AMERICAN LOGISTICS ASSOCIATION
1101 Vermont Avenue N.W. Suite 1002 Washington D.C. 20005
Phone: (202) 466-2520 Fax: (202) 296-4419
www.ala-national.org

Introducing private label products in commissaries

Look before leaping--Failure to validate and test before implementation could lead to major impact on commissary operations and patrons

Items for consideration by Defense and Congressional policy makers

ALA position

- Congress should adhere to the reform review process set forth in the FY 2016 Defense Authorization Act that mandates a GAO review of DoD plans prior to proceeding.

- Industry analysis shows that for every dollar gained in "revenue" for commissaries introducing private label, $1.50 to $2 may be lost. A potential loss of $244 million.

- In the legislative proposals presented by DoD in the 2107 PB, DoD plans to proceed with testing concepts that Congress said must be presented and evaluated prior to fielding.

- The pilot authority included in the fiscal year 2016 NDAA should not be expanded to permanent authority until the test is completed and objectively evaluated.

- There is potential for violation of the Competition in Contracting Act when private label vendors are provided with across-the-board preferential treatment in product selection and shelf space allocation.

- DeCA would be well served to consider a parallel test of expanding the existing lines of value brands that provide comparable prices to private label.

- If DoD is to pilot or test introducing private label products into commissaries, existing law should not be permanently changed until a test is conducted and objectively evaluated along these lines:
    1. Establish clear parameters and success measures (numbers and timeline) prior to test execution.
    2. The test should be limited in scope and duration.
    3. Limit tests to smallest possible geographies/fewest categories to allow DeCA to effectively measure the cost versus return (ROI).
    4. Ensure No current brands are deleted with sales or share above certain pre-determined levels.
    5. Leverage these predetermined success measures to secure chain wide "go/no go criteria" agreement with DOD prior to test market execution.
    6. Track and measure results via scorecard process in weekly, monthly, quarterly, six month and annual increments.
    7. Competent and comprehensive in house private label capabilities.
    8. Closely define the parameters for any test of variable pricing to ensure a proper evaluation of the model is reviewed and accepted before expansion. We would suggest no more than one or two product categories are included in a test for evaluation. Patron savings levels must exceed current patron savings levels in the test categories.
    9. Because of the importance of the value brands to the young military family, DeCA should be required to evaluate current levels of patron savings from value brands by category. They should test no more than 1 or 2 categories with private label and must achieve better patron savings level than the value brands currently deliver in those categories.
    10. DeCA should consider best source pricing by category for its private brands that will include current value brand suppliers.
    11. Any incremental cost of developing and implementing a private label program, as well as a variable price program, should be included in the patron savings calculation.

DoD Proposal

The DoD's plan (see attached) for commissaries is to institute changes to the supply chain that would enable commissaries to generate revenue to offset operating expenses without raising prices to the patrons. Recently the law was changed to allow for the introduction of more private label products into commissaries.

Current commissary planning calls for increasing the number of private label brands, using the variable pricing pilot authority to have a mark up on these products to offset operating costs for DeCA that are currently paid for by appropriations.

DoD has proposed legislation to provide permanent authority to implement “flexible” pricing and full implementation of a private label, perhaps system-wide (see attached).

Background and data supporting the ALA position

One of the business model changes DoD is proposing to improve the value of the commissary shopping experience and a possible reduction in reliance on Appropriated funding is the introduction of “private label” products into the commissary system. This was initially proposed as part of a pilot test of this concept along with pricing changes that would be submitted to congress for review and approval after a follow on evaluation of the proposed program by the GAO. Now, it appears that that GAO review requirement is falling by the wayside. It is important with a change of this magnitude and the downside associated with a failure of these pilot programs that the initial intent of congress to conduct a pilot and to have an independent review of the DoD proposals must be adhered to. Therefore we submit the following topics for consideration as the Armed Services Committees begin the deliberations on the 2017 NDAA.

ALA was operating under the assumption that there would be a comprehensive review of the DoD’s proposals prior to implementation and that we would have the opportunity to provide our views. It now appears that this initiative is moving forward without this review. As ALA members represent 90 percent of the exiting supply chain, it is imperative that the existing industry that serves these programs be allowed to provide its views to ensure success of the program.

Data from top manufacturers currently marketing to the resale industry show that introduction of more private Label products in commissaries may not yield revenue increases for DeCA but would instead result in significant losses. Under the best-case scenario, commissaries would be able to generate only $28 million over four years, but, more importantly, the risk for commissaries is a $244 million reduction in product support for commissaries (see attached).

This reduction in industry support occurs primarily because of promotional funding loses from manufacturers. Other the risks include:

- Expense to implement the program
- Robinson Patman Act impications for manufacturers
- Vendor stocking
- Secondary transportation pricing
- Lost coupon proceeds
- Media support reductions
- Vendor trade fund accrual loss
- Brokerage coverage
- Trade down in category dollars
- Subjecting DeCA to the same pricing considerations offered to all retailers.

Had the Department of Defense or it's consultants talked to the existing resale industry, they would have learned these potential pitfalls and risk to the program.

According to a DeCA-commissioned study by Willard Bishop and Dove Consulting in 2004, any gains from lowering product acquisition costs, marking up products and using the proceeds to offset operating costs resulted in major losses in vendor promotional and stocking support. The report recommended against changing the business model for DeCA.

The complex actions and competitiveness of the private label business will require DeCA to invest significant resources (appropriated dollars) without a test to validate its cost/benefit. There doesn't seem to be a test to validate DeCA's assumptions. Furthermore, DeCA currently has a comprehensive Value Brand program that affords the military patrons opportunities to purchase alternative brand name products, especially those who use SNAP. Is there an assurance from DeCA that any private label initiative will not result in higher prices to its patrons than the value brand program that now exists?

In addition, branded manufacturers provide a significant amount of support to DeCA either directly or through their representatives. Examples of this type of support would include: promotional trade spending, retail store support to include schematic sets, distributor management, and promotional signage, shelf stocking, and working with stores to keep CAO data accurate. It doesn't appear that DeCA has considered the impact of reduction in support from its branded suppliers if it pursues private label.

A comprehensive private label program hasn't been properly reviewed to determine its full impact on the military patron as well as the appropriated dollars. A significant amount of money that would be necessary to standup and manage such a program, which the national brands currently include in their cost of goods, should be evaluated.

Implementing a private label program is a complex undertaking that will require upfront costs to contract and develop products as well as additional ongoing costs to implement. And there will be additional costs to ship, stock, merchandise and promote the items - costs that are all paid by the vendor community today for the national brand items. As BCG points out, DeCA does not currently have the structure in place to fulfill all of the requirements to properly and effectively manage a private label program and would need to create the structure and hire additional people to manage the structure.

The DeCA director publicly stated that value brands already provide significant savings. "The average added savings across all Value Brand items will be about 20 percent, "he said, "and that's below normal commissary discounts."

But what DoD's consultant (BCG) does not identify is how willing industry partners will be to continue to provide the in-store ancillary support, support that is not provided to other retailers, if DeCA is now competing with them at the shelf and generating profits from the products. This support includes promotional trade spending, retail store support to include schematic sets, distributor management, promotional signage, shelf stocking, and working with stores to keep computer assisted ordering data accurate.

If industry no longer decides to pay for and conduct the in-store support, these costs will have to be borne by DeCA. These costs have not been factored into any of the analysis. In BCG's report, they list all of the people they consulted. Unfortunately, industry was not included in their list. The consultant's assumptions on revenue generation, lower product costs, and savings generated through the sale of private label products are flawed in that they did not take into consideration second and third order effects of introducing private label products in the commissaries.

Private label will change everything for everyone affiliated with delivering the commissary benefit. Pursuing private label requires a full-spectrum analysis, which has yet to be conducted. Therefore, we believe further analysis is required to fully understand all of the costs associated with instituting private label before it is implemented.

These costs will come from APF dollars without the benefit of having sold a single product. The complex actions and competitiveness of the private label business will require DeCA to invest significant resources (appropriated dollars) without a test to validate its cost/benefit. There doesn't seem to be a test to validate DeCA's assumptions.

Branded manufacturers provide a significant amount of support to DeCA either directly or through their representatives:

- Type of support include: promotional trade spending, retail store support to include schematic sets, distributor management, and promotional signage, shelf stocking, and working with stores to keep CAO data accurate.
- It doesn't appear that DeCA has considered the impact of reduction in support from its branded suppliers if it pursues private label.
- DeCA should consider best source pricing by category for its private brands that will include current value brand suppliers.
- A significant amount of money would be necessary to standup and manage a private label program, which the national brands currently include in their cost of goods

Pursuing a comprehensive private label program hasn't been properly reviewed to determine its full impact on the military patron as well as the appropriated dollars:

- Because of the importance of the value brands to the young military family, DeCA should be required to evaluate current levels of patron savings from value brands by category.
    - DeCA should test no more than 1 or 2 categories with private label
    - Must achieve better patron savings level than the value brands currently deliver in those categories.

- Any incremental cost of developing and implementing a private label program, as well as a variable price program, should be included in the patron savings calculation.

The commissary system is too small to have a viable private label program. The total size of DeCA in relationship to other grocery retailers is relatively small. DeCA's annual volume in most categories is between 1% to 2% of retail food sales in the United States (US). Less than these percentages if one includes grocery products sold in Food, Drug, and Mass Market Retailers.

DeCA would be well served to consider a parallel test of expanding the existing lines of value brands that provide comparable prices to private label.

Other factors to consider are the cost to create and implement the program, disruption to current business and patron acceptance, resets, and discontinued items. There are also Robinson Patman implications when DeCA changes from a "Benefit" to a for profit retailer that may subject hem to anti-trust. Further, commissaries would be subject to the same pricing considerations offered all other retailers. Further, the trade down in category dollars would reduce surcharge funding.

DeCA is the number on small business contractor in the Department of Defense. Further, private label would replace lower tiered brands impacting small businesses.

Further, DeCA redeems nearly 74 million manufacturer coupons a year, saving patrons nearly $72 million. Private label does not offer coupons and the more private label that is introduced, the fewer coupons that can be redeemed. (See attached spreadsheet on coupon redemption).

Other impediments to a successful private label program in DeCA are its size—DeCA is not a large grocery chain and its 240 stores are spread across the globe. DeCA uses a third party contractor to receive products at its US stores. And, retailers, which introduce private labels, spend significant resources on developing, managing and promoting their private label brands.

Right now, manufacturers spend billions of dollars advertising and promoting their brands. When private label is introduced to grocery chains, the grocery chains themselves take on the cost of marketing the products. Under this scenario, DeCA should have to spend its own funds to promote its private label program.

There are a number of events where manufacturers, brokers and distributors promote name brand products in the stores to promote different causes. These events would be impacted. Examples include USO, scholarships for military children, Newman's Own and Fisher House.

<u>Private Label/Variable Pricing Principles:</u>

- Private label products must continue to justify retention based on savings, movement and share – just as current national/value brands.

- Hold private label vendors to the same service and support standards expected of all other DeCA suppliers - stocking, display building, resets, etc.
- Ensure no appropriated funds should be used to advertise and promote private label products.
- No appropriated funds should be used for private label salvage or product recalls
- Incremental cost of developing and implementing private label and variable pricing should be included, calculated and measured within the patron savings calculation model
- Ensure Private label is not priced higher than the value brand so you can effectively measure/define the patron value (and acceptance) of PL brands.

The BCG study/recommendations seem to ignore DeCA's current distribution system. In many categories, replacing existing value brands would increase COG not lower it. Following is a list of the top 10 Retail Private Label (PL) categories which account for over 38% of retail food PL sales. A review of several of these categories may provide a reality check on the BCG recommendations.

Time : Latest 52 WeeksIRI Ending 06-14-15		PRIVATE LABEL US FOODS			
PRODUCT	Pvt Label Rank	Dollar Sales	Dollar Share of Category	$ Pvt Lbl Contribution	Cume $ Pvt Lbl Contribution
MILK	1	$6,143,835,824	57.99	10.8%	10.8%
NATURAL CHEESE	2	$3,789,023,195	43.37	6.7%	17.4%
FRESH EGGS	3	$2,577,016,617	61.25	4.5%	22.0%
FRESH BREAD & ROLLS	4	$2,503,712,221	26.30	4.4%	26.4%
BOTTLED WATER	5	$1,357,278,344	27.87	2.4%	28.8%
MEAT - RFG	6	$1,253,212,309	62.84	2.2%	31.0%
SALAD/COLESLAW - RFG	7	$1,043,708,277	28.88	1.8%	32.8%
SEAFOOD - FZ	8	$1,042,007,920	40.53	1.8%	34.6%
ICE CREAM/SHERBET	9	$1,020,200,929	23.52	1.8%	36.4%
SELECT FIXED WEIGHT FRESH PRODUCE	10	$906,957,263	49.43	1.6%	38.0%

Attachments:

- ALA private label versus name brand analysis, April 8, 2016
- Commissary coupon redemption spreadsheet
- Legal and regulatory considerations
- Willard Bishop Study on the cost and value of introducing private label products into commissaries, March 17, 2004.
- DoD fiscal year 2017 legislative proposal
- BCG study of commissaries and exchanges