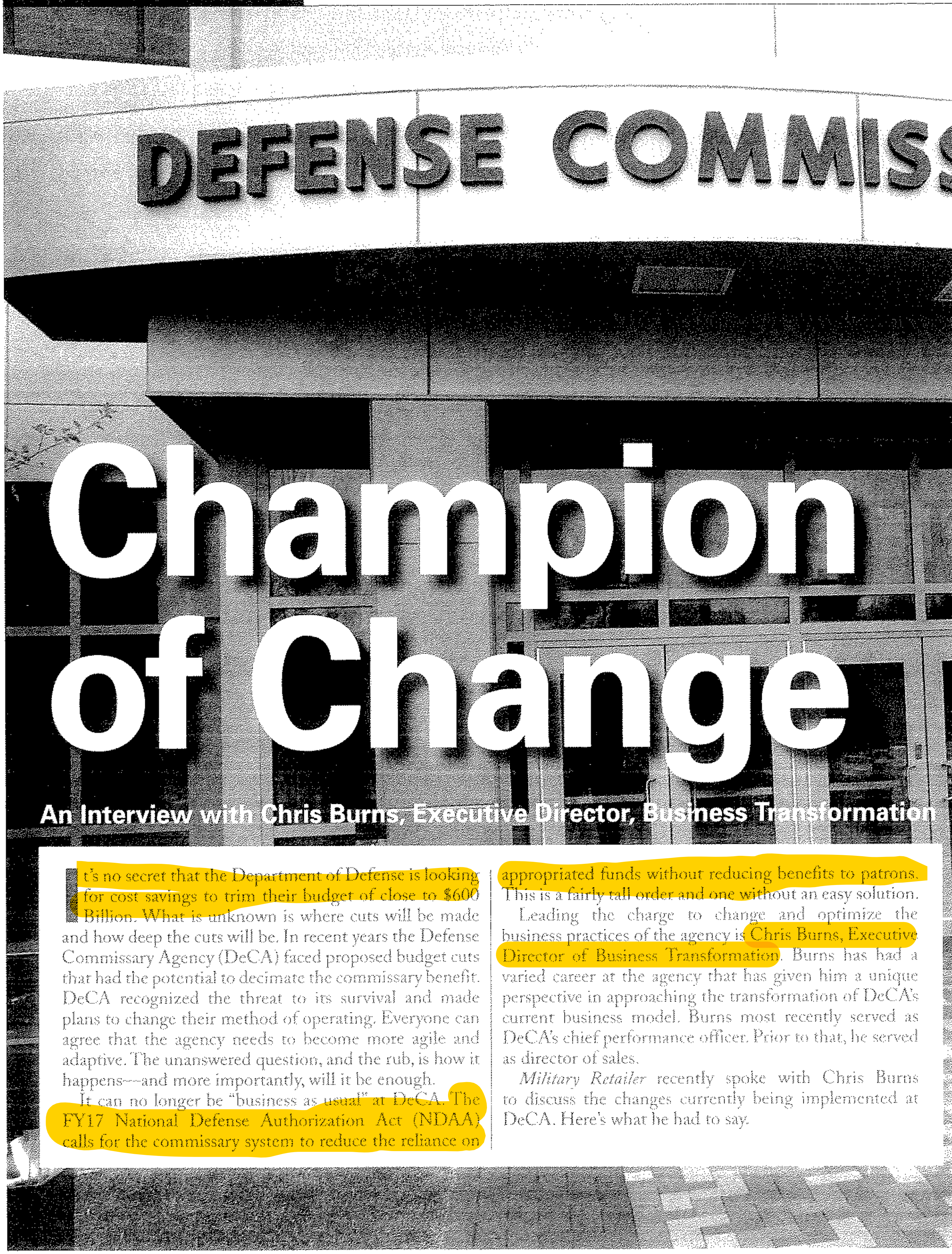

Champion of Change

An Interview with Chris Burns, Executive Director, Business Transformation

It's no secret that the Department of Defense is looking for cost savings to trim their budget of close to $600 Billion. What is unknown is where cuts will be made and how deep the cuts will be. In recent years the Defense Commissary Agency (DeCA) faced proposed budget cuts that had the potential to decimate the commissary benefit. DeCA recognized the threat to its survival and made plans to change their method of operating. Everyone can agree that the agency needs to become more agile and adaptive. The unanswered question, and the rub, is how it happens—and more importantly, will it be enough.

It can no longer be "business as usual" at DeCA. The FY17 National Defense Authorization Act (NDAA) calls for the commissary system to reduce the reliance on appropriated funds without reducing benefits to patrons. This is a fairly tall order and one without an easy solution.

Leading the charge to change and optimize the business practices of the agency is Chris Burns, Executive Director of Business Transformation. Burns has had a varied career at the agency that has given him a unique perspective in approaching the transformation of DeCA's current business model. Burns most recently served as DeCA's chief performance officer. Prior to that, he served as director of sales.

Military Retailer recently spoke with Chris Burns to discuss the changes currently being implemented at DeCA. Here's what he had to say.

Military Retailer: Since the creation of the transformation team and the announcement of DeCA's new business model there has been a lot of uncertainty and rumors in the market. Can you give us an overview of what the Transformation Office has been tasked with?

Chris Burns: Overall, the Transformation Office is involved with the development and implementation of pilot programs authorized by the 2016 National Defense Authorization Act (NDAA) and the implementation of the 2017 NDAA provisions, assuming it will become law, which were recently approved by House and Senate Conferees. Both provide DeCA the opportunity to make some specific changes to our operations that will protect the patron benefit, improve the overall shopping experience, and allow DeCA to offset more of its operating costs.

It is important to note at the outset that Congress has directed DeCA to deliver the current level of the commissary benefit with a lower operating cost under both the 2016 and 2017 NDAAs.

Currently DeCA is pursuing three business changes as part of the transformation:

- We will be launching our own in-store brand of private label products, offering equal quality alternatives to national brands at even better prices for patrons.
- We are evaluating the full range of branded products we carry, their savings, costs and shelf allocation, and entering into commercial negotiations with suppliers to ensure we continue to carry the right product selection at the best possible value to patrons and taxpayers.
- We will also be adjusting some shelf prices, especially for products where we know that DeCA's pricing is less competitive with the market today.

For all these changes, both NDAAs guarantee that patron savings be maintained at current levels, so our patrons will be at least as well off as they are today.

As a prerequisite to these changes, DeCA has been tasked with updating its patron savings methodology to better reflect the savings patrons currently experience at their local commissaries. This baseline will be regionally specific and more frequent, allowing DeCA to ensure patron savings levels are maintained or improved.

MR: What is the Boston Consulting Group's role in DeCA's transformation initiatives?

Burns: The Boston Consulting Group is a leading consulting firm in the arena of grocery retail transformation. They regularly work with the top private sector retailers on similar topics.

They have been engaged to provide advice and category analysis to DeCA in a supporting role only, across the full suite of transformation initiatives. DeCA fully owns all decision-making at all stages of the process, including decisions about vendor management, assortment, private label, pricing, shelf space and commercial terms.

MR: Recently DeCA updated their savings methodology, moving to a more regionally-specific format. Have you determined the baseline savings yet? If so what are they? If not, when will they be complete?

Burns: The baseline savings are currently being assessed based on an independent external audit. It is expected the updated savings baseline will be reported to Congress in January 2017. Thereafter, DeCA will be reporting its savings by region on a quarterly basis, once variable pricing is implemented.

MR: We would like a little more detail about the methodology. Can you explain the difference between the old method which took into consideration the whole store and the new method which involves a blend of the whole store and manual shop to match purchase patterns?

Burns: The existing methodology was designed to provide a global view of savings, which is why we have always expressed our patron savings as an overall worldwide average.

The revised methodology builds on the previous model and still provides a global view of savings. However, it includes more geographically-specific data, for example, a comparison of each store with prices of two to three local competitors that will help DeCA monitor and report savings by region.

This updated methodology will not change the actual benefit patrons receive today. It simply gives DeCA patrons an enhanced view of the savings achieved in the geographic areas in which they live and shop.

The updated methodology will serve as a baseline to ensure the current patron savings benefit is maintained into the future. We cannot stress enough that our patrons will still have the same benefit and the same level of savings, enjoyed before we initiated our new business model.

MR: There have been quite a number of negative comments surrounding DeCA's recent requests that vendors make up for past "performance gaps". How were these "gaps" determined and how is DeCA's now negotiating with vendors? Are your current negotiations in line with practices currently used by commercial grocery stores?

Burns: As part of the transformation, DeCA is evaluating the performance of branded products on our shelves. This includes analysis of sales, costs, patron savings, promotional activity, shelf space productivity, customer loyalty and actual purchase behaviors.

The process for each category within each wave begins with detailed analyses to examine SKU-level performance in terms of sales, cost, and savings performance vs. the rest of the market. This includes analyzing what our commercial counterparts charge at the shelf for products, and inferring what costs they may be receiving. The full economics are considered at a SKU level, including all costs and support provided across competitive manufacturers. Through this analysis, DeCA will identify areas for potential improvement (gaps) in supplier performance and areas where it can strategically deepen business relationships and improve the offering for DeCA and for patrons.

Based on this data, DeCA is entering into commercial negotiations with suppliers to ensure that we are getting the best possible deal on the goods we carry. This type of category review and assortment optimization is a commercially proven practice, and almost all commercial retailers regularly conduct these types of negotiations.

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Most of the objections to this process have been voiced by industry lobbying groups, on behalf of manufacturers who potentially stand to lose shelf space or market share to DeCA private label products or better-performing manufacturers that offer a better deal to the patron and the taxpayer.

MR: What benefit does the patron receive if any cost savings gained goes to offset DeCA's operating costs versus patron price?

Burns: Much of the savings generated through this process will help offset DeCA's operating costs. Some of the savings will flow directly to patrons by way of promotional activity or lower shelf prices. In many cases, promotional and industry funding will increase as a result of the process.

In addition, we hear from customers that they are frustrated when top-selling items are cheaper to buy outside the gate, or when we run out of stock on the most popular or best value items. A more streamlined assortment and a shelf layout that prioritizes the best performing items and brands will help to address both of these pain-points for shoppers.

MR: Can you tell us where you are in the private label process? Have any suppliers been chosen yet?

Burns: After a rigorous private label selection process, DeCA has selected MDV SpartanNash LLC to bring private label products to store shelves. Throughout the process, our goal was to find a partner that could provide quality products to our patrons at a savings level that is equivalent to or better than what they find from private label products at commercial grocers.

MR: What categories are you looking at for private label?

Burns: DeCA is planning to offer a full assortment of private label products across the store—with a focus on those categories where we know our patrons are most urgently looking for private label alternatives. We are taking a phased approach to rollout. Over the next several months, DeCA will work closely with SpartanNash to decide on an initial assortment of products to introduce. The initial assortment should be available at all commissaries worldwide in May 2017 and will include approximately 400 items. Our goal is to continue to grow to approximately 1,000 items by the end of 2017. Over the next two years DeCA will continue to add more private label products to the commissary assortment—while continuing to offer the name brands that patrons have always shopped.

MR: Why does it make more sense at this time to sell private label products versus selling them in the past?

Burns: Private label quality has changed considerably over the years. Today, private label products are equivalent to name brands in terms of quality. In many cases, they are literally produced on the same manufacturing lines or to the exact identical specifications of the branded products. This is a main reason that private label has gained in popularity over the past few decades and today captures more than 20 percent of U.S. grocery sales and is growing.

Today's patrons tell us that they want private label—with 60 percent of customers in a recent survey saying that they would be interested in trying a DeCA private label if it were available.

Variable pricing allows us to provide significant savings for patrons, while generating some income to offset commissary operating costs.

MR: Who will be stocking private label products on the shelves? What percentage of products in the stores do you expect to be private label?

Burns: Private label products will be stocked by DeCA's current shelf stocking contractor and/or in-house personnel where applicable. DeCA will be working with SpartanNash to ensure excellent availability of private label items on the shelves.

As I said earlier, we are taking a phased approach to rollout across the store until private label is available in almost every major category. When the program is fully mature, we hope to match private sector metrics whereas sales and units reach approximately 20 percent for the agency.

In addition, customers will still have access to the popular name brands they currently enjoy, at the same or better savings than they see today.

MR: We have been told that variable pricing will be tested at 10 locations. Can you explain how the variable pricing test will be implemented? How long with the test period last?

Burns: To set the record straight, variable pricing refers to pricing in a manner other than the currently required cost-plus model. We believe what your question refers to is what we have described as the "store based" test.

Variable pricing means that multiple factors can be considered in determining the price of a product—such as market price, cost of acquiring the product, importance to the customer, etc. This is the standard pricing method used by grocery retailers.

This strategy differs from DeCA's traditional cost-plus approach, which adds a flat 5 percent surcharge to the cost of a product—even if that means that DeCA is not competitively priced with the rest of the market.

The store based test will take a handful of items in a handful of stores, and will adjust them to fix areas where we know that DeCA's prices are misaligned with the market today. Over time, this should lead to a more predictable savings level and consistent benefit across the store.

This effort is designed to prove that DeCA can make these kinds of pricing adjustments while maintaining the same overall savings level for patrons (as required by the NDAA). We expect the initial results which will enable a decision of whether to continue or expand this program to be available within six to 12 months.

MR: Will any of the new transformation initiatives do anything to address the long standing and on-going problem of products not being on the shelf?

Burns: Yes—we have heard loud and clear our patrons' concerns about out-of-stocks, especially on their favorite brands and top performing items.

There are many contributing factors to DeCA's stocking challenges, but one of them is that we often carry two to three times as many individual items as private sector retailers, in even less shelf space. This makes it hard to allocate enough room to the fastest-moving items.

Streamlining our assortment and updating our planograms as part of the transformation will help to address this issue, allowing for more space for the best-sellers.

MR: How will these new transformation initiatives bring in more traffic? How will they make the commissary more relevant to shoppers?

Burns: The transformation is helping DeCA create a more modern, consistent and relevant shopping experience:

- We will continue offering national brand products at the significant savings patrons see today.
- These will be supplemented by high-quality private label options, at great prices, that we know our patrons want.
- Shelf space will be allocated to make the assortment easier to navigate and shop, and easier for DeCA to keep sourced and in-stock.
- Patron savings levels will be protected throughout (as required by the NDAA).

And all of this will be achieved at lower operating costs that help ensure the sustainability of the benefit for generations to come.

This transformation is an important step toward ensuring that the commissary remains the best, most relevant option for our shoppers.

All along, DeCA will continue to focus on providing outstanding customer service, expanding on health and wellness items throughout the store and focusing on the perimeter departments.

MR: When fully implemented, what percentage of DeCA's operating costs do you estimate will be offset by revenue generated by these transformation initiatives?

Burns: As Mr. Peter Levine relayed at the 2015 ALA National Convention, we will let the efficiencies drive budget reductions. Not all of these savings will happen overnight, and some will require time to achieve their full potential.

Along the way, we will closely monitor the savings to our patrons.

MR: There are many changes being made to DeCA's business model. It seems as if you are on a fast moving train. Can you give us a little more detail on your timeline for accomplishing these changes? Where do you plan to be at this time next year?

Burns: You're right! This is an intensive effort to achieve a real step-change in our shopping experience and operational efficiency.

A year from now, our customers will enjoy a full range of national brand options, as well as high-quality private label products available across the store.

We will be regularly monitoring patron savings at regional level, so that our customers can shop safe in the knowledge that their benefit is being maintained and protected for future generations.

We will have achieved significant cost savings, and be on track to save even more for patrons and taxpayers in future years.

While significant progress will be completed within the next year, some elements of our transformation effort will still be in flight. Transformation will not be completed within one year.

MR: Recently Mr. Jeu spoke about the numbers of active duty families living further from military installations and the negative effect it has on the number of patrons shopping the commissaries. How do you plan to address this issue and how can you reach out to these shoppers?

Burns: This trend is a reality and is likely to be a permanent challenge that we face. That is why it's more important than ever that we do everything we can through our new business model to ensure that the commissary is always worth the trip.

MR: Click2Go is a very appealing initiative for commissary shoppers. What needs to be done via either policy change or legislatively to allow this initiative to be expanded?

Burns: We expect to have a Click2Go solution for our Internet-ordering/curbside pickup service in the near future. As soon as we are able, we plan to expand Click2Go to most of our U.S. stores. This should help capture new sales. We know that 79 percent of the commissary patrons surveyed say they are willing to pay a five percent fee for using Click2Go.

MR: Is there anything else you would like to add?

Burns: We are focused on giving our customers the products they want at the prices they deserve, while continuing to be a responsible steward of tax dollars. The brands our patrons are loyal to will maintain a substantial presence in the commissary. The private label we are introducing will provide a high quality, low cost alternative to national brands. Patron savings will be protected throughout the process, as required by law. DeCA's requirement for appropriated fund support will be reduced, which will help ensure the commissary will continue providing a benefit for future generations of military families.

Ultimately, our transformation effort will help ensure the commissary offers a modern and relevant shopping experience for our patrons and ensure the benefit is stronger than ever. MR