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Mr. Chairman and Members of the Subcommittee. As Commander of the Army and Air Force Exchange Service (AAFES), it is my privilege to once again appear before this Subcommittee to share this command's strategic direction, business plans and some future challenges. On behalf of the military community we serve, I want to thank this Subcommittee for your support of the exchange benefit and our quality of life programs.

AAFES has a long and proud history of service and support to America's armed forces, and 2006 was no exception. We continue to fulfill our historic two-fold mission; to provide quality merchandise and services at competitively low prices to Soldiers and Airmen stationed around the world; and to generate reasonable earnings to augment the Army and Air Force Morale, Welfare, and Recreation (MWR) programs. This foundation of service and support is at the center of all we do at AAFES. We take great pride in being the retailer of choice for service members and their families at home and abroad and in our contribution to military quality of life, readiness, and retention.

For nearly 112 years, AAFES' goal has been to support the men and women of the armed forces around the world in peace and in war. "We go where you go" epitomizes the AAFES mission, particularly when our service members are stationed far from American soil. AAFES currently delivers the exchange benefit to deployed troops through more than 50 base/post exchange (BX/PX) facilities, 184 name brand fast food operations, 69 phone centers and hundreds of concession activities throughout Iraq, Afghanistan, Kuwait, the Horn of Africa, Bosnia and Kosovo. This commitment of resources makes it clear that support to deployed forces is one of the most important jobs AAFES will ever do.

Operations of this scope, in locations that are often austere, would be impossible without the dedicated and enthusiastic AAFES workforce. On any given day, about 450 devoted AAFES

volunteers are deployed in support of Operations Enduring Freedom (OEF) and Iraqi Freedom (OIF) and since 9/11, nearly 2,000 associates have left the comforts of their home and family—often choosing to extend their tour or redeploy a second or third time. When 450 associates are deployed, their home stores are stretched thin. Jobs go unfilled and junior employees work hard as they step in for more experienced associates.

Total AAFES operational support for military contingencies and natural disasters increased significantly in 2006. AAFES associates took the exchange benefit to the Bright Star exercise in Egypt, to firefighters battling wildfires in Washington State, to the National Guard Border Patrol Operation in New Mexico, and to four locations in Central and South America where the Southern Command is building new roads and infrastructure.

Not only does AAFES provide support to deployed personnel directly, we also offer programs that allow family members and other US citizens to show their patriotic spirit. AAFES has prepaid calling cards for sale at www.aafes.com to anyone wishing to donate to “Help Our Troops Call Home.” Since the inception of the program in 2004, more than 192,000 cards have been purchased to help service members stay in touch with family and friends. There is also a link on the website for purchasing gift certificates for deployed troops that can be redeemed in any military exchange in the world. Americans have generously contributed in excess of \$1.7 million for these “Gifts from the Homefront.” AAFES also provides the Patriot Family Connection which allows the American public to send troops messages of support that are seen and heard in exchanges throughout the contingency theater and overseas.

No matter where military members serve, AAFES provides a comprehensive and customer-focused benefit. In addition to our flagship main retail stores, AAFES operates convenience stores, car care centers, military clothing sales stores, fast food restaurants, retail concession services like flower shops and gift stores, vending, telecommunications services and

a wide variety of personal services through more than 3,100 facilities in 31 countries, five US territories, and 49 states. Overseas, AAFES operates bakeries and dairy, ice cream, and water plants to ensure our shoppers have access to the same quality products they enjoy in the United States. We bake and package goods not only for sale in exchanges, but also for issue to commissaries, dining facilities, hospitals, and clubs. In support of Department of Defense (DoD) schools overseas, we are providing more than 24,000 lunches every school day at 99 schools in nine countries.

AAFES also offers a wide variety of merchandise through our e-commerce and catalog platforms, which we operate on behalf of all exchanges. The exchange has been in the mail-order business since 1904 and we publish two “big book” catalogs and numerous supplemental catalogs each year. Online shopping has become as common as traditional store browsing. To keep our services convenient to the customer, AAFES provides the exchange online store via the aafes.com website. Troops and their families know they will find the low prices and great values they have come to expect from their exchange shopping experience, regardless of whether they visit an exchange location, order from catalogs, or shop online at www.aafes.com.

To remain responsive to the needs of those we serve, the exchange services must continue to provide the product selection in the categories of merchandise that military shoppers expect. AAFES will continue to advocate for the repeal of the merchandise restrictions that deny Army and Air Force families the ability to buy a more extensive range of products and services from their exchange. This will please our customers and allow the exchanges to increase support to the MWR programs.

Satisfying our customers is a top priority and one for which AAFES received several national awards in 2006. Nation’s Restaurant News honored our food operations, which stretch from Ft Bragg to Baghdad, with the 2006 Golden Chain Award, while DiversityInc named

AAFES a Noteworthy Company for demonstrating corporate diversity success. Furthermore, AAFES was ranked 38th on the National Retail Federation's Top 100 Retailers list and rated 60th in the Guide to Retail Web Sites top 400 Internet Retailers.

As you can see, AAFES is more than just a retail store. As one of the largest employers of military spouses and family members, it is also a part of the fabric of military life. Currently, about 23 percent of AAFES' more than 45,000 associates are military family members and another 1.1 percent are military members who work part time in the exchanges during their off-duty hours.

In 2006, AAFES embarked upon one of its most challenging years in recent history. Unmet retail industry expectations, the impact of troop restationing, and long-term support of contingency operations are some of the challenges AAFES faced in 2006. Remarkably, we project revenues for AAFES fiscal year (FY) 2006 will reach \$8.9 billion, an increase of \$257 million over FY05. Earnings subject to dividend are expected to be \$330 million. This represents a one percent increase from FY05 and is six percent higher than the financial plan for FY06. The ability to surpass the plan is attributed in large part to Congress' supplemental funding for our support of the military missions in the War on Terror; AAFES was reimbursed \$80 million in FY06. This funding helps offset extraordinary expenses incurred during operations in OEF/OIF. Without this support, MWR dividend contributions would have been significantly reduced. For FY06, AAFES is expected to contribute \$219 million in dividends which support the Army, Air Force, Marine, and Navy service members.

AAFES receives minimal indirect appropriated funds (APF) to support exchange operations. The largest component, \$136 million, was applied to Second Destination Transportation (SDT) expenses in 2006. Second Destination Transportation funding enables AAFES to provide balanced pricing for Soldiers and Airmen stationed overseas and fulfills

Congressional intent to provide the staples of an American lifestyle and improve the quality of life for military families serving abroad. AAFES takes very seriously its role as steward of these appropriated funds and implemented a number of initiatives that avoided \$18.6 million in SDT costs in 2006.

AAFES earnings not only generate dividends directly supporting MWR programs, but also provide for re-investment in capital infrastructure for new and renovated facilities without expense to the taxpayer. AAFES invested \$195 million in capital improvements in 2006 to build and upgrade 275 new activities that serve as retail, dining, and services destinations for military families around the globe. Currently, more than \$473 million of improvement projects are under construction at installations such as Ft Benning, GA; Ft Campbell, KY; Schofield Barracks, HI; Beale AFB, CA; Andersen AB, Guam; Ft Lee, VA and Peterson AFB, CO.

AAFES continues to exhibit solid financial performance, but to properly plan for the future we must clearly assess the strategic situation. AAFES contends with the pressures of an extremely intense, aggressive, and competitive retail environment. Military transformation, including the impacts from BRAC and GDPR, competition for installation support funds and the support to long-term contingency operations create challenges that require strategic thinking, organizational agility, and the flexibility to implement better ways to conduct business. For those reasons, AAFES is focused on two strategic imperatives: first, to be the best retailer we can be; and second, to develop and grow new, profitable businesses.

To be the best retailer, supply chain transformation is critical to improving performance. We are implementing a new web-based transportation management system that will improve visibility and control over the entire supply chain network. Another key component of our capital investment strategy has been Project Retek, which is scheduled to begin full implementation by the first quarter 2008. This initiative is the largest information technology project in AAFES

history and will help AAFES increase sales, reduce inventory investment, increase gross profit and decrease operating costs. We expect to generate savings of \$537 million over five years and project a \$261.4 million positive impact to earnings. To support the transformation into the Oracle Retail software, AAFES is reorganizing its Sales Directorate and has established a Business Intelligence Group to improve corporate level, long-term analysis and research that will help us better deliver the right product, at the right price, and at the right time.

The second strategic imperative, to develop and grow new, profitable businesses, will allow AAFES to help installation commanders provide better quality of life and community support for their troops while reducing reliance on APF. We will continue to work with all the DoD stakeholders and with private sector partners to improve military communities.

Since my previous testimony, we have created a Strategic Partnership directorate within AAFES to concentrate on identifying and developing new, profitable business opportunities. Presently, this team is focusing on several initiatives, including Community Development and Advanced Telecommunications.

In recent years, the retail landscape has increasingly shifted away from traditional formats to emerging “lifestyle centers”; retail developments reminiscent of the small downtown shopping districts and town centers where parents strolled along with their children on their way to the local ice cream shop or to the park to feed the birds. That sense of place and spirit of community is becoming a central part of commercial retail developments once again. Conventional covered malls anchored by department stores, such as the nearby Springfield Mall, provide some sense of place, but their enormity provides little convenience. Power centers – a “big-box” super center surrounded by strip shop retail - offer high convenience, but no sense of place.

Because military consumers desire a sense of community and convenience that lifestyle centers can provide, the AAFES Community Development Initiative is aimed at creating a safe and secure environment where service members and their families can shop, watch a movie or get a bite to eat, all within a close distance of their homes. With the installation planners and all of the relevant DoD stakeholders, we are focusing on building communities where shoppers feel an emotional attachment and a sense of place – key factors that positively impact military recruitment and retention. Integral to the success of these new developments, AAFES is creating partnerships with the Army Family and MWR Command, Air Force Services, as well as DeCA to broaden the offerings and leverage the natural synergies that exist between these organizations.

Not every installation is geographically or physically suited to the new town center concept. In these cases, AAFES is implementing a new shopping center prototype that will afford military shoppers maximum convenience and choice. These one-stop facilities focus on low prices, large assortments, and expanded name brand fast food and services. The first prototype shopping centers are now open at Holloman AFB, NM, Los Angeles AFB, CA, and Stuttgart Panzer Barracks; Grafenwoehr, Germany will open this year. The success of this strategy is already apparent by the 30 percent increase in sales at these larger facilities.

Another format that has become increasingly popular in recent years is the supercenter concept, which combines grocery items with general retail merchandise. We recognize that any proposals for implementing this concept on a military installation would require consideration of the unique and fundamental differences between the missions and funding streams of the commissary and the exchange; DeCA supported by APF and AAFES fueled by Soldier and Airmen dollars.

In the last few years, we have all witnessed a significant change in the telecommunications industry and its effect on how we obtain Internet, cable television, and telephone services in our homes. Previously, we obtained such services from three separate companies. Today, many of us obtain all three services from a single company. At the same time, changes in technology allow us to provide that convenience to our Soldiers and Airmen overseas and stateside. Our new Advanced Technology Initiative will allow AAFES to explore partnerships with leading companies in the telecommunications industry to provide service members and their families the same entertainment experience on overseas bases as they could have in the United States. We believe this initiative will dramatically improve quality of life for our Soldiers and Airmen throughout their military career and help grow the MWR dividend.

In addition to the internal AAFES efforts to improve operational efficiency, profitability and growth, we are engaged in cooperative effort initiatives as a means to implement synergistic efficiencies among the various elements of the military resale system. For many years, the Military Exchange Services have participated in cooperative efforts, collaborating on projects of common value. In 2006, the Exchange Cooperative Efforts Board placed additional emphasis on these initiatives. Three core cross functional teams are focusing on short- and long-term efficiencies across the exchanges: indirect/non-resale procurement, logistics and enterprise architecture. A fourth team is addressing cross acceptance of exchange gift cards which will become a reality later this year. Initial discussions with our Army MWR and Air Force Services colleagues have also generated ideas that could support common warehousing, transportation and food service procurement. We have made great progress in strengthening these relationships and in defining common objectives.

Discussions on mutually beneficial cooperation are not limited to our sister NAF organizations. AAFES recently began exploring initiatives with DeCA that focus on win-win-

win opportunities for both organizations based on three guiding principles: maintaining or growing the MWR dividend, reducing DeCA's APF requirements, and growing their surcharge account. I say win-win-win because these combined efforts should result in benefits for the exchange, DeCA, and the military community. We are exploring ways to collaborate, but we must be careful not to subsidize APF responsibilities with NAF resources. This is especially important in the intense budget pressures of a wartime environment when mission requirements soak up every excess dollar and the funding obligations for quality of life programs are largely unmet.

In summary, while AAFES continues to meet the unique and diverse needs of mobile military service members, the road ahead is a difficult and challenging one. The actions we take together today will ensure the long-term fiscal viability of AAFES tomorrow—with a focused and dedicated effort on our mission of serving the best customers in the world.

I look forward to your questions.