

QUALITY OF LIFE

RECOMMENDATION 9: PROTECT BOTH ACCESS TO AND SAVINGS AT DEPARTMENT OF DEFENSE COMMISSARIES AND EXCHANGES BY CONSOLIDATING THESE ACTIVITIES INTO A SINGLE DEFENSE RESALE ORGANIZATION.

Background:

The Defense Commissary Agency (DeCA) operates “a worldwide chain of commissaries providing groceries to military personnel, retirees, and their families.”⁶⁴⁷ DoD operates a separate system of exchanges, providing goods and services similar to commercial department or discount stores.⁶⁴⁸ This system includes the Army Air Force Exchange System (AAFES), the Navy Exchange (NEX), and the Marine Corps Exchange (MCX).⁶⁴⁹ Together, commissaries and exchanges provide goods and services with total annual sales of more than \$17 billion in 2013.⁶⁵⁰ There are a limited number of cases where a commissary and an exchange are operated together as a single store including Navy Exchange Markets (NEXMARTs) overseas and a limited number of combined stores in the United States.⁶⁵¹

In addition to the main commissary and exchange stores that form the foundation of the defense resale system, the exchange systems 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, and rental services.⁶⁵² Over time, exchanges have also assumed responsibility for military uniform stores, book stores, liquor stores, and personal phone and telecommunication services for Service members around the world.⁶⁵³ Exchanges also support small retail outlets on Navy ships and field tactical exchanges, provide services through embedded Marines in combat zones, and, when called upon, assist with disaster recovery and other emergency response missions.⁶⁵⁴ In addition, the Navy Exchange Command (NEXCOM) manages Navy Lodges and the Navy Clothing

⁶⁴⁷ “About Us,” Defense Commissary Agency (DeCA), accessed October 17, 2014, http://www.commissaries.com/about_us.cfm.

⁶⁴⁸ See Armed Services Exchange Regulations, DoDI 1330.21 (2005). See also Armed Forces, 10 U.S.C. § 2481.

⁶⁴⁹ Army and Air Force Exchange Service Operations, AR 215-8 and AFI 34-211(I) (2012). Responsibility and Authority for Navy Exchange Operations, OPNAVINST 5450.331A (2008). MCCS Policy Manual, MCO P1700.27B (2007).

⁶⁵⁰ AAFES, *Army and Air Force Exchange Service, 2013 Annual Report*, 22, accessed December 16, 2014, http://www.aafes.com/images/AboutExchange/PublicAffairs?2013_annualrpt.pdf. NEXCOM, *Navy Exchange Command 2013 Annual Report*, 14, accessed December 16, 2014,

<http://www.mynavyexchange.com/assets/Static/NEXCOMEnterpriseInfo/AR13.pdf>. Marine Corps Exchange data provided by Office of the Under Secretary of Defense for Personnel and Readiness, e-mail to MCRMC, December 16, 2014. DECA, *Defense Commissary Agency, FY 2013 Annual Report*, 7, accessed December 16, 2014, <http://www.commissaries.com/documents/whatsnew/afr/afr-2013.pdf>.

⁶⁵¹ Armed Forces, 10 U.S.C. § 2487(a)(2). See also Armed Forces, 10 U.S.C. § 2488.

⁶⁵² Armed Services Exchange Regulations, DoDI 1330.21 (2005), Enclosure 3, 13-14.

⁶⁵³ Ibid.

⁶⁵⁴ Tom Shull, Chief Executive Officer, Army & Air Force Exchange Service Overview, briefing to MCRMC, June 10, 2014. AAFES, meeting to discuss AAFES response to Commissary legislative proposals with MCRMC, July 2, 2014. Robert Bianchi, Chief Executive Officer, Navy Exchange Service Command Overview for Military Compensation and Retirement Modernization Commission, briefing to MCRMC, September 18, 2014. Robert Bianchi, Chief Executive Officer Navy Exchange Service Command Overview, briefing to MCRMC, December 2013. Robert Bianchi, Chief Executive Officer, Navy Exchange Service Command Overview, briefing to MCRMC, September 18, 2014. NAF Business & Support Services (MR) Division, Manpower and Reserve Affairs, HQMC, 23, briefing to MCRMC, September 17, 2014.

and Textile Research Facility, sharing a common IT infrastructure, staff support, and other resources.⁶⁵⁵ The MCX shares support staff and other resources with the Marine Corps' Morale, Welfare and Recreation (MWR); Warfighter and Family Services; and Child, Youth, and Teen programs.⁶⁵⁶

Commissaries and exchanges have evolved from loosely organized systems of sutlers and post traders into a complex "ecosystem" of services and benefits. Although the two systems are, by law, operated as separate entities,⁶⁵⁷ there are strong interactions between them. For example, AAFES estimates that 20–30 percent of its foot traffic, representing at least \$1 billion in sales, is attributable to proximity to commissaries.⁶⁵⁸ To limit direct competition, laws, policies, and decisions made by the Defense Resale Board restrict the categories of products and services that each can sell.⁶⁵⁹

Although both commissaries and exchanges provide discounted goods to Service members, they operate using different business models. The commissaries sell groceries at cost⁶⁶⁰ plus a 5 percent surcharge⁶⁶¹ and their operations are funded with appropriated funds (APF).⁶⁶² Exchanges sell merchandise for profit, more like commercial retailers. Gross profits are used to support the exchange system, covering operating and other expenses; recapitalize facilities and systems; or are provided as dividends to fund MWR programs.⁶⁶³ Both commissaries and exchanges provide access to U.S. goods in areas of military concentration around the world, and both provide a nonpay financial benefit to patrons through discounts.

Commissaries and exchanges also have different models of coordination with the Military Services. DeCA, as a separate defense agency, reports to the Office of the Secretary of Defense.⁶⁶⁴ DeCA also has a Board of Directors (BOD) with representation from all the Military Services.⁶⁶⁵ This BOD promotes alignment of commissary services, investments, and operations with the needs of the individual Military Services.⁶⁶⁶ AAFES relies on its BOD, which includes Army and Air Force representation, for such alignment.⁶⁶⁷ In addition to having a BOD, the NEX is part of

⁶⁵⁵ Robert Bianchi, Chief Executive Officer, Navy Exchange Service Command Overview, briefing to MCRMC, September 18, 2014.

⁶⁵⁶ NAF Business & Support Services (MR) Division, Manpower and Reserve Affairs, HQMC, 23, briefing to MCRMC, September 17, 2014.

⁶⁵⁷ Armed Forces, 10 U.S.C. § 2487(a)(1).

⁶⁵⁸ Army and Air Force Exchange Service, *Memorandum for ASD (R&FM), Army and Air Force Exchange Service (AAFES) Response to Commissary Legislative Proposal*, March 17, 2014.

⁶⁵⁹ See, e.g., Armed Forces, 10 U.S.C. § 2481(a) (establishing "a world-wide system of commissary stores and a separate world-wide system of exchange stores"). See also Armed Forces, 10 U.S.C. § 2484 (stating that commissary stores are intended to be similar to commercial grocery stores); Armed Services Exchange Regulations, DoDI 1330.21, Enclosure 3, 13-14 (2005) (permitting exchanges to engage only in enumerated retail activities and stating that commissaries have "primary" role in selling groceries); and Army and Air Force Exchange Service Operations, AR 215-8 and AFI 34-211(l), 61-62, (2012) (enumerating specific items that may be sold by AAFES and stating that food items sold by AAFES "supplement the primary full-line grocery service provided by the commissary system").

⁶⁶⁰ Armed Forces, 10 U.S.C. § 2484(e).

⁶⁶¹ Armed Forces, 10 U.S.C. § 2484(d). See also Armed Forces, 10 U.S.C. § 2484(h).

⁶⁶² Armed Forces, 10 U.S.C. § 2483.

⁶⁶³ Based on data provided by Office of the Under Secretary of Defense for Personnel and Readiness, e-mail to MCRMC, March 31, 2014. In FY 2012, \$333 million of \$496 million in net income was provided to MWR.

⁶⁶⁴ See DoD Commissary Program, DoDI 1330.17 (2014), Enclosure 7, 45.

⁶⁶⁵ DoD Commissary Program, DoDI 1330.17 (2014), Enclosure 8, 47.

⁶⁶⁶ *Ibid.*

⁶⁶⁷ Board of Directors, Army and Air Force Exchange Service, Army Regulation 15-110, 2 (2009). Board of Directors, Army and Air Force Exchange Service, AFI 34-203(l), 2 (2009).

NEXCOM, which is more integrated with the operational Navy.⁶⁶⁸ For example, NEX general managers report to the installation commander to ensure that exchanges are responsive to the needs of the command.⁶⁶⁹ Installation commanders review financial performance and facility planning and provide input on the general manager's performance evaluation.⁶⁷⁰ The MCX is also tightly integrated as part of Marine Corps Community Services (MCCS). Falling under the same organization as MWR and Marine and Family Programs, allocation of resources and exchange profits between all these programs are made in an integrated fashion.⁶⁷¹

In 2013, the commissaries received \$1.4 billion in APF, of which \$152 million was spent on second destination transportation costs for transporting U.S. goods overseas.⁶⁷² That same year, the exchanges received approximately \$397 million in APF.⁶⁷³ This amount included \$170 million for contingency support, covering expenses associated with the transportation of merchandise from warehouses to remote exchange sites, incremental inventory variances above the noncontingency average, danger pay, deployment bonuses, overtime, and foreign post differentials for deployed associates.⁶⁷⁴ Also included was \$179 million for second destination transportation,⁶⁷⁵ and \$47 million for direct and indirect exchange operating costs, including a limited number of active-duty military personnel, military travel, and utilities for authorized overseas locations and a limited number of CONUS remote and isolated locations.⁶⁷⁶

For additional information on defense resale, please see the Report of the Military Compensation and Retirement Modernization Commission: Interim Report (Section 5.1.1 and Section 5.8.2).

Findings:

In the Commission's survey, town halls, and other public forums, commissary and exchange benefits frequently received strong support, with a primary focus on commissary discounts, yet some Service members did challenge the value of the commissary and exchange benefits. Typically they were skeptical of the claimed savings and the quality of nonbranded products such as produce.⁶⁷⁷ Even among skeptics, however, there was consistent acknowledgment of the additional benefit offered overseas, and in remote and isolated locations, where commercial alternatives are either not available or not comparable.⁶⁷⁸

⁶⁶⁸ Morale, Welfare and Recreation (MWR)/Navy Exchange (NEX) Board of Directors (BOD), OPNAVINST 1700.13B, 1 (2004).

⁶⁶⁹ Responsibility and Authority for Navy Exchange Operations, OPNAVINST 5450.331A, 3 (2008).

⁶⁷⁰ Ibid.

⁶⁷¹ NAF Business & Support Services (MR) Division, Manpower and Reserve Affairs, HQMC, 23, briefing to MCRMC, September 17, 2014.

⁶⁷² Information provided by DeCA, e-mail to MCRMC, May 6, 2014.

⁶⁷³ Office of the Under Secretary of Defense for Personnel and Readiness, e-mail to MCRMC, November 6, 2014. For a description of the authorized use of APF in military exchanges, see also Armed Services Exchange Regulations, DoDI 1330.21 (2005), Enclosure 9, and Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources, DoDI 1015.15 (2008), Enclosure 4.

⁶⁷⁴ Ibid.

⁶⁷⁵ Pursuant to 10 U.S.C. § 2643, second-destination transportation funding covers the expenses of transporting exchange supplies and products to destinations outside the continental United States.

⁶⁷⁶ Office of the Under Secretary of Defense for Personnel and Readiness, e-mail to MCRMC, November 6, 2014.

⁶⁷⁷ Survey respondents, comments submitted via MCRMC survey, July 1, 2014 to October 10, 2014. See also, e.g., MCRMC letter writer, comment form submitted via MCRMC website, June 18, 2014 ("In addition, we MUST do a better job of providing fresh produce that is nice and fresh and not rotten, which is not the case in most commissaries.")

⁶⁷⁸ Examples include audience member comments made at MCRMC town hall meeting, Joint Base San Antonio, San Antonio, Texas, January 7, 2014.

In FY 2013, DeCA reported the average discount for commissary patrons to be 30.5 percent⁶⁷⁹ and the exchanges reported savings between 20 and 24 percent.⁶⁸⁰ In Defense Manpower Data Center's 2013 Living Patterns Survey, 92 percent of active-duty respondents indicated they had purchased goods or services at a military commissary in the previous 12 months.⁶⁸¹ For military exchanges, the level was 96 percent.⁶⁸² In surveys conducted by the commissaries and exchanges, patrons indicate a high level of overall satisfaction as compared to industry averages. Exchange surveys in 2013, based on the American Customer Satisfaction Index (ACSI), reported overall patron satisfaction scores of 75 (AAFES), 79 (NEX) and 83 (MCX),⁶⁸³ compared to the average department and discount store rating of 77.⁶⁸⁴ The commissary ACSI score for 2013 was 82 as compared to the industry average of 77.⁶⁸⁵ The 2014 Military Lifestyle Survey conducted by Blue Star Families ranked commissaries and exchanges as the most utilized service, with the third highest satisfaction rate, behind MWR and chaplain services.⁶⁸⁶ Comments made during the Commission's town halls and other meetings as well in survey responses supported these findings:

*While there are some items that may be found at a lower individual price on the economy the total combined savings remains constant.*⁶⁸⁷

*The prices at competing grocery stores are what they are because these outfits know that the Commissary Store exists in the community. If that competition goes away we will all pay more.*⁶⁸⁸

*When I went out in town and we tried to get the same amount, we got about half of the groceries that we could afford at the Commissary.*⁶⁸⁹

⁶⁷⁹ "New Price Study Validates 30% Savings," Defense Commissary Agency (DeCA) web site, January 9, 2014, accessed June 11, 2014, http://www.commissaries.com/press_room/press_release/2014/DeCA_01_14.cfm. DeCA reported an average patron savings of 30.5% in FY 2013. If this level of savings is accurate, then the total financial benefit to Service members in FY 2013 was approximately \$2.8 billion. Although multiple groups in discussions with MCRMC have challenged this estimate as being overstated, the evidence offered to support these challenges has typically been small, local, market basket surveys that are not structured to represent a world-wide, appropriately weighted average. That being said, DeCA's estimation method has limitations. For example, it only compares products that have identical Universal Price Codes (UPCs) and thus does not consider store brands (private labels) or some very large sizes at commercial grocery and discount stores. Estimated discounts vary based on location and individual shopping patterns, but these variations are typically not communicated to patrons.

⁶⁸⁰ "AAFES Media Advisory 12-059, Don't Shop 'til you Drop – Survey Says Make the Exchange your First Stop!," Army Air Force Exchange Service, October 10, 2012, accessed May 7, 2014, <http://publicaffairssme.com/pressrelease/?p=1000>. See also NEXCOM Fall 2013 Savings by Market report, survey conducted by RetailData, LLC, December 19, 2013, e-mail to MCRMC, May 21, 2014.

⁶⁸¹ Defense Manpower Data Center, *Living Patterns Survey, Tabulation of Responses*, 18, http://www.mcrmc.gov/public/docs/report/qol/2013_DMDC_LivingPatternSurvey_Commissary_Usage.pdf.

⁶⁸² Ibid, 19.

⁶⁸³ David Turner, NAF Business & Support Services (MR) Division, Manpower and Reserve Affairs, HQMC, briefing to MCRMC, September 17, 2014.

⁶⁸⁴ "Department and Discount Stores," American Customer Satisfaction Index, accessed October 15, 2014, http://theacsi.org/index.php?option=com_content&view=article&id=147&catid=&Itemid=212&i=Department+and+Discount+Stores.

⁶⁸⁵ Statement of Joseph H. Jeu, Director, Defense Commissary Agency before the Military Personnel Subcommittee of the Committee on Armed Services, U.S. House of Representatives, First Session, 113th Congress, November 20, 2013, accessed October 20, 2014, https://www.commissaries.com/foia/documents/director_statement_before_congress_2013.pdf.

⁶⁸⁶ Blue Star Families, *2014 Military Family Lifestyle Survey, Comprehensive Report*, 24, accessed December 14, 2014, https://www.bluestarfam.org/sites/default/files/media/stuff/bsf_report_comprehensive_reportfinal_single_pages.pdf

⁶⁸⁷ Survey respondent, comment submitted via MCRMC survey, July 1, 2014 to October 10, 2014.

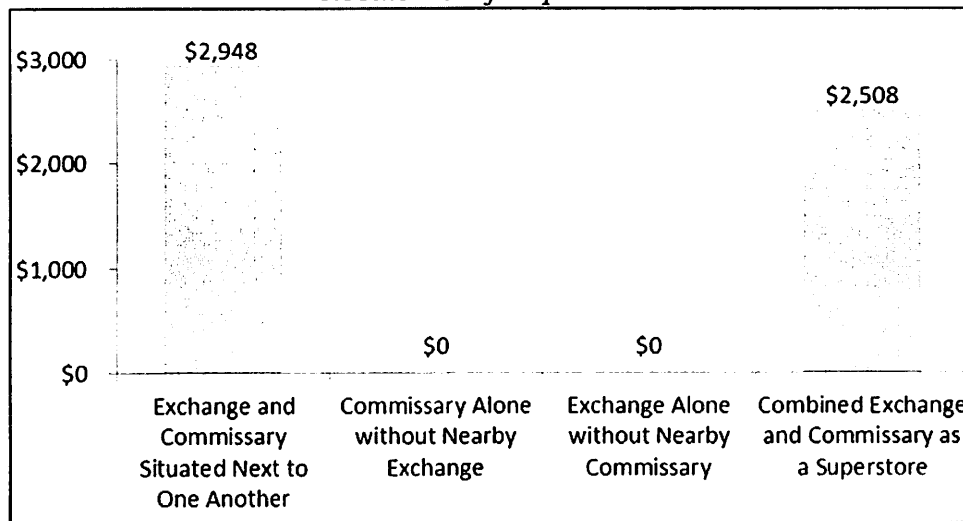
⁶⁸⁸ Survey respondent, comment submitted via MCRMC survey, July 1, 2014 to October 10, 2014.

⁶⁸⁹ Audience member, comment made at MCRMC town hall meeting, Norfolk, VA, December 2, 2013.

The Commission’s survey found similar results.⁶⁹⁰ For the commissary benefit, discounts and convenience were ranked higher than other features such as product assortment, a wide selection of name brand products, or a sense of military community. As the level of discount was hypothetically increased, the perceived value placed on discounts increased even faster.⁶⁹¹

The Commission’s survey also showed that Service members and retirees value commissaries and exchanges that are collocated.⁶⁹² As seen in Figure 21, beneficiaries expressed a strong preference for the availability of both benefits in the same location or same store. Conversely, survey respondents did not prefer availability of either store without the other nearby.⁶⁹³ This result reaffirms the complementary offerings of commissaries and exchanges and reinforces the preference for convenience.

Figure 21. Active-Duty Services Members’ Perceived Value: Resale Benefit Options⁶⁹⁴



The commissaries and the three exchange systems perform similar missions, for similar patrons, with similar staff, using similar processes. In 2003, the Deputy Secretary of Defense directed the development of a plan to form a “single optimized Armed Service exchange system.”⁶⁹⁵ Soon thereafter, the Unified Exchange Task Force (UETF) was formed to perform the associated analysis.⁶⁹⁶ Focusing on five areas of support, finance and accounting (FA), human resources (HR), information technology (IT), logistics, and procurement, the UETF worked with exchange staffs to inventory and analyze the processes in each of these areas of support, for each exchange. Table 14 summarizes the task force’s assessment of commonality.

⁶⁹⁰ Survey results, MCRMC survey, July 1, 2014 to October 10, 2014.

⁶⁹¹ Survey results, MCRMC survey, July 1, 2014 to October 10, 2014.

⁶⁹² Survey results, MCRMC survey, July 1, 2014 to October 10, 2014.

⁶⁹³ Survey results, MCRMC survey, July 1, 2014 to October 10, 2014.

⁶⁹⁴ 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.

⁶⁹⁵ Paul Wolfowitz, Deputy Secretary of Defense, *Memorandum for Secretaries of the Military Departments Chairman of the Joint Chiefs of Staff regarding Future of the Armed Services Exchange Systems*, May 9, 2003.

⁶⁹⁶ Unified Exchange Task Force, *Modified Business Case Analysis for Military Exchange Shared Services*, August 26, 2005, provided to MCRMC by the Office of the Under Secretary of Defense for Personnel and Readiness, June 11, 2014.

Table 14. UETF Assessment of Process Commonality in Selected Exchange Functional Areas⁶⁹⁷

Functional Areas	Processes	Estimated Number of Common Processes	Percent Commonality
FA	147	146	99%
HR	121	109	90%
IT	67	67	100%
Logistics	55	55	100%
Procurement*	23	21	91%
TOTAL	413	398	96%

Numerous studies commissioned by DoD or other Federal entities have recommended some form of consolidation or increased cooperation in pursuit of improved cost-effectiveness. Following the “Jones commission,” which led to the consolidation of commissaries, in 1990,⁶⁹⁸ the “Jones II commission” produced a “DoD Study of the Military Exchange System.”⁶⁹⁹ The study recommended that, “the military exchange systems be consolidated into a single organization in order to eliminate current redundancies, improve operational efficiencies, and achieve projected annual savings from consolidation of \$35 million.”⁷⁰⁰ In 1991, the Logistics Management Institute (LMI) reviewed the methodology, findings, financial analyses, and conclusions of the 1990 DoD study.⁷⁰¹ The LMI assessment estimated the annual savings associated with exchange consolidation to be \$36.6 million,⁷⁰² but recommended against immediate consolidation in favor of a series of “first steps”⁷⁰³ that would “make sound business sense whether or not the exchange systems are eventually consolidated.”⁷⁰⁴ The LMI assessment recommended waiting 3 years to reevaluate the situation, stating that, “After 3 years, the results of those first steps, together with a clearer picture of troop reductions and the evolving retail environment, will substantially lower the risks of any decision.”⁷⁰⁵ Most of the first step recommendations were not implemented.⁷⁰⁶ A 1995 review by the Government Accountability Office (then known as the General Accounting Office) concluded that “appropriated fund support to the commissaries and exchanges could be reduced about \$331.5 million by merging some commissaries and exchanges (\$319.5 million) and closing certain other commissaries (\$12 million).”⁷⁰⁷ An SRA International Inc. review in 1996 determined that full

⁶⁹⁷ Ibid, 3. The asterisk following “Procurement” refers to a footnote in the UETF report, which notes that this line of the figure refers only to non-resale procurement, and further notes that no comparable data was available to the UETF regarding revenue-generating contracts or real property processes.

⁶⁹⁸ See MCRMC, Report of the Military Compensation and Retirement Modernization Commission: Interim Report, June 2014, 124-25, <http://www.mcrmc.gov/index.php/reports>.

⁶⁹⁹ Office of the Assistant Secretary of Defense (Force Management and Personnel), *DoD Study of the Military Exchange System*, September 7, 1990.

⁷⁰⁰ Ibid, ch. 1, 10.

⁷⁰¹ “Toward a More Efficient Military Exchange System,” Logistics Management Institute, Report PL110R1, July 1991, accessed November 20, 2014, <http://oai.dtic.mil/oai/oai?verb=getRecord&metadataPrefix=html&identifier=ADA255738>.

⁷⁰² Ibid, iii.

⁷⁰³ Ibid, iv.

⁷⁰⁴ Ibid, Ch. 1, 7.

⁷⁰⁵ Ibid, Ch. 1, 7-8.

⁷⁰⁶ Office of the Deputy Assistant Secretary of Defense, Director, Morale, Welfare, Recreation, and Resale Policy, e-mail to MCRMC, October 2, 2014.

⁷⁰⁷ General Accounting Office, *Potential Reductions to Operation and Maintenance Program*, GAO/NSIAD-95-200BR, September, 1995, 12, accessed December 21, 2014, <http://www.gpo.gov/fdsys/pkg/GAOREPORTS-NSIAD-95-200BR/pdf/GAOREPORTS-NSIAD-95-200BR.pdf>. Note that this recommendation was rejected by a DoD Study group in December 1995. Although the study group did not have the resources available to come to any definitive

integration was viable, and estimated annual savings to be \$176 million.⁷⁰⁸ The UETF's 2005 report examined a 1999 PricewaterhouseCoopers (PwC) study which recommended a "Unified Exchange" model, predicting that the use of best-practice processes and systems would produce a more creative, more flexible, and more responsive organization.⁷⁰⁹ PwC estimated \$206 million in annual savings as a result of full integration.⁷¹⁰ The UETF, originally chartered to evaluate full exchange integration, was redirected by its executive board to limit its study to partial integration, establishing Shared Services Business Units in five areas of support.⁷¹¹ Using this model, the UETF estimated steady-state annual savings to be \$151 million to \$162 million.⁷¹² Most of these studies started with an assumption that there would be no reduction in patron benefits and cited ways in which the benefit would improve from a patron perspective as a result of increased cooperation, partial integration, or full consolidation.

In 2000, as an alternative to consolidation, the Under Secretary of Defense for Personnel and Readiness directed the establishment of a formal process to identify efficiencies by individual service exchanges and collectively through cooperative efforts.⁷¹³ That same year, the Exchange Cooperative Efforts Board was created. In 2012, DeCA became a voting member of the board, and the board was renamed the Cooperative Efforts Board (CEB).⁷¹⁴ In its 2013 annual report, the CEB cited 33 examples of cooperation,⁷¹⁵ with quantified 2013 savings of approximately \$16 million,⁷¹⁶ about 0.4 percent of the combined operating expenses of the exchanges and commissaries.⁷¹⁷ A large portion of these savings resulted from long standing arrangements such as avoidance of merchant fees through NEXCOM's and MCX's use

conclusions with regard to the savings, the GAO recommendation was rejected because it did not maintain the commissary pricing model (cost plus 5%) and guarantee no loss of MWR dividend.

⁷⁰⁸ Systems Research and Applications (SRA) International, *Integrated Exchange System Task Force Analysis, 1996*, accessed December 21, 2014, http://www.mcrmc.gov/public/docs/report/qol/1996_Exchange_Study-SRA_International-Provided_by_OSD-11JUN2014_DeRA-FN45.pdf.

⁷⁰⁹ See Unified Exchange Task Force, *Modified Business Case Analysis for Military Exchange Shared Services*, 5-6, August 26, 2005, provided to MCRMC by the Office of the Under Secretary of Defense for Personnel and Readiness, June 11, 2014 (citing PricewaterhouseCoopers, *Joint Exchange Due Diligence*, 1999).

⁷¹⁰ *Ibid.*

⁷¹¹ Unified Exchange Task Force, *Modified Business Case Analysis for Military Exchange Shared Services*, E-1, August 26, 2005, provided to MCRMC by the Office of the Under Secretary of Defense for Personnel and Readiness, June 11, 2014.

⁷¹² *Ibid.*

⁷¹³ Under Secretary of Defense, *Review of Exchange Systems in the Department of Defense, July 31, 2000*, accessed December 21, 2014, http://www.mcrmc.gov/public/docs/report/qol/Review_of_Exchange_Systems_in_the_DoD-USD_PR_Memo-31JUL2000_DeRA-FN50.pdf.

⁷¹⁴ Cooperative Efforts Board (CEB) Guiding Charter, March 28, 2012.

⁷¹⁵ Department of Defense, *Memorandum for Principal Deputy Under Secretary of Defense (Personnel and Readiness), 2013 Annual Report on Exchange Systems Cooperative Efforts*, April 29, 2014.

⁷¹⁶ *Ibid.* Note that the \$16 million total does not include savings that are implied but not quantified, savings that occur in years other than FY 2013 (e.g., 9 of the 10 years of the CCTV contract savings), and savings that occurred but were not the result of cooperation between the defense resale organizations (e.g., merchant fees avoided by AAFES as a result of its private-label credit card). The actual savings may be less than \$16 million because not all relevant savings were validated.

⁷¹⁷ The 0.4% figure is based on an overall operating expense of \$2,467 million, as calculated by combining financial statements provided by the several exchanges and DECA to the commission. See AAFES, *Army and Air Force Exchange Service, 2013 Annual Report*, 22, accessed December 16, 2014, http://www.aafes.com/images/AboutExchange/PublicAffairs?2013_annualrpt.pdf; NEXCOM, *Navy Exchange Command 2013 Annual Report*, 14, accessed December 16, 2014, <http://www.mynavyexchange.com/assets/Static/NEXCOMEnterpriseInfo/AR13.pdf>; Marine Corps Exchange data provided by Office of the Under Secretary of Defense for Personnel and Readiness, e-mail to MCRMC, December 16, 2014; DECA, *Defense Commissary Agency, FY 2013 Annual Report*, 7, accessed December 16, 2014, <http://www.commissaries.com/documents/whatsnew/afr/afr-2013.pdf>.

of the MILITARY STAR® card,⁷¹⁸ and not from recent efforts to cooperatively reduce costs. The deeper level of cooperation proposed in many of the studies mentioned above, including consolidated support processes and staffing, consolidated infrastructure, convergence to common IT systems, and aggressively combined procurement and logistics, have not been achieved under the current structure.

DeCA stated to the Commission that it has already reduced annual operating costs by more than \$700 million since 1992 through operating efficiencies.⁷¹⁹ It has also shifted a portion of its costs to military patrons by including distribution and shelf-stocking costs in the cost of goods. Yet the FY 2015 DoD budget submission proposed a 71 percent reduction in the DeCA budget, from \$1.4 billion to \$.4 billion, over a 3-year period.⁷²⁰ Such a significant reduction in funding would necessitate a change in the commissary business model. Groceries could no longer be sold at cost, discounts would be significantly reduced, and the financial benefit to Service members would be diminished. Respondents to the Commission's survey indicated that a commissary discount of 10 percent or less offers little to no value.⁷²¹ In response to the reductions proposed by DoD, DeCA recommended fundamental changes in the laws and policies governing its operations. DeCA proposed a relaxation of many restrictions imposed upon it as an APF organization engaged in retail sales, allowing it to operate more like commercial grocery stores. DeCA also proposed relaxation of restrictions that limit its ability to compete with the exchanges.⁷²²

Although they have been able to maintain their MWR contributions, there are also indicators of significant financial pressures on the exchanges. AAFES saw a 6 percent drop in sales from 2011 to February 2014, from \$6.5 billion to \$6.1 billion, and projects a 23 percent drop in sales between 2011 and 2017, to \$5 billion, based largely on expected reductions in the force structure.⁷²³ In the current environment, AAFES would have little to no net profit without the income derived from its private-label credit card, concessions, or the sale of alcohol and tobacco.⁷²⁴ In December 2013, Moody's downgraded AAFES's long-term issuer rating to Aa3,⁷²⁵ due to a deterioration in its credit profile as a stand-alone entity.⁷²⁶ Public discussions and Congressional hearings have included proposals to reduce or eliminate the appropriated funding currently provided to exchanges to cover costs such as overseas utilities and second

⁷¹⁸ The MILITARY STAR® card is a private-label credit card managed by AAFES. Although originally accepted only at AAFES, its use has been expanded to the other military exchanges.

⁷¹⁹ Director, Defense Commissary Agency, briefing to MCRMC, 10, October 7, 2013.

⁷²⁰ Department of Defense, Office of the Under Secretary of Defense (Comptroller), *National Defense Budget Estimated for FY 2015*, April 2014, 112, 119, accessed October 20, 2014, http://comptroller.defense.gov/Portals/45/Documents/defbudget/fy2015/FY15_Green_Book.pdf.

⁷²¹ Survey results, MCRMC survey, July 1, 2014 to October 10, 2014.

⁷²² Army and Air Force Exchange Service, *Memorandum for ASD (R&FM), Army and Air Force Exchange Service (AAFES) Response to Commissary Legislative Proposal*, March 17, 2014.

⁷²³ Army and Air Force Exchange Service brief from Director, AAFES, e-mail to MCRMC, February 2014.

⁷²⁴ Army and Air Force Exchange Service, *Statement of Earnings 2012*, 19, accessed November 7, 2014, <http://aafes.imirus.com/Mpowered/book/vaar12/i1/p20>.

⁷²⁵ Moody's rates the creditworthiness of securities on a 9-point scale, ranging from Aaa (the highest) to C (the lowest). Ratings from Aa (the second-highest) to Caa (the third-lowest) can be modified by adding a 1, 2, or 3. AAFES's long-term issuer rating was Aa2 before being downgraded one unit, to Aa3. See Moody's Investors Service, *Rating Symbols and Definitions*, accessed October 27, 2014, https://www.moody.com/research/documentcontentpage.aspx?docid=PBC_79004.

⁷²⁶ "Rating Action: Moody's downgrades Army and Air Force Exchange's issuer rating to Aa3," Moody's Investors Service, https://www.moody.com/research/Moodys-downgrades-Army-and-Air-Force-Exchanges-issuer-rating-to-PR_289276.

destination transportation.⁷²⁷ Absent changes to the overseas benefit, such cuts would further reduce profitability, patron discounts, and/or MWR distributions.

Conclusions:

The commissary and exchange benefits are valued by many Service members, retirees, and their families, and should be maintained. These resale organizations provide familiar U.S. goods and services, meeting basic needs of Service members and their families, particularly in remote, isolated, and overseas locations. The discounts provide nonpay compensation that contributes to the financial health and readiness of many military families. No evidence was found to show a positive effect on recruiting or retention, but multiple sources confirmed that commissaries and exchanges are considered by many to be a relevant and important contributor to military quality of life.

A consolidated resale organization, with combined resources, increased operational flexibility, and better alignment of incentives and policies, would improve the viability and stability of these systems. It would sustain the benefit while reducing the combined reliance on appropriated funding over time. The increased flexibility and opportunities available to a consolidated organization could enable a deeper level of cooperation to improve quality and drive the efficiencies recommended by numerous studies. The many similarities, overlaps, and redundancies in processes, staffing, and support infrastructures favor the consolidation process. Establishing an executive structure and means of oversight that ensures alignment with the needs and goals of Service members and the Military Services is critical.

Recommendations:

- A single organization should be established that consolidates DoD's commissaries and three exchange systems into a single defense resale system, herein referred to as the Defense Resale Activity (DeRA).
- A DeRA Executive Director should be appointed who reports to a consolidated and simplified BOD. The BOD should replace the boards that currently oversee each of the separate exchange systems and DeCA. The consolidated DeRA BOD should also assume the responsibilities of the Executive Resale Board and the Cooperative Efforts Board and should incorporate expertise from private-sector retail. Supporting committees should be established and empowered as needed.
- A DeRA executive team, along with operational advisors from the current organizations, should immediately be established to define the key attributes of the new organization and plan the transition. This discussion should include a consideration of the recommendations made in this Report and in other consolidation studies. Creation of a single organization should facilitate consolidation of many back-end operation and support functions, alignment of incentives and policies across commissaries and exchanges, as well as consistent implementation of best practices for aligning with the needs of Service members and the Military Services. Core commissary and exchange benefits should be maintained at military installations around the world by continuing the sale of groceries and essential items at cost (plus a surcharge)

⁷²⁷ See e.g., S. 2289, 113th Congress, National Defense Authorization Act for FY 2015, § 907, accessed October 27, 2014, <http://www.gpo.gov/fdsys/pkg/BILLS-113s2289is/pdf/BILLS-113s2289is.pdf>.

and other merchandise at a discount. Under the combined organization, some or all commissary staff could be converted from APF to nonappropriated funds (NAF) employees to reduce commissary employee costs.

- The branding of the current exchange systems and commissaries initially should be retained. A director for each of these branded exchange systems and the commissaries should be appointed under the DeRA Executive Director. These directors should oversee operation of these systems as needed to represent the unique needs of each military service. Personnel evaluations for these executives should be cosigned by the DeRA executive director and appropriate Service representatives. Branding and organizational structure can be modified over time by the BOD.
- DeRA should assume responsibility for the operation of exchanges but not the other organizations currently managed by NEXCOM and MCCS. If approved by the BOD, the current points of integration and shared resources can be maintained through liaison positions and formal memoranda of agreement. For example, if it is mutually advantageous to share support staff between DeRA and Marine Corps MWR, options are available to continue the arrangement that currently exists with the MCX.
- A portion of Military Service MWR programs should continue to be funded from DeRA profits. The BOD should approve the amount of net revenue to be contributed as MWR dividends and should ensure an equitable distribution among the Military Services.
- Laws and policies should be updated to reflect this consolidated structure and allow greater flexibility related to how products are sourced, where they are sold, and how they are priced, as noted below:
 - Allow the sale of convenience items in commissaries at a profit, including products and services typically found in commercial grocers. Food and other essential items should continue to be sold at cost when sold in commissaries or combined commissary and exchange stores (excluding convenience stores). This expanded commissary product line would include beer and wine, but those sales must align with DoD's efforts to deglamorize alcohol and reduce its abuse.
 - Allow for the payment of second destination transportation costs with NAF. Allow significant flexibility on local sourcing overseas, particularly when it is beneficial to the Service member.
 - Allow more flexibility in the creation of combined stores, as currently controlled by Section 2488 of Title 10 of the U.S. Code.
 - Allow the use of the commissary 5 percent surcharge for similar expenses in the exchanges. Conversely, allow the use of exchange profits to cover commissary costs currently covered by the surcharge.
 - Adjust policies on the sale of "brand name" groceries in commissaries to better accommodate the sale of private-label products.

Implementation:

- 10 U.S.C. Chapter 147 governs the activities of the commissary and exchange systems, as well as other MWR entities. It should be amended throughout, with section and subsection headings changed to reflect the consolidation of the several exchanges and the commissary system, and statutory text amended as follows:
 - 10 U.S.C. § 2481 should be amended to make clear that commissary and exchange stores may be combined into single stores, and that commissary stores or the commissary sections of combined stores must still sell grocery items at reduced prices. It should also state that the Secretary of Defense will designate the defense resale system's executive director and the DeRA BOD described above.
 - 10 U.S.C. § 2483 should be amended to authorize the defense resale system to receive appropriated and nonappropriated funds, and to use nonappropriated funds generated by the system to cover the expenses of operating the system.
 - 10 U.S.C. § 2484 should be amended to state that the commissaries' requirement to sell items at reduced prices should be limited to the following categories of items: (A) Meat, poultry, seafood, and fresh-water fish. (B) Nonalcoholic beverages. (C) Produce. (D) Grocery food, whether stored chilled, frozen, or at room temperature. (E) Dairy products. (F) Bakery and delicatessen items. (G) Nonfood grocery items.⁷²⁸
 - 10 U.S.C. § 2485 should be amended to establish the DeRA BOD described above, granting the Secretary of Defense the authority to establish the board, which should include five voting members—a senior representative from each Military Service and the Under Secretary of Defense for Personnel and Readiness—as well as nonvoting members with experience related to logistics military personnel and entitlements, and other relevant areas. The section should also be amended to allow the Secretary to assign a limited number of active-duty Service members to the defense resale system, when necessary, including to serve as the Executive Director.
 - 10 U.S.C. § 2487 should be amended to eliminate references to the separation of commissaries and exchanges and disestablish the Defense Commissary Agency.
 - 10 U.S.C. § 2488, which sets forth limited conditions under which commissary and exchange stores may be combined, should be repealed.
- Any other regulations (including the Code of Federal Regulations, if applicable), instructions, directives, or internal policies necessary to conform to the recommendation described above should be reissued, updated, amended, retracted, or otherwise changed as needed.

⁷²⁸ Nonfood grocery items are further defined in DoD Commissary Program, DoDI 1330.17 (2014), Enclosure 4, 28-29. In conjunction with the consolidation of commissaries and exchanges, the Commission recommends redefining nonfood grocery items to specifically include categories of personal health such as aspirin and diapers, omitting beauty products such as makeup and perfume.