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HOUSE ARMED
SERVICES COMMITTEE

STATEMENT OF
RADM ROBERT E. COWLEY III
BEFORE THE
HOUSE ARMED SERVICES COMMITTEE
SUBCOMMITTEE
ON
MILITARY PERSONNEL
13 MARCH 2007

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Mr. Chairman and Distinguished Members of the Subcommittee, it is my great privilege to represent the Navy Exchange System (NES) and our dedicated associates worldwide, and it is my honor to update you on our Quality of Life (QoL) Program serving Sailors, their families, reservists, retirees, and joint forces worldwide, everyday. During April 2006, we proudly celebrated our 60th Anniversary providing the Exchange Benefit to the Navy Family since 1946, contributing more than \$2.2 billion over the period to Navy Morale, Welfare and Recreation (MWR) Programs. While our operations have greatly changed since then, our commitment to the Military Family has remained steadfast and strong.

QoL Programs are critical to attracting and retaining a high quality Naval and Military Force. These programs demonstrate Navy's commitment to Sailors and their families, recognizing their dedication and sacrifice to our nation. QoL Programs are not just the right thing to do, but research has shown that such programs positively and directly affect the recruitment, retention, and performance of our people. Our Sailors can better concentrate on accomplishing their missions, when they know they and their families are being well cared for. Navy Exchange (NEX) plays a critical role in family readiness. This role was best described by Admiral Mike Mullen, Chief of Naval Operations, who said, "I am convinced that family readiness is tied directly to combat readiness. Our families serve as we serve..." Today, I will report on what NEX is doing to fulfill this critical role today and in the future.

It begins with our QoL mission, which we deliver through our global retail and service operations – “*Providing quality goods and services at a savings and supporting Navy MWR Programs*”. Balancing this mission is the role of Navy’s combined MWR/NEX Board of Directors. As QoL Programs contribute to personnel readiness and effective functioning of the Navy, our Board of Directors (BoD) is comprised of Senior Navy leadership assigned broad responsibilities for Navy QoL Programs, as well as Fleet customers.

MWR/NEX Board of Directors

Deputy Chief of Naval Operations (Fleet Readiness and Logistic) – Chair
 Commander, Navy Installations Command
 Director, Navy Staff
 Deputy Commander, U.S. Fleet Forces Command
 Deputy Commander, U.S. Pacific Fleet
 Deputy Commander, U.S. Naval Forces Europe
 Deputy Chief of Naval Operations (Manpower and Personnel)
 Deputy Chief of Naval Operations (Resources, Requirements and Assessments)
 Commander, Naval Supply Systems Command
 Commander, Naval Reserve Force
 Commander, Navy Exchange Service Command
 Assistant Commander, Navy Personnel Command for Fleet Support
 Master Chief Petty Officer
 Ex-officio Member:
 Navy Judge Advocate General

Committees

Finance
Reviews financial policies, annual budgets, long range plans

Facilities
Integrates and reviews capitalization requirements, prioritizes needs versus available resources

Audit
Reviews findings of external independent audit reports, ensures internal managerial controls

Responsibilities:

- Provide strategic direction for MWR & NEX
- Establishing requirements, including financial targets

Our Shareholders – 421,000 Active & Reserve Sailors Worldwide plus Joint Forces, Retirees & Families

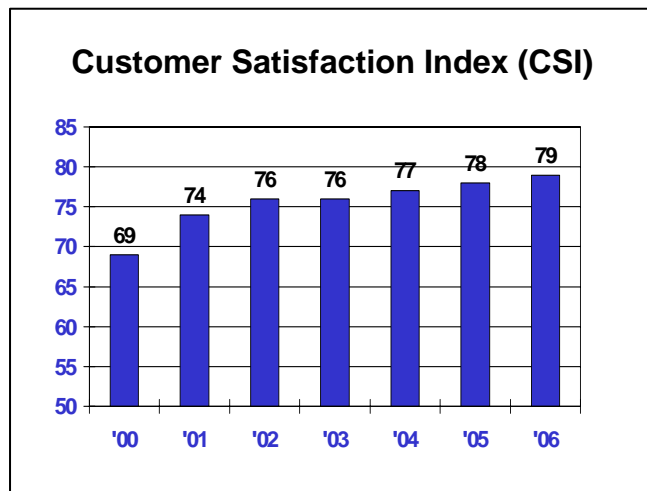
This Board sets the strategic direction and provides specific guidance, as required, for MWR and NEX to ensure both programs align to meet the needs of our forces worldwide through effective programming and adequate appropriated and non-appropriated fund support. Following BoD direction and guidance, everything we do is focused on Sailors and their families.

We serve Sailors and their families at base installations and regions worldwide, where our General Managers report to Installation Commanding Officers and our District Managers report to Regional Commanders; all part of Navy’s Community Support

alignment. Our sales and advertising flyers feature command and customer testimonials from Commanding Officers to young enlisted members on why they value NEX. We also work with MWR programs, providing cross-promotional support of the many programs they offer. Last year, CNO launched the Navy Professional Reading Program, “Accelerate your Mind”, designed to contribute to Sailors’ professional and personal growth, education and development and to stimulate critical thinking. NEX was selected as the enabler of this important Navy program, making the books available aboard fleet units, in libraries, and in global NEX locations, as well as on-line and through our retail sales call center. Too, NEX is a participant in CNO’s Wellness Study Group to identify how we can better provide Sailors with healthier food options in support of Navy’s “Fit for Life” Program. In addition, NEX continues to play an important supporting role in Navy’s disaster relief mission. We continue to work with other Navy elements on crisis response plans to address large-scale disaster such as hurricanes, typhoons, and influenza pandemics. All of these initiatives leverage our mission of service to our military members. Our entire enterprise, Merchandising, Store Operations, Food Service Operations, and all our support functions, are aligned for Navy and Navy Family support; building upon our vision of “One Team, One Focus, One Mission”.

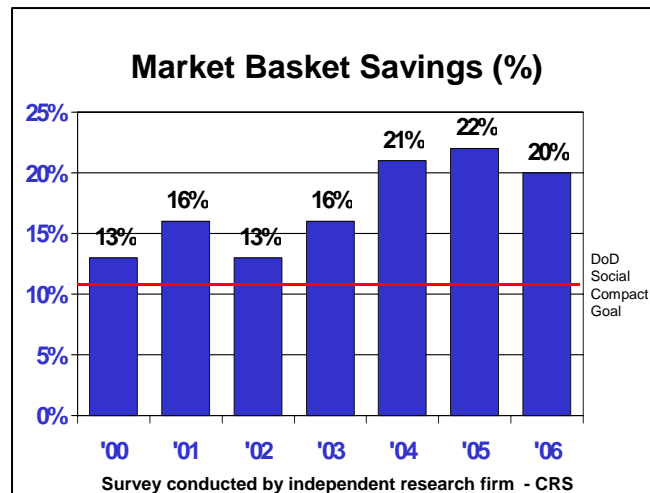
While our mission is QoL, we deliver the Exchange Benefit through our global retail operations and services. We measure our program execution using standard commercial retail methods and metrics, using third party commercial retail intelligence firms serving the commercial retail industry at large. We know that key to keeping our service members happy and satisfied is to provide them the opportunity to tell us what they want

and then deliver it to them at the best value. Toward that end, we survey our customers annually to develop a Customer Satisfaction Index (CSI) using Claus Fornel International, Group. During 2006 we received an index score of 79, one point over the prior year and more importantly continuing a seven year consistently improving CSI trend. This trend, with this year's index score of 79, places us in the very top quartile of participating commercial retailers.



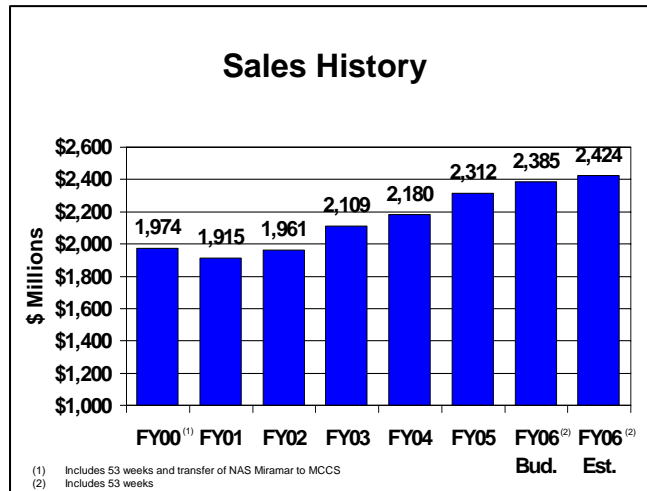
From this CSI survey, we know that savings is the key driver for customers shopping at NEX. Seventy-four percent of NEX patrons cite savings as the major reason for using NEX. This is a significant change from one year ago, when forty-six percent cited savings as the major reason. This illustrates the impact of economic pressures and higher fuel prices on Navy Families. This survey also tells us that delivering value, not just in retail operations, but also through the broad services portfolio we offer, is very important to our families. As in the commercial sector, convenience is important to our service members and families and NEX is addressing this critical need. Where we can, we offer our products and services portfolio at one convenient location – one stop shopping.

Our mission is to provide savings. These savings multiply our service members' purchasing power – a non-pay benefit. To measure our effectiveness, we conduct “Market Basket Surveys” twice yearly using RetailData, Inc. On average, we provide twenty percent overall savings, exclusive of sales tax, measuring our eight major markets.



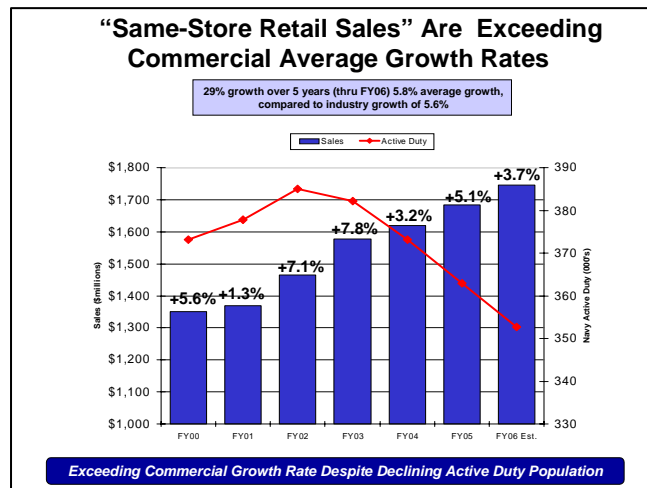
Including sales tax raises overall average savings to twenty-six percent. This market basket analysis surveys approximately 450 branded items in our eight major markets – Norfolk, VA; Jacksonville and Pensacola, FL; Bethesda, MD; San Diego, CA; Pearl Harbor, HI; Seattle, WA; and Great Lakes, IL – against a portfolio of 200 commercial retail firms.

Also, like our commercial retail counterparts, we measure our financial performance by sales and profit execution-to-plan. Our total sales execution has been on a continuing upward trend since FY01, meeting or exceeding our BoD approved annual financial plan targets.



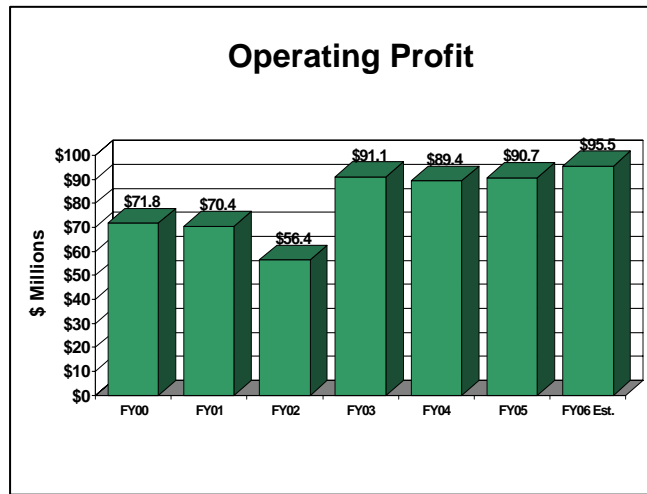
Same-store, or comparable-store, sales percentage increase is another key metric in the commercial retail industry, measuring real retail sales growth for stores open a full year; thereby normalizing the impact of newly opened or closed stores during the period.

Despite a declining active duty population, we have achieved twenty-nine percent growth over the past five years, averaging 5.8 percent annually which exceeds the average commercial retail growth of 5.6 percent. These “comp-store” sales numbers are another measure demonstrating we continue to address the needs of our service members.



NEX is also a source of revenue for Navy MWR operations. Our continuing dividends provide stable cash flows to maintain our Navy MWR programs, assisting in

supporting recreational facilities and services required by our Sailors. Our profit execution has been consistent, meeting BoD identified MWR requirements.



Our relationship with and support of MWR goes much further than dividends. We are truly partners in delivering Navy QoL, working together to complement our operations and seeking cross-organizational efficiencies in the delivery of our programs.

A significant difference between NEX and commercial retailers is the broad diversity of our store portfolio. The top third of our stores account for just under ninety percent of our total exchange operating profit. Thirty-six percent of our stores generate less than \$5 million in sales annually and are considered “Fact of Life” operations. Despite this, these smaller stores are just as important to Sailors’ QoL as are larger ones; in many cases more so, because they are in remote or overseas locations. NEX supports locations with an active duty presence to meet Navy’s requirement for comparable level of QoL support to each member and their families no matter where they are assigned around the world. By meeting this requirement, we are an organization of smaller stores.

As Navy's operations evolve around the globe, so too will NEX operations. Last year, we opened a new NEX Store in the Kingdom of Bahrain. What was previously a Ship Store with several hundred line items is now an NEX offering some 20,000 line items. From the day the doors opened on the new facility, the response from our Fifth Fleet Sailors has been overwhelming. We will continue to work to better support our forward-deployed troops to ensure their needs are met in all locations.

We currently employ sixteen different store models within the NES. We utilize large retail stores, small retail stores, convenience stores, gas stations, uniform shops, hospital stores and student stores for the greatest efficiency and effectiveness in support and retail operations. No store is the same size, same configuration, or offers the same merchandise assortment; and all are customized to meet the service needs of the disparate base installations, regions, and customer groups we serve. And, we are comprised not only of retail operations, but also multiple commercial services, food service operations, personal and vending services. We do this through 1,364 different store front operations.

Our operations cross the spectrum of commercial retail store categories. These categories include discount mass retailers, department and specialty stores, convenience stores, and specialized discount stores. Exchanges are the only single retailers that sell hardlines, softlines, electronics and consumables, at opening, moderate and higher price points. The brands we sell cover each of our customer segments using multiple brands comprised of the various price points. Eighty-plus percent of our sales in both dollars

and units are in opening and moderate price points. We provide best value and quality to all our patrons, no matter what their income level.

Addressing the needs of our active duty, reservists, retirees, joint forces, and family members is the driving focus of our program. The needs of our single Sailors are different from those with families. The needs of our reservists, retirees and joint forces differ also. Commercial retail models show that to be a successful “going concern” you must focus on the needs of your target market. Given our mission and our diverse customer base, we cannot serve just one group; we must meet the needs of all. I am pleased to report that Navy Exchange continues to refine our merchandise assortment that has proven successful in meeting the needs of all in the past. We continue to rationalize our assortment through customized customer segmentation. Through information obtained from our CSI analyses, we have identified eight distinct segments covering the life cycle of our service members from newly enlisted Sailors to 65 and over retirees. We are able to break out the percentage of each of these segments by store to enable us to better customize our merchandise assortment to meet their individual needs. We are excited to be able to bring this industry best practice into our operations, giving us another way to further customize our stores to meet our diverse customer base.

At sea, we take care of our Sailors through our very robust Ships Store Program. In any given day, fifty-two percent of Navy ships are at sea and thirty percent are forward deployed. We provide health and comfort, convenience, and entertainment merchandise – everything from toiletries to electronic entertainment media, snacks, reading material

and high-velocity uniform items. All items are sold at a savings while generating profits to support afloat MWR Programs. We also provide vending and non-retail services, including barber shops and laundry operations. In a single day, an aircraft carrier will process 2,400 pounds of laundry, provide 168 haircuts and sell 9,000 sodas. Our Sailors rate Ships Store as one of their Top Five QoL programs.

Our commercial Telecommunications Program keeps Sailors in touch with their families and friends no matter where duty calls. The majority of the services provided are through contracts with our commercial business partners, who also provide the required infrastructure and maintenance. Our Afloat Program provides ship to shore personal calling via satellite on 183 Navy ships and Coast Guard vessels at only 45 cents per minute, a fifty-five percent reduction in the calling rate since the inception of the program in 1997. We also provide free phone cards to Sailors, Marines, and Coast Guard personnel who are deployed at sea during holiday periods. In 2006, we provided 17,000 such free cards. Our phone cards offer low calling rates within the United States and around the world with savings up to thirty-eight percent on calling within the U.S. and up to forty-seven percent on calls to the US. During times of crisis, such as Hurricane Katrina, the Pacific Tsunami, and the evacuation of Beirut, Lebanon, we also provided free phone cards. Further, we provided cards to Naval Hospital Bethesda for the wounded service members returning from Iraq. Cellular services are provided through our industry partner who waives activation fees for the military members and their families. Likewise, termination fees are waived for deployments and permanent change of station transfers. Staying connected through access to the internet is important to our

Sailors and we have collaborated with MWR to supply “no cost” wireless service to MWR Single Sailor Centers, libraries, and NEX food courts.

Our Navy Lodge Program was established to support Sailors and their families on permanent change of station orders. This mission has evolved to serving all active duty personnel on orders or during leisure activities. As with our retail operations, we measure our Lodge Program execution using standard commercial hospitality methods and metrics, using third party hospitality intelligence firms as available. Navy Lodges continue to win the prestigious Meritorious and Golden Pineapple awards from the American Hotel and Lodging Association. Navy Lodge current occupancy rate is eighty percent compared to an industry average of fifty-six percent. The Navy Lodge Program continues their assistance with the Wounded Warrior Program in support of wounded service members returning from Operation Iraqi Freedom/Operation Enduring Freedom. Navy Lodges provided over 13,500 room nights in 2006 for lodging to family members of injured service members, and to the service members themselves. I commend all our Navy Lodge associates for the excellent support they provide our wounded service members and their families in a very difficult time.

During last year I had the opportunity to revisit our Navy Exchanges in the Gulf Coast. What a difference a year makes. When I first visited in the aftermath of Hurricane Katrina, the devastation was enormous. I am pleased to report that our extensive recovery efforts have been completed and Navy Exchanges have returned to normal business operations. I am proud of how far our facilities have come and thank our associates and our industry partners who made it all possible.

As you can see, our passion is caring for our Sailors in many ways. I will now report on selected initiatives we have undertaken to ensure the viability of the Exchange Benefit well into the future and our continuing effort to improve the service we provide to our patrons. We are currently engaged in several program-level modernization initiatives – logistics/supply chain management, non-resale procurement consolidation, and enterprise architecture modernization. Our Logistics/Supply Chain Management Program brings together merchandising, distribution, marketing, operations, financial management and information systems departments within NEX headquarters and field environments, as well as our industry partners, to rationalize and improve the entire supply chain from the shelf back to the vendor. We are aggressively attacking lead times and understanding where opportunities exist to shrink “pipeline inventory” along the entire supply chain. All participants are focused on getting the right merchandise to the sales floor in the quickest and most cost-wise method possible, driving greater operational efficiency and effectiveness.

As I have reported in past testimony, we continue to update our enterprise business architecture and enabling technology to increase customer savings and reduce operating cost. I am pleased to report that our Enterprise Information System Program, Oracle Retail, is deployed across our NEX enterprise and is operational. Oracle Retail is a state of the art commercial system that employs a merchandise system, store inventory management system, warehouse management system and data warehouse, and provides forecasting and optimization tools. In addition to our Oracle Retail Program, we have deployed three other enterprise systems, Lawson Purchase Order for non-resale

procurement, Computer Associates Asset Management System for fixed assets, and MEI Easitrax for world-wide vending management. We are now focusing on our broader Enterprise Business Architecture, a methodology to drive change and standardization. This program will document operational, systems and technical views of NEX's business architecture at the process level, a set of technology standards, and a governance model to drive change and modernization across NEX business operations.

Exchange Commanders and Director DeCA have developed an excellent collective working relationship. Using the combined creative talent of the three Exchanges and DeCA, we are leveraging our joint efforts to make our organizations collectively stronger to meet future challenges. Exchange Services have a mutual respect for the valuable role each play in meeting their respective Services' missions. Through the Exchange Cooperative Efforts Board (ECEB), our teams will continue to find back room efficiencies supporting the Exchange operating companies – Army and Air Force Exchange Service, Marine Corps Community Services, and Navy Exchange System – addressing our respective quality of life missions for Airmen, Marines, Sailors, and Soldiers.

Our commercial industry partners are valued and vital members of our team. They share our mission and dedication to our military members and their families. During 2006, with their support, NEX was able to bring many special events and celebrities to locations all around the globe. Sailors on the USS Kearsarge were treated to an onboard premier showing of “X-MEN III - The Last Stand”. Stars from the movie (Halle Berry,

Hugh Jackman, and Kelsey Grammer) were flown aboard ship to meet the crew and sign autographs. Other celebrity appearances included Pamela Andersen, Chef Emeril Lagassi, New York running back Tiki Barber, author Tom Clancy, and the Washington Redskin Cheerleaders, to name a few. None of this would have been possible without the great support of our industry partners. Also through the generosity of our vendors, Customer Appreciation Days have been held at Guantanamo Bay, Guam and Naples. These special events provide our forward deployed customers a super sale opportunity coupled with entertainment and exciting activities. Customers come to the store at opening and often stay the entire day enjoying the sales, food, and fun. In partnership with our industry partners, it is a special way to connect with our customers and thank them for their service to our country. Another way industry touches Sailors is by recognizing the top Sailors in the Navy each year with their donations to the Sailor of the Year program. The support of industry doesn't stop there. We also work side by side with them as we strive for more efficient operations, particularly our Supply Chain initiatives. We value their expertise and advice, and deeply appreciate all they do for our military members.

Mr. Chairman and Distinguished Members of the Subcommittee, we have come to rely on the absolutely superb support of this Subcommittee in taking care of our military families. Through your sustaining efforts, we are able to do more for our Sailors and their families. On their behalf, I thank you. In closing, please know Navy Exchange continues to be a "going concern", financially strong, and engaged on many fronts to improve the QoL of Navy families. Together with our commercial and government

partners, and with the strong support of this Subcommittee, the Exchange Benefit will not only be sustained in the future but improved, remaining a critical non-pay benefit for Sailors and their families who serve our country with such great dedication, energy, and pride.

