

American Logistics Association Analysis of Privatization Aspects of DoD Budget Neutrality Report



On May 25, 2016, the Department of Defense released a report that was requested in the Fiscal Year 2016 NDAA. “Report on Plan to Obtain Budget Neutrality for the Defense Commissary System and the Military Exchange System.” The report strengthens the argument that privatization should not be mandated until it is more closely examined by Congress and the DoD. The report cites a huge number of unknowns to privatization. It simply demands more review. Let’s look at what the report found:

- Commissaries are an important aspect of the compensation support structure of DoD. “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.”
- 80 percent of active duty personnel use the commissary.
- DoD needs time to develop a “structured approach to develop collaborative solutions to achieve efficiencies and savings.”
- DoD is in the midst of major reforms on the commissary benefit.
- Privatization “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.
- “Would require dramatic reductions in the commissary and exchange workforce, which is made up, in large part, of military family members.”
- DoD does not believe privatization could replicate the range of benefits, level of savings, and geographic reach provided by the Defense commissary system and achieve budget neutrality.”

DoD needs time to continue their investigation of full or partial privatization based on private sector interest. They surveyed a number of private sector companies and three indicated an interest in providing the commissary benefit.

- There are different forms of privatization. It is in fact not an all-or-nothing proposition.
- The companies that might be interested in supporting privatization are not of a single sector, size, or reach.
- In order to privatize, 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.

- 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).
- Concerned 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.
- Continued dialogue with these companies and others is necessary to fully assess how and what to privatize.
- Concern about the ability of these companies to deliver 30 percent savings in an industry that routinely averages 25-28 percent gross margins.
- Concern 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.
- The Department is still in the midst of its privatization feasibility review. They have published 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.

The report cites a number of considerations that need to be closely examined before any decision to privatize:

- 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.
- 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.

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)
- 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))
- The loss of ancillary industry support, valued at almost \$250 million annually.

The report also underscores the importance of the existing commissary structure to DoD:

- 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 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.
- The commissary favorably impacts Departmental resources and 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.
- 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 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 Significantly Disabled Statute: The DeCA supports the AbilityOne Program which is managed and implemented by the U. S. AbilityOne Commission.
- 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.
- Food Donations: In FY2015, 134 of DeCA's commissaries donated 2.32 million pounds of nonsalable, 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.