

STATEMENT BY:
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BEFORE THE
MILITARY PERSONNEL SUBCOMMITTEE
OF THE
COMMITTEE ON ARMED SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
109TH CONGRESS, 2ND Session
HEARINGS ON
MORALE WELFARE AND RECREATION PROGRAMS
AND RESALE ACTIVITIES
15 MARCH 2006

NOT FOR PUBLICATION
UNTIL RELEASED BY
THE HOUSE ARMED
SERVICES COMMITTEE

Mr. Chairman and Members of the Subcommittee. As the Commander of the Army and Air Force Exchange Service (AAFES), it is my privilege to appear before this Subcommittee to update you on the essential service and support that AAFES provides to our men and women of the Armed Services and their families throughout the world. First, however, I want to take this opportunity to thank this Subcommittee, on behalf of the military community we serve, for your support of quality of life programs.

Today, in the era of the all volunteer force with operational tempos not seen in decades, the importance of Morale, Welfare and Recreation (MWR) programs to the quality of life of service members and their families is more significant than ever. AAFES takes pride in its support for these programs and their contribution to military readiness and retention. While our brave Soldiers, Sailors, Airmen, and Marines serve on behalf of their country, I am proud to say that they do not serve alone. As we have for over 110 years, AAFES is alongside them providing necessary goods and services and perhaps most importantly, a welcomed sense of home.

AAFES is defined by our two-fold mission: to provide quality merchandise and services at competitive prices and to generate earnings to augment the Services' MWR programs. Our individual customers look primarily to the low prices that have traditionally characterized exchange shopping. To them, we are the BX and PX they have shopped throughout their careers, and they look upon their Exchange as a major form of non-pay compensation. Each day, AAFES strives to fulfill these expectations and is committed to providing value, service, and support to military members, their families, and retirees.

The Army and Air Force Exchange Service has matured into a progressive, global retailer with more than 45,000 employees in over 30 countries, 5 U.S. territories, and 49 states. Our

customers are the 11.6 million active duty, Reserve, National Guard, and retired military members and their families stationed around the world. We also provide service to Marines in Okinawa, Iraq, and Afghanistan. Operating over 3,100 customer service facilities worldwide, AAFES provides a wide variety of retail, food, and services operations. In addition to our well known anchor – the BX/PX main stores - AAFES provides the military community with a wide range of convenience and specialty stores for things such as DVD/video rental, furniture, military uniforms, and accessories. Our business portfolio also includes car care centers, gas stations, and a variety of vending operations. Additionally, AAFES operates 1,765 food activities providing a combination of name brand fast food including Burger King and Taco Bell, and AAFES proprietary brands like Robin Hood specialty sandwiches and Anthony's Pizza. Working with your constituents via local small businesses and community entrepreneurs, we partner for a host of personal services like beauty salons, barber shops, and dry cleaning services to complement the direct support we provide to the military community. AAFES also operates movie theaters on installations worldwide, and along with stars like Matthew McConaughey and Jessica Simpson, AAFES hosts free movie screenings of some of the latest films just for our military families.

Overseas, we operate bakeries, along with ice cream and bottled water plants to ensure our customers have the same fresh, high quality products they enjoy in the United States including Wonder Bread, Baskin Robbins Ice Cream, and Culligan Water. These plants prepare and package goods not only for sale in our stores, but also for other components of the military community including commissaries, troop dining facilities, military hospitals, and MWR clubs. As the designated School Feeding Authority for the Army and the Air Force, AAFES provides 26,500 nutritious meals per day to 115 DoD schools in 9 countries on a breakeven basis.

AAFES serves an extremely mobile customer base. We meet this need through our e-commerce website (www.aafes.com) and mail order catalog. AAFES manages these operations for all of the Military Services, so if America's service members are not near a store, we can bring the store to them. In addition to the large AAFES stock assortment, there are thousands of items offered by our virtual vendor partners like Dell and Hewlett Packard computers and Outdoor Superstore's boating, camping, and fishing equipment. To further enhance the shopping experience, customers can access special discounts on unique merchandise and services through the AAFES online concession site, Centric Mall. The offerings continue to grow on this robust online program, now celebrating a decade of service.

The Military STAR Card, developed and managed by AAFES for all of the exchanges, is the 3rd largest proprietary credit card in the United States. The Military STAR Card offers one of the most competitive interest rates in the country and even better interest and payment policies for our deployed customers. As part of AAFES' commitment to our patrons and to honor those serving in harm's way, AAFES has absorbed almost \$1 million in Military STAR Card debt for those killed in action since Sept. 11, 2001.

While AAFES is committed to providing value, service, and support to the military community in a variety of important ways, our promise to the men and women deployed in service to their country is at the heart of our existence. AAFES provides support to joint and coalition forces serving in OPERATIONS JOINT FORGE, JOINT GUARDIAN, IRAQI FREEDOM and ENDURING FREEDOM to include the Combined Joint Task Force – Horn of Africa. AAFES currently has 62 contingency exchanges in operation and supports 39 imprest fund activities in the theater of operations. On average, AAFES has 490 associates who volunteer to support these ongoing contingency operations downrange. I am proud and honored to say that AAFES volunteers understand shared sacrifice and the importance of their support to

deployed service members. One AAFES associate, Mr. Daren Braswell, made the ultimate sacrifice shortly after volunteering to extend in theater for a second 6-month tour.

In addition to our support downrange, AAFES has developed programs to support service members and their families beyond the area of operation. For those wounded in OEF/OIF and evacuated to Landstuhl Regional Medical Center in Germany, AAFES associates provide personal shopper services to ensure troops have the basics including personal items and clothing. Extending into cyberspace, the “Serving Troops Downrange” web link contains valuable information about all AAFES deployed operations supporting troops around the world. This useful tool is designed to assist individuals and military units as they prepare for deployments.

To assist American citizens in expressing their support for our service members, the joint service “Help Our Troops Call Home” program allows any American to purchase a Prepaid Phone Card (PPC) at www.aafes.com for delivery to deployed service members serving in OEF or OIF. To date, 135,176 phone cards have been purchased. There is a similar link on the website for the purchase of gift certificates that can be redeemed in any exchange around the world. We are honored by the support of everyday Americans who have donated over \$1,173,000 for these “Gifts from the Homefront.”

AAFES also deploys in support of non-combat operations, military exercises, and natural disaster relief operations. In 2005, AAFES supported EXERCISE NEW HORIZONS in Panama and Nicaragua as well as EXERCISE BRIGHT STAR in Egypt. Our experience in supporting remote locations was an invaluable asset in our response to Hurricanes Katrina and Rita. AAFES responded to these natural disasters by placing tactical field exchanges in Mississippi, Louisiana, and Texas, which served Soldiers and Airmen deployed in disaster relief operations. Our first tactical field exchange was operational at Kessler AFB 48 hours after Katrina passed. At the height of our efforts, AAFES had six tactical field exchanges in operation serving service

members and relief workers at various locations. AAFES continues to live up to its motto of “We go where you go.”

I am pleased to report that AAFES remains a strong and viable organization. Our continued efforts to cut corporate costs and implement strategies to improve customer satisfaction are paying off; AAFES expects to end its fiscal year (FY) 2005 with total revenue of \$8.6 billion. This total is comprised of projected net sales of \$8.2 billion, financial revenue of \$181 million, and concession sales of \$172 million. After cost of goods, other expenses, and pension trust income adjustment, AAFES earnings are projected to be \$324 million. This translates into projected total dividends of over \$234 million to the military Services and per capita dividend for each Soldier and Airman at \$237, in addition to the dividends AAFES pays to the Navy and Marine Corps.

In support of our operations, AAFES receives about 2.4% of our total expenses in appropriated funds (APF); the largest component of which is applied to Second Destination Transportation (SDT) expenses. In 2005, excluding supplemental funding, approximately \$142 million was spent to transport affordable products to military members and their families who are serving their country overseas, fulfilling the Congressional intent of maintaining the military family’s Quality of Life by offering affordable goods to those serving overseas. In the 2006 National Defense Authorization Act, this committee’s actions reinforced the importance of this support by ensuring that SDT funds are not optional. As always, AAFES will continue to look for efficiencies that could decrease the amount of appropriated funds needed.

We know that our customers are at the heart of our existence and continued success. So that we can be sure we are meeting our customer’s expectations, AAFES subscribes to the American Customer Satisfaction Index (ACSI), an independent national survey conducted annually by the University of Michigan. The independent ACSI results indicate that our

customers recognize our progress. Our 2005 ACSI score from the Department and Discount Store Industry went up 2 points to 74 while industry went up 1 point, narrowing the gap between industry and AAFES to only 1 point. This is an improvement of 2.8% over our 2004 score of 72 and 7.2% over our benchmark year score of 69. Taking into consideration that many of our patrons have been deployed this past year, these numbers are very encouraging.

The AAFES ACSI score improvement validates our 2005 internal Customer Satisfaction Index (CSI) score of 73, which duplicated our highest ever overall score achieved in 2004. These scores indicate that our continued emphasis on the key drivers of customer service, such as problem resolution, pricing, merchandise selections, store layout, and the overall shopping experience, is important to our patrons. Our online Customer Satisfaction Action Planning process helps our managers and associates stay focused on specific strategies and actions to improve customer service throughout the year. With this emphasis, AAFES expects 2006 to be another record setting customer satisfaction year.

Customers are also recognizing the value AAFES provides in comparison to the competition. Our most recent market basket survey indicates that AAFES is regularly saving customers an average of 22.09% on the typical military family's basic, everyday necessities—and that's without considering the fact that they receive sales tax relief. If we consider the index including an average tax savings, each patron's savings would be 28.1%. These numbers demonstrate that AAFES continues to provide a significant benefit to our military members and their families.

Not only are customers recognizing AAFES' accomplishments, but our industry partners are as well. The food service industry recognized AAFES' expansion of name brand fast food through the Restaurant Developer of the Year by both Pizza Hut and Godfather's Pizza; and AAFES Baby's Choice infant formula received the prestigious Good Housekeeping Seal of

Approval ® from the Good Housekeeping Institute. Finally, Black Professionals Magazine named AAFES one of its Top 25 organizations for African-Americans, recognizing our leadership in work force diversity.

AAFES is working hard to keep customer satisfaction and dividends high by constantly improving the shopping experience on military installations. The condition of our facilities, modern technology, and our ability to replenish merchandise are key drivers that impact the customer's perception. In 2005, AAFES completed 93 major construction projects totaling \$174 million. As a result of these projects, AAFES opened 234 new retail, food, and service activities to include 4 shopping centers. In addition, AAFES completed 342 Image Update and renovation type projects with a value of \$69 million. 2005 was a robust year for facility improvements; altogether, \$243 million of improvements were completed to construct, sustain, and modernize shopping facilities around the world, a 44% increase over 2004. Currently, AAFES has over \$425 million of capital improvement projects underway at installations such as Ft. Drum, NY; Little Rock AFB, AR; Dyess AFB, TX; Ft. Bragg, NC; Ft. Campbell, KY; Los Angeles AFB, CA; Ft. Irwin, CA; and our largest complex ever, Ramstein KMC in Germany. As we look ahead, the 2006 capital program will be one of the largest and most aggressive programs we have had in recent years as we continue to provide our patrons modern, customer-friendly exchange facilities.

A key component of our capital investment strategy for FY 2006 and beyond is the acquisition of the Oracle Retail (Retek) merchandising information technology system. Once implemented, we expect that Oracle Retail (Retek) will increase sales, reduce inventory investment, increase gross profit, and decrease operating costs which will have a positive impact to earnings up to \$261.4 million over the next 5 years.

Certainly we have had much to celebrate in 2005, but we recognize that our work is not done and that there are significant risks and challenges ahead for 2006 and beyond. AAFES is working closely with the Military Services to prepare for the challenges of force re-stationing initiatives overseas and to respond to projected costs both in terms of local national workforce displacement, relocation, and lost sales. We are encountering similar challenges resulting from last year's Base Realignment and Closure (BRAC) actions. Many of the costs associated with these transformation efforts are authorized to be paid with appropriated funds, but there is still concern that these actions will ultimately impact our contributions to the MWR programs. AAFES estimates that re-stationing in Germany and Korea could impact dividends by \$47 million and BRAC 2005 by \$29.7 million through FY 2011.

In the face of these challenges, AAFES looks forward to the coming years with confidence and optimism for our mission and for our customers alike. We will focus on maximizing earnings and dividends, but at the same time, we will not shy away from offering the value, service, and exceptional support to military members in ways that other retailers can not provide, in places they will not go. AAFES is implementing a number of strategies that will keep us focused on growing our business and reducing our costs. We will continue to work at making shopping more convenient by using similar standardized store layouts that are well-signed and well-stocked. In addition, we're making shopping AAFES more fun by expanding what we call "retail-tainment." Book signings by popular authors, shows by professional football team cheerleading squads, appearances by professional wrestlers and actors create excitement, while demonstrating to customers and their families how much AAFES is committed to their support.

While AAFES continues to offer the latest industry styles and trends, we are revising our lifestyle stock assortment from an emphasis on prestige brands to a more casual and affordable

variety. In addition to name-brand fashion and clothing, we are expanding our private labels like R&R Casuals and Passports. With our private labels, we seek to offer good quality fashion at an affordable price. We expect 2006 to be another banner year for growth in our consumer electronics category, bolstered in large part by this body's endorsement of the recent update to the Armed Services Exchange Regulations (ASER) to allow the sale of projection televisions. I would like to personally thank this subcommittee for your support in expanding this category of merchandise, along with your backing to raise the cost limits on finished furniture. Our customers expressed their thanks at the register as AAFES has experienced significant increases in the projection TV sales since September 2005, which resulted in increased dividends to MWR. We will continue to advocate removal of the remaining ASER merchandise restrictions; our military consumers should be allowed to use their exchange to purchase any item they need or desire for their family at lower prices and at the industry's most favorable credit terms.

As the AAFES Commander, it has been my honor and privilege to travel the globe and talk to Soldiers and Airmen first hand to hear about what the exchange benefit means to them and what a difference the BX/PX has made to their morale. I am extremely proud of the AAFES team as they have worked hard to continue to ensure the viability and relevance of the exchange benefit for service members. As an organization AAFES is committed to partnering with DeCA and the other exchanges in a common goal of improving the value and benefit to all military members. I appreciate the support this Sub-Committee has provided AAFES in the past and I am confident that with your ongoing support, AAFES will continue to provide the quality of life benefit that Soldiers, Airmen, retirees, and their families deserve and expect for years to come.

I look forward to answering the Committee's questions.