three predominant possibilities are to 1) fully operate the commissary system through a NAF instrumentality (NAFI) to the extent authorized by legislation; 2) transition only the APF workforce to NAF; and 3) contract with another Department NAFI to perform management, support, and operational functions.

Conversion could open the door to leveraging experience, expertise, processes, and technology across the Defense Resale Enterprise, since all of the individual systems could eventually use consistent (if not common) business practices, processes, and systems. DeCA could avail itself of hard-learned lessons and expertise from the exchange systems. Further, the entire Enterprise could share collaborative solutions for efficiencies and savings, as well as expertise to kick-start DeCA's implementation of merchandising, flexible pricing, and other elements of a more commercially-structured marketing mix including the launch of a managed or brokered private-label product line.

NAF conversion would also provide DeCA with the tools and latitude to reshape its workforce over time, bringing more work in-house and changing some of the chaotic contract labor processes that are driven in large part by the current pricing model. Additionally, DeCA would be able to take personnel actions more dynamically, make business-based decisions to adjust the size and composition of the workforce with consideration to market conditions, and offer performance-based pay.[31] The Department would take steps to ensure that no commissary employee would be reduced in pay as a result of the NAF conversion.

Adoption of common back-office systems and processes with the exchanges and workforce reshaping are not the only advantages of a NAF conversion for the DeCA. Acquisitions made with NAF funds would allow DeCA to purchase and contract in a more efficient manner, comparable to its private sector competitors, and increase the ability to share contracts among all the resale activities.

Another advantage is in financial control and management. DeCA's APF are held and managed by the United States Treasury via a working capital fund and a trust account (for collected surcharges), while the exchange systems, as NAF entities, operate more like commercial retailers on a cost-management basis outside of the Treasury. APF must be used for specific purposes and within established timeframes for budget execution while NAF are not subject to a similar requirement. Currently, the commissary system is not legally permitted to use any of its funds outside of the uses specified in title 10, United States Code, chapter 147, and appropriated fund law generally prohibits offsetting APF requirements by generating additional revenue. BCG concluded the cost savings levers that DeCA is able to pull will be limited as long as it continues to be an APF entity, and those levers -- such as reducing store hours-- are likely to have a negative impact on commissary patrons.

Other Initiatives: The Department believes that there are a number of other modifications to the current system which have the potential to generate overall system savings while simultaneously preserving patron benefits.

Through efforts to procure produce and other items from sources geographically closer to foreign store locations, the Department expects to save approximately $50 million annually. The commissary system receives annual APF to ship goods to commissary stores located outside of the United States. Prior to FY2016, DeCA shipped fresh fruits and vegetables to the Pacific

[31] Boston Consulting Group, "Military Resale Study," July 10, 2015, 48.

commissaries from the ports of San Francisco and Los Angeles, California, thereby incurring significant SDT charges. In early FY2016, DeCA implemented a practice of requiring vendors to deliver fresh produce to designated overseas central distribution centers or commissary locations. This change has aligned the Pacific commissaries with the practice currently used to support European commissaries.

An additional initiative already underway, aimed at reducing the burden on the taxpayer through a reduction on the necessity for appropriated funding, includes closures of commissary stores that were previously identified for closure as part of base realignments and closures. Thirteen stores were planned for closure prior to the February 2015. Of those, seven of the stores have already been closed.

A new source of revenue that could increase contributions to MWR and other quality of life programs is the expansion of the online shopping benefit to Honorable Discharged veterans. This initiative is currently designated as the Veterans Online Shopping Benefit (VOSB) and is being developed by the exchange system. This initiative is being spearheaded by DRBOB and requires a policy change with respect to the Department's patronage tables.

SECTION 2: ALTERNATIVE APPROACHES TO ACHIEVE BUDGET NEUTRALITY

The Department considered a number of alternative approaches to achieve the additional $1.5 billion in annual savings needed to achieve budget neutrality by October 1, 2018. These included across-the-board price increases and store closures. For the reasons described below, the Department has rejected these alternatives.

Commissary Closures and Price Increases: As required by section 651 of the NDAA for FY2016, the Department considered all alternative approaches to achieve budget neutrality by October 1, 2018, including store closures and price increases. Although DeCA has closed some commissary stores (seven stores in FY2015, with an additional six planned in FY2016-FY2017), these store closures were predominately due to base closure decisions, not efforts to achieve savings in the appropriated fund subsidy.

When considering the proximity of commissary stores to one another, DeCA has conducted multiple reviews of the commissary system for overlap over the last 20 years and, as a result, redundant stores have largely been eliminated. An example of this is the closure of the separate store on Pope Air Force Base, North Carolina, where the patron base was absorbed by the commissary at nearby Fort Bragg.[32] In their study, the BCG noted that there are only five commissaries (in the United States) within a 10 minute drive of another commissary store, so the opportunity for further proximity closures is small.[33]

Although closures would have a significant impact on the APF subsidy, there are numerous risks involved. Proximity closures of commissaries could cause patron volume levels to be driven too

[32] DeCA information paper, "Defense Commissary Agency (DeCA) FY16 Budget Reduction of $322M," 2015.
[33] Boston Consulting Group, "Military Resale Study," July 10, 2015, 217.

high for the neighboring commissaries to efficiently absorb. Unlike the commercial sector, commissaries are sized based upon the expected shopping population.[34] Additionally, the commissary system relies on an economic model that leverages volume of sales to drive product cost negotiation positions with the manufacturers and brokers. If enough stores close or are combined, this volume could be lost, subsequently driving up prices at the remaining commissaries. Nonetheless, annual re-evaluation of sales and patron density is expected to continue with data-driven closure decisions made wherever practicable.

Proximity to commercial alternatives is another factor when considering store closures across the Defense Resale Enterprise. In the case of Army and Air Force installations in the United States alone, all but two have a Walmart located within 15 miles[35] of the gate.[36] Closing commissaries stores in favor of commercial alternatives may substantially decrease the savings benefit to patrons. Even if proximity and convenience were not an issue, if forced to turn to commercial alternatives, cost increases would more than likely be incurred as there would be no guarantee of discount savings.

The commissary is a highly utilized benefit of service members. DeCA data shows that 80 percent of active duty members or their families use the commissary at least once annually, with the highest percentage of users utilizing the benefit two to three times per month.[37] Based on a monetization of the benefit conducted by DeCA that estimated the annual savings for every commissary household for active duty service members to be $1,501, the cost to the Department to compensate for the loss of the benefit would be $2.37 billion, significantly higher than the current APF subsidy.[38] Because active duty members account for only about half of all commissary users, this figure does not take into account retirees and their families. If the stores were to shutter that would deny those retirees and their families any benefit at all.

An additional factor that must be considered is the impact on cross traffic between the commissaries and exchange stores. The BCG report notes that roughly 20 percent of exchange store traffic is driven by the proximity to a commissary.[39] AAFES estimates that 20–30 percent of its foot traffic, representing at least $1 billion in sales, is attributable to traffic derived from being located near commissaries.[40] MCRMC findings demonstrate that patrons value the colocation of the exchanges and commissaries and do not have an interest in one store without the other nearby (see Figure 1).[41] If foot traffic at the exchanges were to experience even a 20

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[34] DeCA.

[35] While this is true with respect to the proximity of Walmarts to installations, it should be noted that DoDI 1330.17 uses 20 miles as the measure for determining the number of eligible patrons when establishing a new commissary.

[36] AAFES, "AAFES/WalMart – Major Locations, USA," (accessed December 10, 2015).

[37] Numbers based on DeCA's I.D. card scanning data

[38] Numbers based on 1.58 million military active duty households

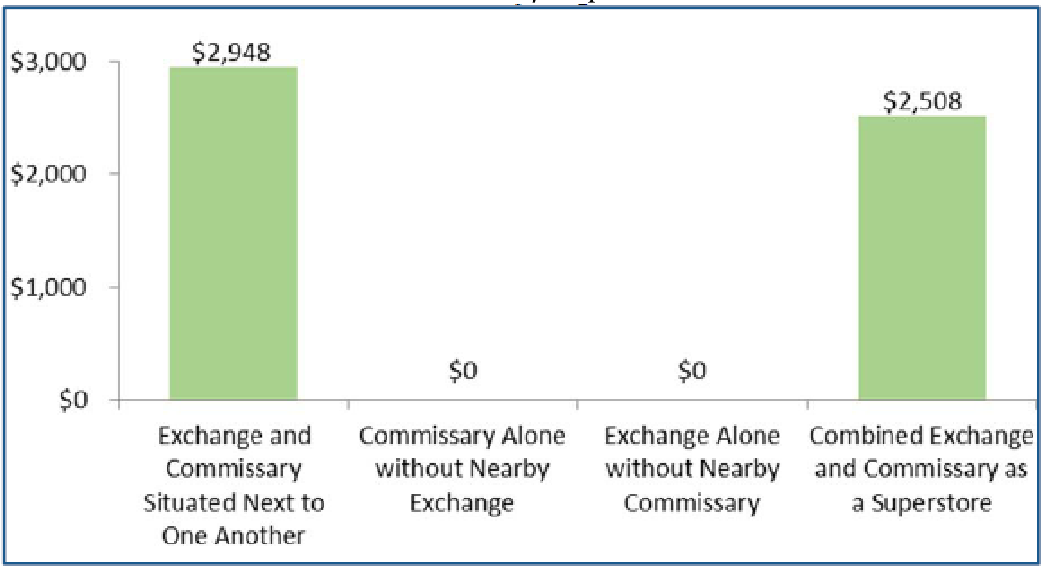
[39] Boston Consulting Group, "Military Resale Study," July 10, 2015, 109.

[40] Report of the Military Compensation and Retirement Modernization Commission, Final Report, January 2015, 142.

[41] Report of the Military Compensation and Retirement Modernization Commission, Final Report, January 2015, 145. Survey results, MCRMC survey, July 1, 2014 to October 10, 2014. This figure displays the average amount in dollars that survey respondents valued compensation alternatives. Presentation in dollar values allows the value of compensation features to be directly compared.

percent dip in foot traffic, with a corresponding reduction in sales, the direct result would be a massive decrease in dividends provided to MWR for important quality of life benefits.

Figure 1. Active-Duty Services Members' Perceived Value: Resale Benefit Options



The BCG findings recommended against store closures, stating, "Store closures or reductions in store operating hours would pose a risk, but we would not recommend closure of commissaries as the opportunity is small and poses definite risk to patron benefit."[42]

As stated above, the Department would need to achieve an additional $1.5 billion in savings, beyond those that could be achieved through efficiencies, to achieve budget neutrality by October 1, 2018. Based on DeCA's current global sales of $5.5 billion, a price increase of 27 percent, would be required to produce $1.5 billion in added revenue. However, that increase in prices assumes no reduction in current shopping habits, i.e., that all current commissary patrons would continue to purchase the same items they do today at a 27 percent price increase. As stated in the BCG report, higher prices are likely to result in significant decreases in purchases in the commissaries. BCG found:

"Similarly, our study shows patrons are sensitive to the idea of even small price increases. Respondents suggest that if prices increased even five percent, they would shop 25 percent fewer times per month …. while patrons are likely overstating their actual price sensitivity, it is a real risk. Therefore, we do not recommend any overall price increase at this time."[43]

With this sensitivity to price, a 25 percent price increase is anticipated to result in a 50 percent drop in units sold for a dollar sales loss of nearly $2.1 billion. If this estimate is correct, a further price increase of 50 percent would be required to cover the loss in sales. The downward spiral

[42] Boston Consulting Group, "Military Resale Study," July 10, 2015, 217.
[43] Boston Consulting Group, "Military Resale Study," July 10, 2015, 108

would continue with each additional increase in price until the commissary system prices itself out of existence or with loss in savings becomes only a convenience.

We have concluded that budget neutrality could not be reached through store closures unless the commissary system is shut down completely. Even if all commissaries in the United States were closed, leaving only the 63 stores operating in overseas areas (which includes the United States Territories of Guam and Puerto Rico), it is anticipated that an appropriation of $520 million would still be required for their operation. Sales would dip below $1 billion and would result in DeCA doing business with wholesalers instead of directly with the manufacturers as today. This loss of buying power and the need to purchase through a "middle man" would cause an estimated 20 percent increase in the price of goods to commissary patrons. DeCA's operating costs would also increase, as industry store level support for such items as merchandising and shelf stocking would be lost. This would increase DeCA's store level costs by five percent of sales. The direct annual operating costs for the commissary system overseas today is approximately $500 million.

Adopting either increased pricing or store closure options would likely also result in a drastic reduction in the customer base for the exchange system and a concurrent loss in MWR funding, and would be inconsistent with the NDAA requirement to maintain customer benefit at its current level. The Department does not recommend either option.

SECTION 3: MEASURING SUCCESS

The Defense Resale Enterprise exists as part of the compensation, retention and non-pay benefits package for those prepared to go in harm's way in service of our nation. The benefits created by the Defense Resale Enterprise—both immediate and tangible as well as broader and more intangible—are consistently recognized by service members, retirees and their families as among the most-valued noncash benefits of any earned through military service.

Section 651 of the NDAA for FY2016 requires that this report ensure: (1) the maintenance of high levels of customer satisfaction in the delivery of commissary and exchange benefits; (2) the provision of high quality products; and (3) the sustainment of discount savings to eligible beneficiaries. Recognizing the necessity for a yardstick to measure desirability or success of proposed or attempted changes, it further calls for "specific, measureable benchmarks" to assess adherence to these principles.

In considering specific, measureable metrics, it is helpful to understand that the scorecard metrics identified in the NDAA for FY2016 only consider part of the benefit created by military resale. There are additional obvious or quantifiable metrics that need be considered as well as task- or program-related benefits that are provided to patrons and/or the military by virtue of command structures and/or operations.

Scorecard Metrics: Some benefits are obvious and easily quantifiable. Several of these are comparable to metrics often used by the resale industry and are helpful in understanding how successful military resale is at conferring something of value on its patrons.

Perhaps the most obvious measure of benefit is whether the military resale patron can make their paycheck go further by saving money at the commissary or exchange. Cost (or discount) savings relative to outside retailers are of direct cash benefit to the patron, comparable to a meaningful pay raise. To measure the discount savings it provides, each component of the Defense Resale Enterprise regularly conducts price comparison surveys, in which its own prices are compared with those of outside competitors.

The three exchange systems all use a similar system, with a minimum 40 percent item commonality across exchanges. The survey is conducted by a common, industry-leading third-party provider. Pricing on several hundred items from varied product areas is compared to an identical item at nearby stores. Although the specific mix of products varies slightly from year to year, an identical basket of products is used for an exchange system and its competitors in any given survey.

The commissary likewise uses data from a third-party provider to conduct an exact Universal Product Code comparison of prices. The Defense Commissary Agency (DeCA) uses a comprehensive database of actual prices from commercial grocery stores and commissaries to ascertain savings for all scannable items sold at locations within the 48 contiguous states, except tobacco products (which are not included in DeCA's price comparison study). Within the United States, prices on over 38,000 items are compared. Prices for all major supermarket chains and certain supercenters are included in the scan data comparison. For non-scannable items (fresh meat and fresh produce) where it is not possible to use the database described above, a price comparison is obtained through a survey of the produce contract core items and mandatory meat items at a proportionate random sample of 30 commissaries compared to two outside retailers for each commissary location. For overseas locations, as well as Alaska and Hawaii, a physical audit of prices is conducted across a more limited sample that still covers a variety of areas.

Taxes for food and nonfood items are applied to all commercial retail sales prices while surcharge is applied to commissary prices. For scannable items, an average food and average nonfood sales tax rate for the states/district in CONUS where there are commissaries is used. For survey data, the actual state/country sales or value added tax is applied to applicable retail store prices. DeCA weights savings across seven major categories - meat, produce, dairy, grocery food, frozen food, grocery non-food and health and beauty care – based on a typical market basket of how patrons spend their money. DeCA's sales are also weighted by geographical areas which are then factored into the formula to arrive at a worldwide savings percentage**.**

These price comparison surveys are useful in measuring the benefit in two main ways. First, they provide a rough estimate of what a patron might expect to save. While every shopper is different, and varying product selections affect actual savings, the savings percentage expressed by the survey is a rough estimate of what patrons may expect to save in the aggregate. Second, because the surveys use a consistent, year-to-year methodology, they provide a benchmark of performance relative to competitors, regardless of whether the savings percentage is realized for each patron.

A new baseline survey methodology is being developed, with the assistance of the BCG, to measure patron savings which will allow a commissary-to-local competitor comparison of a market basket consisting of several hundred items and weighted based on sales. An actual in store price survey of the market basket items will be conducted quarterly. During the interim months, DeCA will monitor patron savings to ensure they remain on track, by using Universal Product Code data provided by a third party contractor, to prepare an aggregate overall savings trend analysis.

Customer Satisfaction Index: Customer satisfaction is not only a direct reflection of the overall success of the Defense Resale Enterprise but is an obvious and easily measureable indicator of whether the system is delivering a benefit to the patron. Low-quality products are rarely appreciated at any price, so customer satisfaction serves as an indirect measure of the difficult question whether the Defense Resale Enterprise is providing high-quality products as well. Further, customer satisfaction is valuable in determining the degree to which sales associate performance, stock and selection, décor, atmosphere and the many other aspects of the customer's shopping experience are creating a feeling that patrons' military service is appreciated and recognized by the military and by extension the nation.

The exchange system as well as the commissary system have engaged a respected outside research firm to conduct a common, yearly survey of customer satisfaction. The American Customer Satisfaction Index (ACSI) uses customer interviews as input to a multi-equation econometric model developed at the University of Michigan's Ross School of Business. The ACSI model is a cause-and-effect model with indices for drivers of satisfaction (customer expectations, perceived quality, and perceived value), for satisfaction itself, and for outcomes of satisfaction (customer complaints and customer loyalty, including customer retention and price tolerance). The indexes are multivariable components measured by several questions that are weighted within the model, to maximize the explanation of customer satisfaction on customer loyalty. Looking at the indexes and impacts, users can determine which drivers of satisfaction, if improved, would have the most effect on customer loyalty.

The ACSI results not only allow each component of the Defense Resale Enterprise to track its performance—its success at delivering the benefit—year over year, but allow for them to make a direct comparison of the overall shopping experience they create relative to outside competitors.

The Defense Commissary Agency also conducts an internal Commissary Customer Satisfaction Survey (CCSS) annually. The CCSS is conducted for 10 consecutive days at all commissaries during the summer of each year. For most locations, survey data is collected electronically using tablets that transmit data directly to a central location for processing. Paper survey forms are used as an alternative at locations where internet connectivity is not reliable. Surveys are administered during morning, midday and evening hours. The surveys ask patrons to rate their commissary's performance in 14 areas on a scale of one to five, with one being very poor, and five being very good. The areas surveyed are: low prices/overall savings; well stocked, full shelves; convenient hours; entrance/sales area/restrooms cleanliness; produce quality/selection; meat quality/selection; deli quality/selection; bakery quality/selection; other food items (dry goods, frozen foods & dairy) selection; store layout and time required to shop; checkout waiting time; attractive displays/store décor; courteous, friendly and helpful employees; and overall satisfaction (How did we do?). In addition, extensive demographic and shopping behavior questions are included to provide an understanding of the different segments of our commissary user population. Approximately 20,000 completed survey forms are processed each year. The response rate is typically near 90 percent.

In addition to the ACSI, the three exchange systems internally administer a separate Customer Satisfaction Index (CSI), which provides actionable insights at both the enterprise- and store-levels. Unlike the ASCI, the Customer Satisfaction Index surveys all business lines (as opposed to only the main stores) of the exchange systems and is not comparable with industry or other DoD resale entities.

Associate Satisfaction Index: Another obvious and easily measureable indication of the performance of the Defense Resale Enterprise is a survey of associates employed by the system. Happy sales associates translate directly into happy customers, and measuring employee satisfaction helps ensure the resale system is conferring a positive and rewarding experience on the patron.

The Associate Satisfaction Index (ASI), created by the same research group, allows year-to-year feedback on employees' work experience in areas such as management, advancement, environment, training, benefits, etc. A direct correlation between associate satisfaction and customer satisfaction may be observed. As such, use of both indices allows inferences regarding the success at delivering a benefit to the patron, as well as probable sources of changes in customer satisfaction. Like the ACSI, the exchange system uses the Associate Satisfaction Index as an obvious, tangible metric. The commissary system uses a similar model through the Office of Personnel and Management's Organizational Assessment Survey and the Federal Employee viewpoint Survey.

Morale, Welfare, and Recreation Dividends: The exchange system creates another obvious and tangible benefit that can be directly measured. Beyond funding most of their own operations with sales proceeds, each exchange generates millions of dollars per year that are directly reinvested in the wellbeing of service members. Approximately one-third of these "profits" are used to construct or refurbish exchange facilities used by the patron. The majority—hundreds of millions of dollars each year—are transferred to the military services' MWR operations. This use of NAF to support the troops directly reduces, dollar-for-dollar, the amount of appropriated funding that would otherwise be needed by these critical programs, if they are to be sustained. Whether proposed changes impact dividends generated by the exchanges, and reduce MWR funding will be a key metric in considering any initiative.

Inherent Tasks and Programs: While the obvious, tangible benefits created by the Defense Resale Enterprise are of great value to the military member and their family, it provides a myriad of less obvious but perhaps more important benefits. Saving a certain dollar amount, even a significant one, while in the United States is of value. But service members here at home often have access to significant civilian resources. For those deployed or stationed overseas, and in remote or hardship locations, however, life is quite different. Obtaining familiar or needed products is often difficult, time-consuming and expensive—if they are available at any price. Finding a reliable repair shop, tailor, barber or even a place to have a relaxing moment away with a meal or a movie may be all but impossible. For the young military member serving in Djibouti, Africa, or at a contingency location in Afghanistan or in Bosnia, Defense resale provides a taste of home and a quality-of-life boost that is immeasurable. Just a few of the major initiatives include:

- The Defense Resale Enterprise operates hundreds of facilities at the remote or austere locations where military members or their families are deployed or stationed. These facilities, due to their location, size or mission operate at a loss, are provided as support for the military and as a quality-of-life benefit, supported by larger, stateside operations.

- In many areas, no other entity would provide groceries, clothing, tailoring, laundry and dry cleaning, barbershops, financial services, gas stations, food operations, repair services, optical shops, minimarts, household goods, variety and department-store items.

- The Defense Resale Enterprise routinely alters its available goods and services to support DoD policies and initiatives, despite the pure economics of a given issue. For example, alcohol sales operate within specified quantity, time, location and other limits, forgoing profit that a private entity would seek in favor of supporting service-wide efforts to reduce alcohol use and incidents.

- Veteran, spouse, and family member employment is an important objective of the Defense Resale Enterprise components. Not only does this focus allow spouses and family members to have a viable, portable career during frequent military-mandated transfers, but it puts additional dollars right into the often tight budget of military families.

- Disaster relief and contingency support is an important, uncredited task often tackled by the Enterprise. When natural disaster or other crisis hits, base commanders often rely on immediate aid from the exchanges or base commissary, sourcing much-needed supplies that are in short supply. Beyond stock-on-hand, the Enterprise is often called to use its reliable and established supply chain to rush additional resources into the area in support of families, dependents and military civilians.

- The Defense Resale Enterprise performs a number of important military-related functions outside the operation of commissaries and the many types of exchange stores and service centers. For example, the Navy Lodge branch of NEX operates lodging facilities worldwide, providing the Navy's temporary housing solution in conjunction with permanent change-of-station moves. It also provides all uniform testing, development and production for the Navy, as well as operating telephone systems, cellular stations, and Wi-Fi connectivity for military members at bases and stations worldwide.

- NEX operates ship's stores, providing needed products for those deployed at sea, and supports operations of afloat supply departments on vessels around the world.

- AAFES is similarly a multi-function operation that does far more for the service member than operate exchange stores. For example, in Europe and the Pacific, AAFES operates bakery plants that provide fresh, familiar, reasonably priced baked goods to bases and posts throughout the European theater of operations. They use their own distribution centers to guarantee timeliness of delivery and quality of product. The bakeries also produce specific products in support of military families participating in the Women, Infant, and Children overseas program.

- Exchanges operate overseas school lunch programs[44] at DoD schools to K-12 students on military installations in nine countries, including free and reduced-price meals for qualifying students, serving more than 3.2 million meals in 2014-2015. Additionally, AAFES supports programs in 76 cafeterias on Army and Air Force installations throughout Europe and the Pacific to ensure military members and their families receive fresh and nutritious meals.

- On the Marine Corps side, exchange operations are completely integrated with MWR functions, creating a single-source entity that supports the community through retail operations and myriad of leisure, family support and quality-of-life programs.

Historically, DeCA has measured the value of the benefit based on the patron savings for groceries and other household items that were sold in the commissary to Service members and their families. Thus, the tangible value of the commissary benefit is rooted in a patron savings of 30 percent, which equates to $2.35 billion annually. This is a direct compensation benefit to the DoD in that it extends the household budgets of uniformed personnel, families, and retirees.

While patron savings has been the traditional measurement of success, the true value of the commissary system is more complex. There are a number of second and third order effects inherent in the commissary benefit providing an intangible benefit. There are four primary facets of value that comprise the commissary benefit—Quality of Life, Military Readiness, Cost Avoidance, and Socio-Economic Impact.

- *Quality of Life:* While patron savings are a definite enhancement, the commissary system brings additional income into military families through its business partners' activities and by employment of family members. DeCA's industry support provides significant ancillary benefits to our military and was estimated to be worth approximately $250 million annually. Examples include charitable contributions, scholarships, giveaways, contests and prizes, or special events and celebrity appearances. Such benefits would not accrue to military installations or families except for the existence of the commissary system. The commissary system is also a significant source of employment for family members (spouses and other family members), Guard and Reserve members, military retirees, and service compensable veterans, who comprise 65.9 percent of DeCA's workforce as of June 2015. DeCA's supporting industry also employs a significant number of spouses and family members. For example, one large brokers reports that 60 percent of the individuals hired as vendor stockers are military family members.

[44] Army and Air Force Exchange Services, "School Meal Program," http://www.aafes.com/about-exchange/school-lunch-program/ (accessed December 10, 2015).

- *Military Readiness:* Commissaries provide peace of mind to deployed Service members, allowing them to focus on their mission, knowing the commissary benefit helps to enhance their well-being, to include the financial readiness of their families back home. A 1999 GAO report[45] documented that the commissary benefit had a positive contribution to military retention for critical specialties and is one of the key quality of life factors listed as reasons to stay in the service. Commissaries also provide support to military communities and operations during natural disasters, such as the 2011 Tsunami which struck northeast Japan. During that disaster, when shelves in local supermarkets were empty, commissaries not only took care of the local military communities, but also supplied multi-national personnel assigned to recovery operations. DeCA suffered no interruptions to its supply chain, and, in fact, was able to expedite required emergency supplies. For example, under normal conditions, DeCA's system gives suppliers 17 days to process orders, load containers, and get them to the port. However, because of its established working relationship with the shippers, DeCA suppliers diverted orders for domestic sources and made shipments to Japan in a greatly reduced time period; 2 days in the best case scenario. Service such as this prompted the Deputy Commander at Misawa Air Base to describe the commissary as the "bedrock of the community."

  The Defense Travel System (DTS) contains many costs which are shared among all DoD DTS users. The loss of the exchanges and DeCA's transportation volume would increase US Transportation Command fees for the remaining DTS users, thereby increasing APF requirements for military transport across the enterprise. Loss of the AAFES volume alone could increase ocean shipping rates to DoD, and offset any appropriated SDT savings realized. This problem is further compounded when the entire resale enterprise is forced to look for the greatest transportation savings to reduce landed costs and pushes logistical shipping options outside of the DTS.

- *Cost Avoidance:* Two areas where the commissary favorably impacts Departmental resources are cost of living allowances (COLA) and the DTS. The presence of a commissary is a cost avoidance factor included in the formula for computing COLA rates (title 37, United States Code, section 403b). AAFES and DeCA also serve as the retainer for the DTS, as the top two peacetime overseas shippers within the Department. That peacetime use allows the Department to reserve additional shipping, at more favorable rates, when required for operational needs.

- *Socio-Economic Impact:* The commissary system also supports a number of social programs. For example:

  - Hiring People with Disabilities: In fiscal 2015, the DeCA received accolades for Patriotic Civilian Service from the US Army Warrior Care and Transition Program for its emphasis and action on expanding employment opportunities to Wounded Warriors. DeCA increased the number of employees with targeted disabilities on its

[45] GAO/NSIAD-99-197BR, August 1999

rolls from 1.56 percent at the end of fiscal 2014 to 1.61 percent in first quarter fiscal 2016. The DoD goal for hiring people with targeted disabilities is two percent – the DoD-wide average percentage was 0.76 and the federal-wide average was 0.88. DeCA was also recognized by the Virginia Department of Aging and Rehabilitative Services with a Champions of Disability Employment Award for the proactive employment of people with targeted disabilities.

- Support of the Committee for Purchase from People Who Are Blind or Severely Disabled Statute: The DeCA supports the AbilityOne Program which is managed and implemented by the U. S. AbilityOne Commission. The Commission designated two central nonprofit agencies (NPA), SourceAmerica and the NIB, to administer the program and assist people who are severely disabled or blind by seeking contract opportunities for employment. The DeCA contracts with NIB NPA for various commissary resale items which in fiscal year 2015 were valued at approximately $18.8 million. In addition, DeCA contracts with NIB NPA for a number of operating supplies (e.g., plastic bags) for all US commissaries. In fiscal year 2015, the DeCA's contract awards for these supplies amounted to $11.1 million dollars. DeCA also contracts with SourceAmerica NPA for shelf stocking, custodial, and receiving/storage/holding services. DeCA currently has 99 contracts for these services at an annual cost of $90.6 million dollars.

- Small Business: In fiscal year 2015, DeCA purchased over $1 billion of goods and services (nearly 29 percent of the dollars eligible for small business awards) from more than 850 small businesses. Every effort is made to afford small business concerns an equitable opportunity to compete for all contracts that they can perform, consistent with the Government interest and efficient performance.

- Environmental Stewardship: DeCA is committed to the environment. In fiscal year 2015, 83 percent of all recyclable material (62,541 tons) brought into stores was recycled. Money generated from those sales - $1.3 million in fiscal year 2015 - goes into DeCA's surcharge fund. DeCA is also an ENERGY STAR Partner—a joint program of the Environmental Protection Agency and Department of Energy—that helps save money and protects the environment through the use of energy efficient products and practices. DeCA's program fosters recycling, building efficiencies, control of environmentally sensitive substances, and promotes the sale of environmentally friendly products including compact fluorescent lamp (CFL) bulbs, reusable bags, and other items such as bio-friendly and organic products.

- Food Donations: In FY2015, 134 of DeCA's commissaries donated 2.32 million pounds of nonsaleable, but edible, food to 117 area food banks. In 2015, commissaries also played a key role in supporting the Feds Feed Families food drive campaign. Military customers and federal employees donated nonperishable food and personal hygiene items to local food banks using marked bins located at the entries or exits of participating commissaries. In 2015, DeCA accounted for 1.6 million of DoD's 3.2 million pounds donated.

- Scholarships: Many of DeCA's trading partners fund scholarships for military family members. One of the oldest and more successful programs is the Scholarships for Military Children, administered by the Fisher House Foundation. In 2015, the Foundation celebrated the Program's 15th anniversary and a major milestone – the cumulative awarding of nearly 9,000 who've been awarded more than $13.9 million in scholarships to military children around the world. Other scholarship programs funded by commissary vendors, manufacturers, brokers, suppliers, and the general public, are sponsored locally or target spouses. It is a tribute to these programs that every dollar donated goes directly to funding scholarships.

As DRBOB works to evaluate optimization ideas, ensuring proposed changes do not harm these intangible but critical benefits will be a primary objective.

SECTION 4: OTHER CONSIDERATIONS

Beyond the Main Commissaries and Exchanges: In addition to main commissary and exchange stores, the Defense Resale Enterprise also directs a variety of additional quality of life and retail-related activities on which service members and their families have come to rely.

The commissary system operates 63 overseas stores that provide a convenient, familiar place to shop with access to American grocery products that might not otherwise be available in their location. Additionally, it manages small stores in remote locations that are necessary to serve patrons but which would not be cost-effective or self-sustaining without subsidization. Of DeCA's total 240 commissaries, the 16 largest stores (6.7 percent of the stores), yield 20 percent of its sales, while the smallest 135 commissaries, (56 percent of DeCA's stores, many in remote or overseas locations), make up 20 percent of its sales.

While the exchange systems operate 212 main retail stores around the world,[46] they also provide resale activities to support military missions on board 158 ships and in 73 contingency operations, including deployed locations and disaster relief areas.[47] These operations provide provisions for service members who otherwise would not be able to obtain them on the local economy.

The individual exchanges are not identical in their organizations and provision of programs, services, and activities, which complicates discussions of shared services or consolidation within the Defense Resale Enterprise. The MCX in particular is part of a broader integrated construct under Marine Corps Community Services that provides more than 100 programs, services and activities for the physical, financial, mental and emotional well-being of all active duty and retired Marines, Sailors and their families. This unique model within DoD is also supported by integrated common back-office support functions (e.g., human resources, finance and accounting, procurement, information technology, and construction). An advantage of this model is that, as a whole, Marine Corps Community Services can develop cross-programming

[46] Boston Consulting Group, "Military Resale Study," July 10, 2015, 160.
[47] Military Resale and MWR Center for Research (2012) "Costs and Benefits of the Department of Defense Resale System," 25.

and promotional opportunities that benefit the patrons, support the military mission, and increase revenues in support of quality-of-life programs. Additionally, MCX provides myriad deployed support capabilities with embedded Marines that specialize in the delivery of in-theater tactical field exchange and MWR support.

NEXCOM and MCX support leadership objectives, such as the 21st Century Sailor and Marine initiative aimed at increasing resiliency within the Department of the Navy. The Marine Corps Exchange and Navy Exchange support this effort through a variety of programs and policies, particularly with regard to healthy living items, and alcohol and tobacco policies.

Additionally, AAFES provides military communities with express convenience stores, movie theaters, car care centers, personal services (beauty and barber shops), professional healthcare (optical and dental services), specialty stores and military clothing stores on installations worldwide. NEXCOM has over 1,200 service operations such as gas stations, food outlets, laundry/dry cleaning, barber/beauty salons, flower shops, tailor shops, optical and optometry services and complete vending services. In additional to operating 84 convenience stores in the United States (33 of which sell fuel) and six convenience stores overseas, MCX oversees distribution and sales of Marine Corps uniforms and provide the personal care products necessary for Marine recruits when they arrive for recruit training.

These relied-upon programs play a significant role for service members and their families in ensuring accessibility to supplies in overseas locations, isolated and remote areas, and contingency operations, and aboard ships. Additionally they provide convenient services and food programs that meet high nutritional standards for families serving overseas.

Consolidation or Merger: While the commissary and exchange systems collectively comprise the Defense Resale Enterprise, each individual system serves different purposes. The commissaries deliver products to service members and their families at cost (plus surcharge). The exchanges sell products and services at a savings while generating profits, and apply those profits to help fund MWR activities. There is a complementary relationship between the commissaries and the exchanges, as the discount prices offered by commissaries help attract customers for the exchanges. The stock assortments between the systems only minimally overlap. Additionally, DeCA is an APF entity operating a revolving fund to purchase and re-sell groceries, while the exchanges are NAF instrumentalities.

Because of their different approaches to fulfilling their specific missions and delivering their respective benefits, the creation of a single resale entity through consolidation is not recommended. It is more appropriate to focus on the short-term goal of achieving greater efficiency in the operation of the commissaries and exchanges, and to defer consideration of the feasibility of any merger until these issues have been effectively addressed.

As with private-sector mergers and acquisitions, there are many internal and external risks and barriers that may limit full and immediate consolidation, despite apparent potential savings or synergies. Among these are:

- Initial operating costs to effect a consolidation (resulting from organizational and personal changes, severance pay, technical and technological changes, training workers, et al.)
- Standardization of accounting methods and financial systems
- Credit market reactions to consolidation, credit ratings, and interest rates
- Alignment of operating models vs brand
- Adjusting to expanded pricing and merchandising strategies
- Communications and cultural differences (branding matters)
- Differences between the military department management structures that oversee exchange system operations and the delivery of MWR and community services

Recognizing these and other challenges, the Department believes the best tactic is a structured approach to develop collaborative solutions to achieve efficiencies and savings. The work of the DRBOB to optimize the business processes of the commissaries and exchanges should reduce many of the risks described above and enable the Department to more accurately assess any remaining risks for the purpose of developing a business case.

APPENDIX A – NATIONAL DEFENSE AUTHORIZATION ACT FOR FY2016, SECTION 651

Subtitle E—Commissary and Non-Appropriated Fund Instrumentality Benefits and Operations

SEC. 651. PLAN TO OBTAIN BUDGET-NEUTRALITY FOR THE DEFENSE COMMISSARY SYSTEM AND THE MILITARY EXCHANGE SYSTEM.

(a) IN GENERAL.—Not later than March 1, 2016, the Secretary of Defense shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report setting forth a comprehensive plan to achieve by October 1, 2018, budget-neutrality in the delivery of commissary and exchange benefits while meeting the benchmarks set forth in subsection (c). In preparing the report, the Secretary shall consider the report required by section 634 of the Carl Levin and Howard P. "Buck" McKeon National Defense Authorization Act for Fiscal Year 2015 (Public Law 113–291; 128 Stat. 3406) and any other previous reports, studies, and surveys of matters appropriate to the report.

(b) REPORT ELEMENTS.—The report required by subsection (a) shall include the following:

(1) A description of any modifications to the commissary and exchange benefit systems the Secretary considers appropriate to obtain budget-neutrality in the delivery of commissary and exchange benefits, including the following:

(A) The establishment of common business processes, practices, and systems to exploit synergies between the operations of defense commissaries and exchanges and to optimize the operations of the resale system and the benefits provided by the commissaries and exchanges.

(B) The privatization of the defense commissary system and the military exchange system, in whole or in part.

(C) Engagement of major commercial grocery retailers or other private sector entities to determine their willingness to provide eligible beneficiaries with discount savings on grocery products and certain household goods.

(D) The closure of commissaries in locations in close proximity to other commissaries or in locations where commercial alternatives, through major grocery retailers, may be available.

(2) An analysis of different pricing constructs to improve or enhance the delivery of commissary and exchange benefits.

(3) A description of the impact of any modifications described pursuant to paragraph (1) on Morale, Welfare and Recreation (MWR) quality-of-life programs.

(4) Such recommendations for legislative action as the Secretary considers appropriate to achieve by October 1, 2018, budget-neutrality in the delivery of commissary and exchange

benefits while meeting the benchmarks set forth in subsection (c).

(c) BENCHMARKS.—The report required by subsection (a) shall ensure—

(1) the maintenance of high levels of customer satisfaction in the delivery of commissary and exchange benefits;

(2) the provision of high quality products; and

(3) the sustainment of discount savings to eligible beneficiaries.

(d) COMPTROLLER GENERAL ASSESSMENT OF PLAN.—Not later than 120 days after the submittal of the report required by subsection (a), the Comptroller General of the United States shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report setting forth an assessment by the Comptroller General of the plan to achieve budget-neutrality in the delivery of commissary and exchange benefits while meeting the benchmarks set forth in subsection (c) as set forth in the report required by subsection (a).

(e) PILOT PROGRAMS.—

(1) PROGRAMS AUTHORIZED.—After the reports required by subsections (a) and (d) have been submitted as described in such subsections, the Secretary may, notwithstanding any requirement in chapter 147 of title 10, United States Code, conduct one or more pilot programs to evaluate the feasibility and advisability of processes and methods for achieving budget-neutrality in the delivery of commissary and exchange benefits and other applicable benchmarks in accordance with this section. The Secretary may authorize any commissary or exchange, or private sector entity, participating in any such pilot program to establish appropriate prices in response to market conditions and customer demand, provided that the level of savings required by paragraph (3) is maintained.

(2) BENCHMARKS.—If the Secretary conducts a pilot program under this subsection, the Secretary shall establish specific, measurable benchmarks for measuring success in the provision of high quality grocery goods and products, discount savings to patrons, and high levels of customer satisfaction while achieving budget-neutrality in the delivery of commissary and exchange benefits under the pilot program.

(3) REQUIRED SAVINGS TO PATRONS.—The Secretary shall ensure that the level of savings to commissary and exchange patrons under any pilot program under this subsection is not less than the level of savings to such patrons before the implementation of such pilot program, as follows:

(A) Before commencing a pilot program the Secretary shall establish a baseline of savings to patrons achieved for each commissary or exchange to participate in such pilot program by comparing prices charged by such commissary or exchange for a representative market basket of goods to prices charged by local competitors for the same market basket of goods.

(B) After commencement of such pilot program, the Secretary shall ensure that each commissary or exchange, or private sector entity, participating in such pilot program conducts market-basket price comparisons not less than once a month and adjusts pricing as necessary to ensure that pricing achieves savings to patrons under such pilot program that are reasonably consistent with the baseline savings for the commissary or exchange established pursuant to subparagraph (A).

(4) DURATION OF AUTHORITY.—The authority of the Secretary to carry out a pilot program under this subsection shall expire on the date that is five years after the date of the enactment of this Act. However, if a pilot program achieves budget-neutrality in the delivery of commissary and exchange benefits and other applicable benchmarks, as measured using the benchmarks required by paragraph (2), the Secretary may continue the pilot program for an additional period of up to five years.

(5) REPORTS.—

(A) INITIAL REPORTS.—If the Secretary conducts a pilot program under this subsection, the Secretary shall, not later than 30 days before commencing the pilot program, submit to the Committees on Armed Services of the Senate and the House of Representatives a report on the pilot program, including the following:

(i) A description of the pilot program.

(ii) The provisions, if any, of chapter 147 of title 10, United States Code, that will be waived in the conduct of the pilot program.

(B) FINAL REPORTS.—Not later than 90 days after the date of the completion of any pilot program under this subsection or the date of the commencement of an extension of a pilot program under paragraph (4), the Secretary shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report on the pilot program, including the following:

(i) A description and assessment of the pilot program.

(ii) Such recommendations for administrative or legislative action as the Secretary considers appropriate in light of the pilot program.

APPENDIX B – ACRONYMS

Acronym	Definition
AAFES	Army and Air Force Exchange Service
ACSI	American Customer Satisfaction Index
APF	appropriated funds
BCG	Boston Consulting Group
CCSS	Commissary Customer Satisfaction Survey
CEB	Cooperative Efforts Board
CFL	compact fluorescent lamp
COGS	cost of goods sold
COLA	cost of living adjustment
CONUS	contiguous United States
DeCA	Defense Commissary Agency
DeRA	Defense Resale Activity
DFARS	Defense Federal Acquisition Regulation Supplement
DLA	Defense Logistics Agency
DoD	Department of Defense
DoDI	DoD instruction
DRBOB	Defense Resale Business Optimization Board
DTS	Defense Travel System
FAR	Federal Acquisition Regulations
FY	fiscal year
FYDP	Future Years Defense Program
GAO	Government Accountability Office
ID	identification
MCRMC	Military Compensation and Retirement Modernization Commission
MCX	Marine Corps Exchange
MWR	morale, welfare, and recreation
NAF	nonappropriated funds

NAFI	nonappropriated fund instrumentality
NDAA	National Defense Authorization Act
NEX	Navy Exchange
NEXCOM	Navy Exchange Service Command
NIB	National Industries for the Blind
NPA	non-profit agency
NSIAD	National Security and International Affairs Division (of GAO)
OMB	Office of Management and Budget
SA	SourceAmerica
SDT	Second Destination Transportation
US	United States

APPENDIX C – SELECT STUDIES ON DEFENSE RESALE SINCE 1989

Study Author, Year, Title, and Recommendations/Findings
Jones Commission (1989) ***"DoD Study of the Military Commissary System"***
Determined that the organization structure of the Commissary system operating under the four separate services to be inefficient and redundant and recommended a centralized approach. This resulted in a consolidated commissary system under one joint service organization.
Jones Commission II (1990) ***"DoD Study of the Military Exchange System"***
Provided a baseline assessment of DoD exchange system and recommended that the military exchange systems be consolidated into a single organization in order to eliminate current redundancies and improve operational efficiencies.
Logistics Management Institute (LMI) Assessment (1991) ***"Toward a More Efficient Exchange System"***
Studied the Jones Commission II work and concluded that the savings were underestimated and that immediate consolidation of the exchange systems entailed significant risk if several foundation actions were not taken first. Recommended increasing cooperation and coordination among the current exchange systems and integrating some of their functions over a three-year period prior to attempting full and immediate consolidation.
Government Accountability Office (1995) ***"Potential Reductions to the Operation and Maintenance Programs"***
Determined that reductions to the commissary and exchange systems could be achieved through streamlining organizational structure, closures, combining operations at some commissaries and exchanges, and using cash surplus from the commissary surcharge to pay costs that are currently paid for by appropriated funds.
Congressional Budget Office (1997) ***"The Costs and Benefits of the Retail Activities at Military Bases"***
Examined the strengths and weaknesses of commissaries and exchanges as a way to compensate service members and to ensure that personnel living overseas or in isolated US locations have access to US goods. Looked at the costs and benefits of four alternative strategies to meet both of those goals, which resulted in savings ranging from $0M (contract out and subsidize costs) to $1B (create a resale authority, based on consolidation and nonappropriated business model).
SRA International Review (1996)
Recommended "Federalized Decentralization" through the establishment of a small central organization for oversight of policy, strategy, and performance, introduction of an Information Exchange Program for comparison of statistical data, expense ratios, and productivity units, and centralization of activities among the Exchanges.
Price Waterhouse Cooper (1999) ***"Joint Exchange Due Diligence Study"***
Recommended that the exchanges form a single Unified Exchange organization with a single Board of Directors, a single Commander, and a single Chief Executive Officer that utilized best-practice processes and systems.
DoD Unified Exchange Task Force (2005)

Examined the costs, benefits, and risks associated with a Shared Service approach for the Exchanges with five focus areas: Human Resources, Finance& Accounting, Information Technology, Logistics, and non-resale procurement. Identified significant benefits associated with the Shared Service approach.
Military Resale and MWR Center for Research (2012) ***"Costs and Benefits of the Department of Defense Resale System"***
Demonstrated the contributions of the defense resale system to service members and their families and to the Department of Defense on an economic basis, as well as its role in caring for service members and contributing to national security.
Military Compensation and Retirement Modernization Commission (MCRMC) (2015)
Recommended establishment of a single defense resale organization (Defense Resale Activity (DeRA)) with a single chief executive officer, and consolidation of the DeCA and three exchange systems into the new organization. Also called for the establishment of a single Board of Directors to replace the four existing boards, new efficiencies in the back-office operations and support functions of the commissaries and exchanges, and statutory changes to enable the commissaries and exchanges to achieve needed efficiencies.
Boston Consulting Group (2015) ***"Military Resale Study"***
Identified "win-win" opportunities that DeCA could pursue to maintain or enhance patron benefit while reducing the need for appropriated funding, most of which would require some legislative change. Focused on assessing viability of variable pricing, private label, second destination transportation, NAF conversion, consolidation, patron impact.

APPENDIX D – QUESTIONS FOR PRIVATE SECTOR ENGAGEMENT

The following questions were provided to select commercial retailers to discuss opportunities for privatization of the Defense Resale Enterprise, as well as opportunities to support our service members, retirees, and their families by providing eligible beneficiaries with discount savings on grocery and other products as an alternative to the current Defense Resale Enterprise.

1. Are you interested in operating commissaries on military installations?

2. What would make taking over the 177 commissaries in the United States and 63 commissaries in 12 countries overseas attractive?

3. What are the limiting factors that would prevent a company from taking over commissaries?

4. How much of the Defense Resale ecosystem is your organization willing to support?

5. Is there willingness to take on current employees and pay them at their current government salary base?

6. Would you be willing to provide preferential hiring to veterans and military family members?

7. Is your organization willing to operate in an environment where the access to the store is restricted because of military security concerns?

8. Is your organization willing to operate the military stores with only the current authorized shoppers excluding much of the general public?

9. What is your organization's willingness to operate and stock what may be considered unprofitable operations (particularly overseas or in more remote/isolated locations within the United States) that are required by military necessity, readiness, or support?

10. Can you adapt to operations that have personnel/customer adjustments due to military missions? For example, significant changes in the customer base when a military unit deploys.

11. What challenges/costs do you expect when operating in a secure military-style environment?

12. Is your organization willing to procure American products and ship them overseas for sale in large and small military resale operations?

13. Would your organization be willing to enter into an agreement where portions of the military-based revenues were returned to the Department (as the dividend to MWR)?

14. Would your organization be willing to run commissaries only carrying the limited stock assortment authorized in current law?

15. Would you be willing to support socio-economic programs, such as small business and AbilityOne?

16. If DoD were to privatize all of its commissary system to you, would you expect to assume control of/responsibility for the existing real property? Under what conditions would you do that?

17. If the Department shutters its resale ecosystem, would your organization be willing to provide an agreed upon level of savings to authorized beneficiaries for the products and services of the former ecosystem? If so, at what cost to the Department? How would you implement? What percentage savings are you prepared to offer?

18. In the alternative, would you be willing to provide a discount to current authorized customers in facilities owned/operated by your company? What percentage savings are you prepared to offer? If so, would there be a cost to the Department?

19. What would it cost for your organization to set up a parallel infrastructure (above-the-store or in-the-store) to accommodate the provision and continuation of the agreed upon benefits? What, if any, costs would you expect DoD to bear?

20. Would your organization be willing to provide only the above-the-store staffing and management (e.g., supervise a government workforce)?

21. Have you ever done business with the Federal Government? Do you have any contracts for which the FAR/DFARS applies? Do you already have contracting and subcontracting staff as well as systems to do the tracing? Do you have the legal staff to interpret FAR/DFARS?

22. How does your organization determine whether to close stores that are in close proximity to others? What are the criteria for opening and closing stores? Do you ever operate unprofitable operations, possibly from a good will or loss leader perspective?

23. If privatization were to occur, would your organization be willing to accept the MILITARY STAR Card?

24. If privatization were to occur, what is the minimum time period for a contract that your organization would consider?