

Shanahan Issues Resale Consolidation Memorandum, Approved Business Case Analysis, Statutory Authority Required

• WASHINGTON

On May 29, Deputy Secretary of Defense Patrick Shanahan signed a memorandum intended at the very least to begin the standardization of defense resale back-office processes and systems — and if a business case analysis (BCA) is approved by the Pentagon's Chief Management Officer (CMO), John H. Gibson, to consolidate the entire defense resale enterprise.

According to Shanahan, this would be the first phase of an overarching community services reform effort that would also encompass morale, welfare and recreation (MWR), lodging, family support services and the defense primary and secondary school systems.

Compared with an earlier draft of the memo that circulated in the resale market in March, the wording of the final signed memo appeared to shift from a phased approach to resale consolidation to a more accelerated merger plan.

A Reform Management Group (RMG) created last year by Shanahan has begun to formulate plans to combine the exchange services into one organization, and if statutory authority permits, eventually attempt to consolidate the commissary system with the exchange systems. A moratorium on non-essential executive hiring was also imposed across the community services domain.

With the issuance of the May 29 memo to the secretaries of the military departments, the chairman of the joint chiefs of staff, under secretaries of defense, the chief of the National Guard Bureau, directors of defense agencies, and other government offices involved in the reform effort, a series of steps and processes was outlined that would lead to the consolidation of the three military exchange systems in the near term if a business case analysis and financial due diligence support it, with the approval of the CMO.

Shanahan said the RMG had received briefings from the military services, and considering the respective views and responses of the military departments, he agreed that a single consolidated organization would offer “the greatest potential to achieve the economies and efficiencies necessary for the survivability of the defense resale enterprise and the continued availability of these benefits to our total force and their families.” He noted that these are “recognized as non-pay benefits or perceived as beneficial to the Department's mission, recruiting, retention, and readiness, so should not be divested or discontinued.”

Acknowledging that legislative relief with respect to Title 10 U.S.C. would be required to enable any organizational consolidation of the commissary system with the exchange systems, Shanahan said the Department of Defense (DoD) would pursue that relief “as soon as practicable.”

TASK TIMELINE

A major milestone for the CMO was to identify a director to manage the Enterprise Management of Community Services task force's work by June 15, 2018, and assemble a cross-functional task force for Community Services by July 1.

[Editor's note: Since this article was written, DoD has announced the selection of former AAFES Commander Maj. Gen. Keith L. Thurgood, USA (Ret.) as the Enterprise Management of Community Services Task Force director on June 21, 2018.]

The task force will first be charged with performing financial due diligence, during which it is expected that stumbling blocks, such as how a potential consolidation might affect resale agency credit ratings, would be reviewed. Also, by Oct. 31, 2018, the task force would complete its analysis of the business case for consolidation and then go on to develop organizational and operational integration plans for the Defense Commissary Agency (DeCA), the Army & Air Force Exchange Service (AAFES), the Navy Exchange Service Command (NEXCOM), and the Marine Corps Exchange (MCX).



Shanahan

The resale systems are to provide financial data and organizational artifacts to the Community Services reform team by June 29, 2018, in accordance with the authorities assigned to the CMO in section 912 of the 2018 National Defense Authorization Act (NDAA).

Following that, the reform team would brief the RMG upon completion of the business case. According to the memorandum, “if the CMO approves the business case, the task force will complete the integration planning by January 31, 2019, after which the plans will be executed pursuant to existing statutory authority.”

Shanahan also said, “The task force director will perform the duties of the new organization's Executive Director,” who would exercise authority, direction, and control, until the permanent position is advertised and filled.

If the CMO were not to approve the business case, Shanahan's memo said, the task force would be immediately disestablished and the reform initiative closed.

BACK-OFFICE

In parallel with its other work, the memo said the task force “will begin standardizing and

optimizing the defense resale enterprise systems and processes, beginning with supply chain and procurement as soon as practicable.”

The memorandum also imposed an immediate moratorium on information technology and executive hiring with certain caveats and exemptions, including public safety, essential services and fiduciary responsibilities with respect to the defense resale enterprise (DRE).

Exceptions would be considered by the task force director, the CMO and the Under Secretary of Defense for Personnel and Readiness (P&R), a position currently filled by Robert Wilkie, who has been nominated to become Secretary of Veterans Affairs.

Shanahan concluded his memo by saying, “The Department should make it clear to all that our intentions are to make these community services better for our members and their families, improve our support to commanders, be exceptional stewards of our appropriated funds, and exhibit fiduciary responsibility for our nonappropriated funds.”

ASSUMPTIONS

Saying he agreed that “a single consolidated organization offers the greatest potential to achieve the economies and efficiencies necessary for the survivability of the defense resale enterprise ...,” Shanahan pricked up the ears of advocates who said they were not aware the exchanges were in danger of not surviving, but rather were thriving, and if any organization was declining, it was the commissary agency which had suffered most from the drawdown of troops and migration of servicemembers to supermarkets and other grocery outlets outside the gate.

Along those lines, the memorandum asserted that “the defense resale enterprise in particular has been studied too much without implementation of the recommendations and is now suffering from the same industry, generational, and demographic trends negatively impacting private-sector grocery and retail companies,” but failed to distinguish between the exchanges' relatively far stronger performance in the face of these obstacles compared with DeCA, which operates in an environment far less impacted by Amazon.

A recent recommendation supporting consolidation was included in the Final Report of the Military Compensation and Retirement Modernization Commission (MCRMC) in January 2015. The Boston Consulting Group (BCG) also recommended exchange consolidation, but did not recommend an integration of DeCA, saying “fully combining DeCA with the exchanges would introduce complexity that would likely exceed any value created. However, we do believe that there are opportunities for DeCA and the exchanges to collaborate to a greater extent, and in particular we think that they should eventually combine some back-office and non-resale procurement functions to generate cost savings.”

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