

REFORMING INVENTORY MANAGEMENT THROUGH INNOVATIVE BUSINESS PRACTICES

HEARING BEFORE THE SUBCOMMITTEE ON NATIONAL SECURITY, INTERNATIONAL AFFAIRS, AND CRIMINAL JUSTICE OF THE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

JULY 24, 1997

Serial No. 105-78

Printed for the use of the Committee on Government Reform and Oversight



U.S. GOVERNMENT PRINTING OFFICE

46-284 CC

WASHINGTON : 1998

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

DAN BURTON, Indiana, *Chairman*

BENJAMIN A. GILMAN, New York	HENRY A. WAXMAN, California
J. DENNIS HASTERT, Illinois	TOM LANTOS, California
CONSTANCE A. MORELLA, Maryland	ROBERT E. WISE, JR., West Virginia
CHRISTOPHER SHAYS, Connecticut	MAJOR R. OWENS, New York
STEVEN SCHIFF, New Mexico	EDOLPHUS TOWNS, New York
CHRISTOPHER COX, California	PAUL E. KANJORSKI, Pennsylvania
ILEANA ROS-LEHTINEN, Florida	GARY A. CONDIT, California
JOHN M. McHUGH, New York	CAROLYN B. MALONEY, New York
STEPHEN HORN, California	THOMAS M. BARRETT, Wisconsin
JOHN L. MICA, Florida	ELEANOR HOLMES NORTON, Washington, DC
THOMAS M. DAVIS, Virginia	CHAKA FATTAH, Pennsylvania
DAVID M. McINTOSH, Indiana	ELIJAH E. CUMMINGS, Maryland
MARK E. SOUDER, Indiana	DENNIS J. KUCINICH, Ohio
JOE SCARBOROUGH, Florida	ROD R. BLAGOJEVICH, Illinois
JOHN B. SHADEGG, Arizona	DANNY K. DAVIS, Illinois
STEVEN C. LATOURETTE, Ohio	JOHN F. TIERNEY, Massachusetts
MARSHALL "MARK" SANFORD, South Carolina	JIM TURNER, Texas
JOHN E. SUNUNU, New Hampshire	THOMAS H. ALLEN, Maine
PETE SESSIONS, Texas	HAROLD E. FORD, JR., Tennessee
MICHAEL PAPPAS, New Jersey	
VINCE SNOWBARGER, Kansas	BERNARD SANDERS, Vermont
BOB BARR, Georgia	(Independent)
ROB PORTMAN, Ohio	

KEVIN BINGER, *Staff Director*

DANIEL R. MOLL, *Deputy Staff Director*

WILLIAM MOSCHELLA, *Deputy Counsel and Parliamentarian*

JUDITH MCCOY, *Chief Clerk*

PHIL SCHILIRO, *Minority Staff Director*

SUBCOMMITTEE ON NATIONAL SECURITY, INTERNATIONAL AFFAIRS, AND CRIMINAL
JUSTICE

J. DENNIS HASTERT, *Chairman*

MARK E. SOUDER, Indiana	THOMAS M. BARRETT, Wisconsin
CHRISTOPHER SHAYS, Connecticut	TOM LANTOS, California
STEVEN SCHIFF, New Mexico	ROBERT E. WISE, JR., West Virginia
ILEANA ROS-LEHTINEN, Florida	GARY A. CONDIT, California
JOHN M. McHUGH, New York	ROD R. BLAGOJEVICH, Illinois
JOHN L. MICA, Florida	CAROLYN B. MALONEY, New York
JOHN B. SHADEGG, Arizona	ELIJAH E. CUMMINGS, Maryland
STEVEN C. LATOURETTE, Ohio	JIM TURNER, Texas
BOB BARR, Georgia	

EX OFFICIO

DAN BURTON, Indiana

HENRY A. WAXMAN, California

ROBERT CHARLES, *Staff Director*

ANDREW RICHARDSON, *Professional Staff Member*

AMY DAVENPORT, *Clerk*

MARK STEPHENSON, *Minority Professional Staff Member*

CONTENTS

	Page
Hearing held on July 24, 1997	1
Statement of:	
Emahiser, James B., Assistant Deputy Under Secretary of Defense for Materiel and Distribution Management; Edward D. Martin, Acting As- sistant Secretary of Defense for Health Affairs; and Jeffrey A. Jones, Executive Director for Logistics Management, Defense Logistics Agen- cy	59
Warren, David R., Director, Defense Management Issues, General Ac- counting Office, accompanied by Kenneth R. Knouse, Jr., Assistant Director; Robert L. Repasky, senior evaluator; and Matthew Lea, senior evaluator	20
Letters, statements, etc., submitted for the record by:	
Burton, Hon. Dan, a Representative in Congress from the State of Indi- ana, prepared statement of	9
Emahiser, James B., Assistant Deputy Under Secretary of Defense for Materiel and Distribution Management, prepared statement of	62
Hastert, Hon. J. Dennis, a Representative in Congress from the State of Illinois, prepared statement of	3
Jones, Jeffrey A., Executive Director for Logistics Management, Defense Logistics Agency, Navy Times article	87
Maloney, Hon. Carolyn B., a Representative in Congress from the State of New York, prepared statement of	17
Martin, Edward D., Acting Assistant Secretary of Defense for Health Affairs, prepared statement of	81
Warren, David R., Director, Defense Management Issues, General Ac- counting Office, prepared statement of	23

REFORMING INVENTORY MANAGEMENT THROUGH INNOVATIVE BUSINESS PRACTICES

THURSDAY, JULY 24, 1997

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL SECURITY, INTERNATIONAL
AFFAIRS, AND CRIMINAL JUSTICE,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 12:10 p.m., in room 2154, Rayburn House Office Building, Hon. J. Dennis Hastert (chairman of the subcommittee) presiding.

Present: Representatives Hastert, Souder, Mica, Barrett, and Maloney.

Ex officio present: Representative Burton.

Also present: Representative Sessions.

Staff present: Robert Charles, staff director; Andrew Richardson, professional staff member; Amy Davenport, clerk; Mark Stephenson, minority professional staff member; and Ellen Rayner, minority chief clerk.

Mr. HASTERT. Good afternoon. The Subcommittee on National Security, International Affairs, and Criminal Justice will come to order.

Today the subcommittee is holding its second hearing on defense inventory management. While seldom openly discussed, this is an issue of tremendous importance to the Nation, and one on which we will begin to focus more vigorously as a subcommittee.

Our first hearing on defense inventory management served as a survey course, providing an overview of existing problems and options. The scope of our hearing today will be more narrow. We shall examine how the Department of Defense has used innovative best business practices, including virtual prime vendor and direct vendor delivery, to improve inventory management. We will also examine how the department can build upon its successes and expand the number of items for which virtual prime vendor and direct vendor delivery are used.

Joining us today are representatives from the General Accounting Office and the Department of Defense to discuss current and future reforms.

As you know, the Defense Department has historically emphasized "just in case" practices, which necessarily involve the overbuying and stockpiling of excess inventory. This approach has offered availability for supply and repair, but only at the cost of efficiency and savings. Today, modern inventory management practices offer both availability and maximum efficiency. In fact, the

American business community has pioneered in sophisticated methods of inventory management which allow both timely delivery and valuable cost savings.

It is time that these methods were more widely adopted by the Federal Government. Methods like “just in time” delivery, supplier parts, and prime vendor contracts could easily be applied to the Defense Department. Obviously, where military readiness is at issue, we side with the need for total preparation, but there are countless opportunities today for increased cost savings.

The department has been slow to adopt the cutting edge business practices, but they have achieved at least one notable success. This is in the area of virtual prime vendor and direct vendor delivery for medical and pharmaceutical supplies. Under steady pressure by Congress and GAO, the department has replaced a slow, costly system of managing medical supplies with one that is more like that used by private hospitals. Instead of numerous warehouses, the department now places orders electronically and receives medical supplies on an as-needed basis from commercial vendors.

Adopting these practices has saved the department over \$700 million since 1991. The GAO has suggested similar techniques for other categories of defense inventory items, including commercially available industrial hardware. The estimated value of potential savings to America’s taxpayers by improved inventory management by the Defense Department is in the billions of dollars. Our message today is, let’s do it.

One last point: The embryonic program at Warner Robbins Air Logistics Center is a step in the right direction, but the department must continue to apply new practices, particularly to acquisition of industrial items. Remarkably, the department has embraced this idea for only this facility, and only since January. If broadly applied, Americans could save billions, and we, as a Nation, would have a more efficient and highly ready military.

In conclusion, I want to emphasize that we all understand the need to reduce infrastructure so our Defense Department can profitably devote greater resources to modernization. We also want maximum readiness. The department’s budget has been cut for 13 consecutive years. But, by contrast, the department’s wide inventory management improvements could bring major rewards home to the average taxpayer. Today, we will together begin that effort.

[The prepared statement of Hon. J. Dennis Hastert follows:]

DAN BURTON, INDIANA
 CHAIRMAN
 BENJAMIN A. OLMAN, NEW YORK
 J. OWENS HALEY, ILLINOIS
 CONSTANCE A. MORELA, MARYLAND
 CHRISTOPHER BRYCE, CONNECTICUT
 STEVEN SCHIFF, NEW MEXICO
 CHRISTOPHER COOL, CALIFORNIA
 KANA, MISSISSIPPI
 JOHN M. MURKIN, NEW YORK
 EDWARD JONES, CALIFORNIA
 JOHN L. MICA, FLORIDA
 THOMAS H. DAVIS, VIRGINIA
 DAVID M. MONTGOMERY, INDIANA
 MARK E. SOUDER, INDIANA
 JOE SCARBOROUGH, FLORIDA
 JOHN BRADLEY, ARIZONA
 STEVE C. LATTIN, OHIO
 MARSHALL "MARK" SARGENT, SOUTH CAROLINA
 JOHN E. SUNUNU, NEW HAMPSHIRE
 PETER BASSON, TEXAS
 MIKE PAPPAS, NEW JERSEY
 VINCE SIMONANGOLA, KANSAS
 BOB BARR, GEORGIA
 BOB PORTMAN, OHIO

ONE HUNDRED FIFTH CONGRESS
Congress of the United States
House of Representatives
 COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
 2157 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, DC 20515-6143

Mailroom (202) 225-2274
 Assembly (202) 225-2281
 TTY (202) 225-4882

HENRY A. WAGMAN, CALIFORNIA
 RAYMOND BRIDGEMAN, MISSOURI
 TOM LAYTON, CALIFORNIA
 BOB WISE, WEST VIRGINIA
 BLAISE F. CHURCH, NEW YORK
 EDWINA TORRES, NEW YORK
 PAUL E. BROWDER, PENNSYLVANIA
 GARY A. CONDT, CALIFORNIA
 CAROLYN E. MALONEY, NEW YORK
 THOMAS H. BARNETT, MISSISSIPPI
 ELIZABETH HOLMES HORTON, DISTRICT OF COLUMBIA
 CHARLES PATTON, PENNSYLVANIA
 BLAINE E. CLARK, MARYLAND
 DENISE EDWARDS, OHIO
 ROY H. BLANDY, MISSOURI
 ROBERT E. DAVIS, ILLINOIS
 JOHN F. TERESA, MASSACHUSETTS
 JOE THORNE, TEXAS
 THOMAS H. BLAKE, MISSISSIPPI
 HAROLD E. FORD, ALABAMA
 BERNARD SANDERS, VERMONT
 REPRESENTATIVE

**TO: Members of the Subcommittee on National Security,
 International Affairs and Criminal Justice**

FROM: The Honorable J. Dennis Hastert, Chairman

DATE: July 17, 1997

**RE: Hearing: "Reforming Inventory Management Through Innovative Business
 Practices."**

On **Thursday, July 24, 1997**, the Subcommittee on National Security, International Affairs and Criminal Justice will hold a second oversight hearing on Department of Defense (DOD) inventory management. The hearing will take place at 12:00 p.m. in **Room 2154 of the Rayburn House Office Building**.

I. **INTRODUCTION**

This hearing will build upon the introductory hearing the Subcommittee held on March 20, 1997 on logistics and inventory management. The purpose of the hearing will be to examine how DOD has used innovative business 'best practices' to improve inventory management, and how DOD can build upon its successes and expand the number of items for which virtual prime vendor and direct vendor delivery are used.

Testifying before the Subcommittee will be representatives from the General Accounting Office (GAO) and the Department of Defense. They have been asked to address the following topics:

- The success that DOD has had in using virtual prime vendor and direct vendor delivery practices for the acquisition and delivery of medical and pharmaceutical supplies to over 150 medical facilities nationwide, as well as the use of innovative business practices for food and clothing items.
- The feasibility of using virtual prime vendor and direct vendor delivery for other types of inventory items, such as hardware items and other readily available commercial products, and the approximate dollar value of such items.

- How sections 102 and 221 of the House National Security Committee's Defense Reform Act of 1997, which was amended to the 1997 authorization bill, may affect inventory management.
- In addition, they may suggest some other legislative or policy reforms that would allow DOD to aggressively implement business best practices.

Historically, DOD has emphasized 'just-in-case' practices of overbuying and stockpiling excess inventory at many different locations and levels. This approach provided good availability of supplies and repair parts, but only by sacrificing efficiency and savings. However, modern methods of inventory management can provide both availability and efficiency. In recent years, American businesses have developed many modern and sophisticated methods of inventory management which ensure timely delivery and also save money. Many of these methods -- such as just-in-time delivery, use of supplier parks, and prime vendor contracts -- could be applied to DOD's inventory management operations to achieve similar efficiencies and savings. Obviously, such commercial methods could not be applied to DOD in a wholesale manner, but would have to be tailored to the unique requirements of military readiness; still, there is significant room for improvement.

A CASE STUDY IN SUCCESS

While the Department still has much work to do to reform its inventory system in general, there is a notable success which both GAO and DOD will address, which merits brief mention here: the use of virtual prime vendor and direct vendor delivery for medical and pharmaceutical supplies. Due to steady pressure by Congress and GAO, DOD replaced its slow and costly system of managing medical supplies with a system more like that used by private hospitals and businesses. Instead of maintaining numerous warehouses, DOD now places orders electronically, and receives medical supplies directly from a commercial vendor.

Virtual prime vendor and direct vendor delivery practices were first applied to medical facilities in June 1993 in the National Capitol Region (the D.C. metropolitan area) which includes 13 medical facilities. The practices were so successful that by December 1995, DOD was using prime vendor for 150 medical facilities nationwide. Both the GAO and DOD assert that the use of virtual prime vendor and direct vendor delivery has been a great success. The successful implementation of these practices was seen first hand by Subcommittee staff at Walter Reed Army Medical Center, Washington, D.C., on April 8, 1997.

The GAO estimates that between September 1991 and September 1996, DOD reduced its pharmaceutical, medical and surgical inventories and associated management costs by about \$714 million through the use of best practices. The majority of savings has resulted from the issuance of medical supplies to military customers without having to replace inventories through the purchase of additional stocks. The prime vendor program also enables DOD hospitals to

reduce inventory costs. In August 1995, GAO reported that Walter Reed, in addition to a \$3.8 million reduction in pharmaceutical inventories, saves over \$6 million a year in related inventory management expenses.

Army medical personnel say that the quality and efficiency of the service have greatly increased as a result of the prime vendor program. According to the Army, from September 1991 to October 1996, Walter Reed was able to reduce stock lines from 4,342 to 534 items; reduce inventory from \$17.4 million to \$1.8 million; reduce military and civilian manpower from 72 to 36 personnel in the materiel division; cut average order to receipt time from 20 days to one day; reduce the amount of inventory, as measured in days on hand, from 380 days to 10 days; and close six out of seven warehouses – a total of 56,506 square feet. Walter Reed was then able to convert one of these warehouses into a modern medical training facility and conference center.

The GAO suggests that similar techniques be used for other categories of defense inventory items, including industrial hardware, such as fasteners, wiring, construction supplies, and similar types of common, commercially available hardware. The estimated value of these items in the inventory is between \$7 and \$10 billion. If implementation of best practices was successful, DOD could reduce the dollar value of the inventory by approximately that amount and reduce the requirement for future purchases of such items, while improving service to DOD customers. However, until this year, DOD had resisted that kind of broad application. Although it has extended these best business practices to the acquisition and delivery of food and clothing items, DOD only began to use these practices for industrial items in January of this year at a single Air Force base. While the pilot program at Warner-Robbins Air Logistics Center is a step in the right direction, the Subcommittee believes that DOD should be more aggressive in applying these new practices throughout the Department.

It should be noted that the lack of spare parts is currently the most aggravating factor affecting total repair times in DOD maintenance depots. By improving the availability of industrial hardware, DOD could expedite repair times in general and aircraft repair times in particular, thus reducing the requirement for the enormous \$40 billion inventory of aircraft parts. Improving this area of inventory management could have a snowball effect that could lead to faster repair times, significant reductions in inventory, and substantial savings to the taxpayers.

DEFENSE REFORM ACT OF 1997

H.R. 1778, the Defense Reform Act of 1997, was amended to this year's 1997 Defense authorization bill. Sections 102 and 221, if enacted, would have significant affect on inventory management, and are therefore appropriate topics of discussion at the hearing. Section 102 calls for a reduction of 124,000 acquisition personnel over the next four years. Section 221 would reduce the overhead of DOD's inventory control points (ICPs), which play an integral part of DOD's procurement system, to no more than 8% of sales by September 30, 2000. This was determined by comparing the ICP's overhead with that of similar organizations in the private sector. DOD is opposed to both provisions, saying that these recommendations were arrived at

arbitrarily, and that such reductions would inhibit reform and jeopardize the combat support mission of the Department.

CONCLUSION

Underlying the Subcommittee's investigation is the realization that the Department has to further reduce its infrastructure so that it can devote greater resources to modernization. Substantial financial savings in inventory management would free up defense dollars for military procurement, research and development, combat training, and other warfighting necessities which have been under funded and somewhat neglected in recent years.

WITNESSES

The following witnesses are scheduled to testify:

Panel One:

Mr. David Warren, Director, Defense Management Issues, National Security and International Affairs Division, General Accounting Office.

Mr. Kenneth R. Knouse, Jr., Assistant Director, General Accounting Office.

Mr. Robert L. Repasky, Senior Evaluator, General Accounting Office.

Panel Two:

The Honorable James B. Emahiser, Assistant Deputy Under Secretary of Defense for Materiel and Distribution Management, Department of Defense.

Dr. Edward Martin, Acting Assistant Secretary of Defense (Health Affairs), Department of Defense.

Mr. Jeffrey A. Jones, Executive Director for Logistics Management, Defense Logistics Agency, Department of Defense.

STAFF CONTACT

If you have any questions, please contact Andrew Richardson, Professional Staff Member, at (202) 225-2577.

Mr. HASTERT. With that, I would like to yield to the chairman of the full committee, Mr. Burton.

Mr. BURTON. Thank you very much, Chairman Hastert.

I want to thank you for holding this important hearing on Department of Defense inventory management. This area has been identified by the General Accounting Office as 1 of its 25 high-risk areas in the Federal Government because of its vulnerability to waste, fraud, abuse, and mismanagement, and it has been on that list for several years.

As the principal oversight committee in the House of Representatives, it is our responsibility to oversee the efficiency and effectiveness of all aspects of Federal Government operations, including the Department of Defense. Congressman Hastert's subcommittee has been vigilant and aggressive in pursuing Department of Defense oversight, especially defense inventory management.

Unfortunately, the Department of Defense has not effectively and efficiently solved many of the long-term inventory management problems, and therefore it is necessary for Congress to hold stronger oversight and scrutiny of the department's practices in inventory management, and we intend to do that.

Today, the department currently holds an estimated \$69 billion worth of inventory. Recognizing that a "one size fits all" solution will not work for inventory management and that the subcommittee cannot tackle the entire issue of inventory management in one hearing, today the subcommittee will be focusing solely on the consumable items within the inventory.

These include items such as medical supplies, food, clothing, screws, lumber, and building supplies. This portion of the inventory is valued at \$18.7 billion. This hearing, according to Representative Hastert, will focus on how the Department of Defense is managing the inventory of items within this category, with particular emphasis on the \$7.2 billion worth of industrial hardware items, such as bolts, valves, and fasteners held by the department.

Over the last several years, the department has successfully applied best business practices to medical, food, and clothing items. Today, we will be given more details about their latest efforts to apply these practices to hardware items.

The subcommittee also wants to learn what the potential savings could be if the department more aggressively adopted modern business practices over the next few years, a goal that is shared by Chairman Hastert and myself. While I am encouraged by the reforms the department has made in this area, I am, frankly, concerned that the department is not moving fast enough, and I think the American taxpayer feels the same way.

At a time when we are contemplating additional cuts in our combat forces, it is vital that the department's infrastructure be as lean and as mean as possible. There is the potential to save billions of dollars over the next few years in inventory management, which could be reinvested in higher priority programs within the Defense Department or returned to the taxpayer. This is an issue that the committee will be working on for the duration of the 105th Congress.

Mr. Chairman, once again, I want to thank you for your leadership on this issue, and I look forward to working with you in the future.

I yield back.

[The prepared statement of Hon. Dan Burton follows:]

*OPENING STATEMENT OF
THE HONORABLE DAN BURTON, CHAIRMAN
COMMITTEE ON GOVERNMENT REFORM
AND OVERSIGHT
JULY 24, 1997*

Good afternoon. Chairman Hastert, I want to thank you for holding this important hearing on Department of Defense inventory management. This area has been identified by the General Accounting Office as one of its 25 high risk areas in the federal government because of its vulnerabilities to waste, fraud, abuse, and mismanagement, and it has been on that list for several years. As the principal oversight

committee in the House of Representatives, it is our responsibility to oversee the efficiency and effectiveness of all aspects of Federal Government operations, including the Department of Defense. Congressman Hastert's Subcommittee has been vigilant and aggressive in pursuing Department of Defense oversight, especially defense inventory management. Unfortunately, the Department of Defense has not effectively and efficiently solved many of the long-term inventory management problems, and therefore, it is necessary for Congress to hold stronger oversight and scrutiny of the Department's practices in inventory

management.

Today, the Department currently holds an estimated \$69 billion worth of inventory.

Recognizing that a one-size-fits-all solution will not work for inventory management and that the Subcommittee cannot tackle the entire issue of inventory management in one hearing, today the Subcommittee will be focusing solely on the consumable items within the inventory. These include items such as medical supplies, food, clothing, screws, lumber, and building supplies. This portion of the inventory is valued at \$18.7

billion. This hearing will focus on how the Department of Defense is managing the inventory of items within this category, with particular emphasis on the \$7.2 billion worth of industrial hardware items (such as bolts, valves, and fasteners) held by the Department. Over the last several years, the Department has successfully applied best business practices to medical, food and clothing items, and today we will be given more details about their latest efforts to apply these practices to hardware items. The Subcommittee also wants to learn what the potential savings could be if the Department more

aggressively adopted modern business practices over the next few years, a goal that is shared both by Chairman Hastert and myself.

While I am encouraged by the reforms the Department has made in this area, I am frankly concerned that the Department is not moving fast enough. At a time when we are contemplating additional cuts in our combat forces, it is vital that the Department's infrastructure be as lean as possible. There is the potential to save billions of dollars over the next few years in inventory management, which could be reinvested in higher

priority programs within the Defense Department
or returned to the taxpayer.

This is an issue that the committee will be
working on for the duration of the 105th Congress.
Mr. Chairman, I want to thank you for your
leadership on this issue, and I look forward to
working with you in the future. I yield back, Mr.
Chairman.

Mr. HASTERT. Thank you, Mr. Chairman. I certainly appreciate your leadership in this area and many areas in the full committee.

At this time, I would like to recognize the Member from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you very much, Chairman Hastert.

I am very pleased that you are holding this hearing today on reforming defense inventory management through innovative best business practices. I applaud your efforts to keep this issue in the public spotlight, because I believe that we have a real opportunity here to eliminate substantial waste at the Department of Defense and save taxpayers billions of dollars.

Very importantly, as both sides of the aisle work very hard to balance the budget, and we have suffered cutbacks in all areas of government, it is important that the limited dollars that we have are spent on keeping our armed services the best equipped and the best prepared in the world, and certainly not on unneeded inventory.

Earlier this year, the General Accounting Office responded to a request from Congressman DeFazio, then Congressman Durbin, and Senator Harkin and myself to investigate the amount of unneeded inventory at the Department of Defense. The GAO reported to us that DOD has \$41 billion in unneeded inventory, including \$14.6 billion in inventory that will never be used, according to the GAO, and \$1 billion in inventory that will last 100 years or more.

I must say that since I have been on this committee, I have read the GAO reports that they have been issuing on this issue, and every time I read about the problem, I think, well, the next GAO report will show that the inventory is becoming less, that the great military Department of Defense that we have will address the problem that they are pointing out to them.

I must tell you I am astonished that every time I read a GAO report, the number gets bigger; it grows. The inventory grows, and I don't understand that, with the expertise that you have in the department, that a problem like this cannot be addressed.

For more than a decade, GAO has documented mismanagement at the department, yet the Department of Defense has made little progress. In fact, the inventory continues to grow. The Department of Defense continues to use outmoded technology and inventory practices which waste money, and delays the timely repair of weapon systems and their components.

For example, just this year, the Navy reported that it stopped repairing more than 12,000 broken aircraft components, valued at \$500 million, simply because parts were not available. At the same time, the military services continued to order parts for which they already have 20 more years' worth of supplies on the shelf. By using best business practices, a modern corporation would not only make sure that it needed the part before ordering more, but it would also receive parts as soon as they needed them.

To bring DOD into the 1990's, I have introduced legislation, H.R. 1850, which Mr. Barrett, the ranking member of this committee, has cosponsored, that would require the Secretary of Defense to begin testing various best business practices to improve defense inventory management.

I also drafted a version of this bill as an amendment to H.R. 119, the House Defense Authorization bill. Unfortunately, the Rules Committee did not accept my amendment. At the same time, I sent a copy to the Senate and urged them to accept my legislation as part of the Senate Defense Department Authorization bill. I am pleased to inform the subcommittee that a version of my legislation passed the Senate on July 11.

I applaud the Senate's actions and urge the House to adopt Senate language in conference that will implement best business practices at the Department of Defense. And I appeal, in a bipartisan way, to the chairman and other distinguished members of the panel to aid in keeping this language in the conference committee report.

I designed my language to promote the use of best business practices, like cellular manufacturing techniques, which involve bringing all the resources needed to complete repairs to one location, the elimination of excess spare parts inventory, and the rapid initiative of repair actions, like the use of private entities for logistics services such as warehousing.

I urge the Department of Defense to implement these techniques. Once implemented, I am confident that the department will discover that these techniques can improve the support to the military customer and enhance readiness, as well as save inventory and related management costs, and therefore allow us to spend more of our dollars on the defense of our country and on the support of our military men and women, and the inventory that they need, but not unneeded inventory.

I yield back the balance of my time. Thank you.

[The prepared statement of Hon. Carolyn B. Maloney follows:]

DAN BURTON INDIANA
 BENJAMIN A. GILMAN NEW YORK
 DENNIS HASTERT ILLINOIS
 CHRISTOPHER A. HORNELL VIRGINIA
 CHRISTOPHER B. SMITH CONNECTICUT
 STEVEN SCHIFF NEW MEXICO
 CHRISTOPHER COOK CALIFORNIA
 DAN Rostenkowski ILLINOIS
 K. MICHAEL MARTINEZ NEW YORK
 JAMES HONAN CALIFORNIA
 JOHN L. MACE ILLINOIS
 THOMAS H. DAVIS VIRGINIA
 DAVID W. MCINTOSH INDIANA
 MARY E. SULLIVAN IOWA
 JOE SCARBOROUGH FLORIDA
 JOHN BRADGORD ARIZONA
 STEVE C. LITOURNETTE OHIO
 MARSHALL VANDER SANFORD SOUTH CAROLINA
 JOHN E. SUNUNU NEW HAMPSHIRE
 PETE BISCOCHIO TEXAS
 MIKE PAPPAS NEW JERSEY
 MIKE BISHOP KANSAS
 BOB BARR GEORGIA
 BOB PORTMAN OHIO

ONE HUNDRED FIFTH CONGRESS
Congress of the United States
House of Representatives

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
 2157 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, DC 20515-6143

MAIL ROOM TEL: (202) 225-3074
 FAX: (202) 225-3081
 TTY: (202) 225-6882

July 23, 1997

HENRY A. JAHMAN CALIFORNIA
 THOMAS M. COFFY MISSOURI
 TOM LANTOS CALIFORNIA
 BOB WISE WEST VIRGINIA
 DAVID E. BONIOR NEW YORK
 EDWARD J. CANN NEW YORK
 PAUL E. HANCOCK PENNSYLVANIA
 JERRY A. COLE CALIFORNIA
 GARDNER B. WHALLEY NEW YORK
 THOMAS W. BRUNETT WISCONSIN
 ELIZABETH HOLMES HORTON DISTRICT OF COLUMBIA
 DANIEL PATRICK MOYNIHAN PENNSYLVANIA
 ELLIOTT C. SPENCER MARYLAND
 SEMPER PARCUM OHIO
 ROD P. BLAGOVESHCHIN ILLINOIS
 DANIEL R. DAVIS ILLINOIS
 JOHN F. TIERNEY MASSACHUSETTS
 JIM TURNER IOWA
 THOMAS H. ALLEN MAINE
 HAROLD E. FORD JR. TENNESSEE

REINHOLD SANDERS VERMONT
 INDEPENDENT

REP. CAROLYN B. MALONEY -- OPENING STATEMENT

HEARING ON REFORMING INVENTORY MANAGEMENT
 THROUGH INNOVATIVE BUSINESS PRACTICES

Thank you Mr. Chairman.

I am pleased that you are holding this hearing today on reforming defense inventory management through innovative best business practices. I applaud your efforts to keep this issue in the public spotlight because I believe that we have a real opportunity here to eliminate substantial waste at Department of Defense and save taxpayers billions of dollars.

Earlier this year, the General Accounting Office responded to a request from me, Congressman DeFazio, then Congressman Durbin, and Senator Harkin to investigate the amount of unneeded inventory at the Department of Defense. The GAO reported to us that DoD had \$41 billion in unneeded inventory including \$14.6 billion in inventory that will never be used and \$1 billion in inventory that will last 100 years or more.

For more than a decade, GAO has documented inventory mismanagement at the Department, yet they have made little progress. DoD continues to use outmoded technology and inventory practices which wastes money and delays the timely repair of weapon systems and their components. For example, just this year the Navy reported that it stopped repairing more than 12,000 broken aircraft components valued at \$500 million dollars simply because parts were not available. At the same time, the military services continue to order parts for which they already have 20 or more years worth of supplies on the shelf. By using best business practices, a modern corporation would not only make sure that it needed the part before ordering more, but it would also receive parts as soon as they needed them.

To bring DoD into the 90's, I have introduced legislation, H.R. 1850, which Mr. Barrett has cosponsored, that would require the Secretary of Defense to begin testing various best business practices to improve defense inventory management. I also drafted a version of this bill as an amendment to H.R. 1119, the Defense Authorization bill. Unfortunately, the Rules Committee did not accept the amendment.

At the same time, I sent a copy to the Senate and urged them to accept my legislation as part of the Senate Defense Department Authorization bill. I am pleased to inform the Subcommittee that a version of my legislation passed the Senate on July 11. I applaud the Senate's actions and urge the House to adopt the Senate language in conference regarding the implementation of best business practices at the Department of Defense.

I designed my legislation to promote the use of best business practices like cellular manufacturing techniques which involves bringing all the resources needed to complete repairs to one location, the elimination of excess spare parts inventory and the rapid initiation of repair actions, and the use of private entities for logistics services such as warehousing. I urge the Department of Defense to implement these techniques. Once implemented, I am confident that the Department will discover that these techniques can improve the support to the military customer and enhance readiness as well as save inventory and related management costs.

Mr. HASTERT. The gentlewoman's time has expired.

I would also like to note that Mr. Sessions, a member of the full committee, will be joining us today. Mr. Sessions is a member of the Results Caucus, and he will be addressing this issue throughout the 105th Congress.

I yield to the gentleman from Texas for an opening statement.

Mr. SESSIONS. Thank you, Mr. Chairman.

I appreciate your allowing me to serve with you today. As chairman of the Results Caucus, I am here to not only participate but to gather and gain information and insight into the testimony that is going to take place today.

The Results Caucus is a caucus that was appointed by Majority Leader Dick Armey, a gentleman who has a distinguished career in looking not only at our military but also the efficiency of government. We are concerned about any government agency that remains on the high-risk series, as a result of GAO and any audits they perform. So my function here really, as chairman of the Results Caucus, is to gather information into what is being discussed today.

From a perspective of purely trying to look at good management—I have heard said many times today, and heard many times today—the efficiency gained from reform in this area of the defense inventory management, I believe, can result in more money for the Department of Defense to support its ultimate target and mission statement, and that is of not only the defense of our country but also combat readiness.

I take a perspective that I believe that the best disinfectant is the light of day, and that oversight by this committee and the Results Caucus will be critical to the success of not only the military but any other area we get into. The Results Caucus and the work that we do should be considered positive, not only by the taxpayers of this country, but also those agencies. I hope that the Defense Department views our interaction with them as positive also.

Mr. Chairman, thank you.

Mr. HASTERT. I welcome the gentleman from Texas' comments and just want to say that we look forward to working with him. I know that both the chairman of the full committee and myself think this is an important issue.

Just let me say for the record, our goal is not necessarily to cut defense spending. Our goal is to make sure that the dollars that are spent are spent to support the men and women who wear the uniforms and protect this country, that they have the wherewithal to do their jobs, and that we are in the most efficient support posture possible, to make sure that the dollars are spent for the things that are most important.

At this time, I would like to introduce our first panel. Mr. David Warren is the Director of Defense Management Issues at the General Accounting Office. He is joined by Mr. Kenneth Knouse, an Assistant Director at GAO, and Mr. Robert Repasky, a senior evaluator at GAO, and Mr. Matthew Lea, also a senior evaluator at GAO.

I thank you, gentlemen, all for coming. In accordance with House rules, we will swear you in, so please stand and raise your right hands.

[Witnesses sworn.]

Mr. HASTERT. Let the record show that the witnesses answered in the affirmative.

Before you begin, Mr. Warren, I would like to extend my thanks to the GAO for your recent and good work with the subcommittee on this issue. I especially want to thank Mr. Repasky and Mr. Lea, both of whom worked out of your Dayton office, for the work that they have done, including travel with the subcommittee staff and investigative trips to military installations nationwide.

Mr. Warren, please proceed.

STATEMENT OF DAVID R. WARREN, DIRECTOR, DEFENSE MANAGEMENT ISSUES, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY KENNETH R. KNOUSE, JR., ASSISTANT DIRECTOR, ROBERT L. REPASKY, SENIOR EVALUATOR, AND MATTHEW LEA, SENIOR EVALUATOR

Mr. WARREN. Thank you, Mr. Chairman. We appreciate that.

I would like to just briefly summarize my remarks, if I could, and have my full statement entered into the record, please.

Mr. HASTERT. Without objection, the full statement will be entered into the record.

Mr. WARREN. I would also, as an opening remark, mention that, as a result of the last hearing, Mr. Emahiser, who will be on the second panel and has major responsibilities in this area, he and I got together and thought it would be constructive to talk about the areas of, in essence, mutual disagreement that we had on certain issues. We have agreed to do that.

We have also agreed to put together a team of folks to look at those items, so we can constructively start working toward solutions. I just wanted to mention that as a positive result of the work that has already come out of this particular set of oversight hearings.

Mr. Chairman, members of the subcommittee, Mr. Burton, we are pleased to be here today to discuss DOD's use of private sector business practices to improve inventory management processes. As you requested, we will look at consumable items. They represent about \$18.7 billion.

Our testimony addresses three points: First, DOD, in fact, has made some progress in reducing inventory cost and improving services to customers.

Second, we still think significant opportunities exist to reduce those costs further, and we think they lie, as you have said, in the area of prime vendor and best commercial practices.

Third, we do, in fact, think that legislation that has been introduced in this Congress represents a positive step forward and is consistent with many of the recommendations that GAO has put out over the past several years with regard to ways to address these problems.

Let me give you a few more details on each of those areas. Regarding DOD's progress, about 2 percent of the consumable items that DOD manages are through the prime vendor program. Simply defined, a prime vendor is a commercial activity that buys, stores, and then provides items to a military customer upon request.

To its credit, DOD has achieved significant cost and service improvements through the medical supplies program, as mentioned in

the opening statements. We estimate that savings in those areas are on the order of magnitude of \$700 million over a 5-year period. This program is also helping to get DOD out the storage, distribution, and inventory holding business, which we think is important, as well, and I think the department would agree.

Another important item with regard to that program is that it puts DOD in a position of not having or minimizing the amount of excess inventory that they have, because they are making a purchasing decision much closer to the point in time that the inventory can be used. So things that would intervene where the period is longer, natural changes in requirements, things of that nature, the likelihood of that happening is reduced.

The first figure that we have here to my left provides an illustration of what was mentioned in the opening remarks regarding the success of this program. The key point to look at, the bars represent the total amount of inventory that was held starting in 1991, about \$600 million, and the amount of inventory that we have today in the medical area, and that's about \$200 million. That's a significant reduction.

Now, some of that, obviously, was occasioned by the force reduction. Other portions of it, clearly, we believe are attributable to the medical prime vendor. That program started in earnest in 1993. Prior to that, we had made recommendations to adopt the program. The department was in agreement with that and started some initiatives to buy down the excess inventory they had, in anticipation of beginning the medical prime vendor.

To me, this is a true success story for the department. The dotted line shows that as the prime vendor program is implemented, you see a trend of the inventory being held moving down. From an overall context, this is the approach the private sector has been implementing, principally during the 1980's and very aggressively during the 1990's.

In addition to reducing inventory costs, this purchasing approach also improves service to the military customer. For example, the use of this practice has reduced the time needed to supply an item from an average of 110 days to 8 days. In short, this means you have helped to improve readiness.

DOD is also making similar progress in the food prime vendor program. They also have a program underway in the clothing area; however, that has not progressed far enough for us to make a full assessment, but the early indications are that the trends are similar to those that you see in the medical area. They moved out very aggressively in the food area. They have a ways to go in the clothing area.

Let me turn to some of the things where we see there are opportunities for further improvement. An area where DOD has made little progress in adopting best practices is hardware supplies. This includes such things as bearing valves, bolts, things of that nature. The reason that we believe it is significant is that it represents 97 percent of the items that DLA manages and represents a substantial financial investment.

For example, DLA annually purchases \$2.6 billion of these types of items and holds these items valued at about \$7 billion. However, our work has shown, in many cases, customer needs can still not

be met. For example, at one repair depot where we did some extensive work on the repair process, we found that mechanics ordering parts received the full order only 25 percent of the time. Obviously, that's not the type of supply responsiveness that we are hoping to see.

To improve hardware inventory management, DLA has implemented a commercial direct vendor delivery program in about 17 percent of the sales in the hardware items. Also, it has started a limited program in the prime vendor area, and that represents about 2 percent of those sales.

Our second illustration, to your far right, the comparison I wanted to make here, you have a very much less aggressive program in the prime vendor going on in the hardware area. You note there, for the amount of inventory being held, that there has been very little change since 1992.

What we would hope and will talk a little bit about here as we go on, and I am sure we will discuss, is that we believe that there is an opportunity to get a similar trend in the hardware area. In other words, as prime vendor use goes up, we hope to see inventory cost go down and supply responsiveness improve.

Last, I would like to make a few comments about the legislation. We think it is important to note that these represent, we think, important opportunities to improve not only inventory management but the use of best commercial practices in that process. As I said, they are consistent with many of the recommendations that we have made over the last several years.

For example, the House Defense Authorization Act of 1989 calls for reductions in the overhead of inventory control points. We believe such reductions are certainly needed. A recent study that was done by LMI and that we evaluated showed that savings could be on the order of magnitude of \$3 billion over, I believe, a 5-year period, if consolidation could be achieved.

Also, we support several requirements in the Senate version of the 1998 Authorization Act. Particularly, we are encouraged by those provisions that relate to the application of best practices at depot-level repair activities and the expansion of the use of concepts such as prime vendor within the Defense Logistics Agency.

We think, by doing these things, particularly in the hardware items, that you have high potential for improving DOD inventory management and, obviously, reducing costs without impacting on the war fighting, and we would hope perhaps improve that service and level of capability.

Mr. Chairman, that concludes my summary. We would be happy to respond to questions.

[The prepared statement of Mr. Warren follows:]

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the Department of Defense's (DOD) use of innovative business practices to improve inventory management and the opportunities we see for further application of best practices to DOD's operations. We have identified defense inventory management as 1 of our 25 high risk areas in the federal government because of vulnerabilities to waste, fraud, and abuse.¹ Today, we will discuss DOD's management of consumable items, which represent \$18.7 billion, or 27 percent of the total secondary inventory dollar value.² As requested, our testimony today will focus on (1) an overview of the success DOD has had in using prime-vendor-type programs for medical, food, and clothing items, (2) the feasibility of using prime vendor systems for hardware items (such as bearings, valves, and bolts), and (3) our observations on recently introduced legislation that pertains to improving DOD's inventory management practices.

RESULTS IN BRIEF

DOD has successfully applied best practices to improve the management of medical and food items, which account for 2 percent of the consumable items DOD manages. DOD's prime vendor program for medical supplies, along with other DOD inventory reduction efforts, has resulted in savings that we estimate exceed \$700 million. More importantly, this program has moved DOD out of the inventory storage and distribution function for these supplies, emptying warehouses, eliminating unnecessary layers of inventory, and reducing the overall size of the DOD supply

¹In 1990 we began a special effort to review and report on the federal program areas we identified as high risk because of vulnerabilities to waste, fraud, abuse, and mismanagement. This effort, which was supported by the Senate Committee on Government Affairs and the House Committee on Government Reform and Oversight, brought a much needed focus on problems that were costing the government billions of dollars. We identified DOD's secondary inventory management as a high risk area at that time because of too high levels of unneeded inventory and inadequate systems for determining inventory requirements.

²Consumable items are items discarded after use rather than repaired.

system. Also, DOD buys only the items that are currently needed because consumers can order and receive inventory within hours of the time the items are used.

Despite the success of its prime vendor program for medical supplies and, to a lesser extent, food items, DOD has made little progress in adopting best practices for hardware supplies, which account for 97 percent of the consumable items. DOD continues to manage hardware items using inefficient and outdated business practices, which have resulted in excessive inventory levels, poor customer service, and delays in the repair of expensive military equipment. Although the private sector has developed solutions to these problems, DOD's efforts to adopt such practices are limited in scope and represent only a small part of its logistics operations.

Since 1991, we have issued a series of reports highlighting best practices we believe have direct application to DOD's operations.³ However, DOD has not applied these best practices to the majority of DOD consumable items, and inefficiencies in DOD's logistics systems remain. In this context, proposed legislative initiatives, if enacted, would encourage DOD to change its inventory management practices. Also, congressional oversight will continue to be a critical element as DOD establishes plans, goals, objectives, and milestones for addressing its inventory management processes.

We strongly support the need to improve the DOD's business practices and further reduce the logistics infrastructure. Because of the potential impact improved business practices would have on DOD inventory levels, operating costs, and the repair of weapon systems and component parts, we believe DOD must be more aggressive in expanding the use of new management techniques for these items.

³See Related GAO Products at the end of this testimony.

DOD INVENTORY MANAGEMENT OVERVIEW

The Defense Logistics Agency (DLA) is the primary manager of DOD's consumable items and acts as the custodian of military aircraft, ship, and vehicle parts. To perform these functions, DLA operates a massive logistics system that currently contains about 4 million items with a total inventory value of \$11.1 billion.⁴ To store and distribute DOD's secondary inventory, DLA has reported that it uses storage structures at 27 sites that provide 531 million cubic feet of storage space. According to DLA, it employed more than 30,000 people in its material management operations in 1996.

DLA's 1996 material management costs, excluding the management of fuels, were reported at about \$8.3 billion. Of that amount, approximately \$5.5 billion was spent to purchase consumable items and \$2.8 billion was spent to manage and distribute inventory. Also, DLA reported that it disposed of \$1.1 billion of excess consumable material in 1996.

DOD recognizes that it can no longer continue to operate a costly and inefficient logistics system. In addition, DOD needs to achieve significant savings in its support infrastructure to help increase funding for weapon system modernization and meet the goal of increasing procurement funding from about \$40 billion to over \$60 billion between fiscal years 1997 and 2002. DOD is relying on initiatives, such as outsourcing and privatization, acquisition reforms, organizational streamlining and consolidations, management process reengineering, base realignments and closures, personnel reductions, and inventory reductions to help produce savings in its support areas.

In this connection, the Secretary of Defense has established, as part of the Quadrennial Defense Review, a Defense Reform Task Force to review the Office of the Secretary of Defense, defense

⁴The \$11.1 billion value of the inventory was estimated using the last acquisition cost of each item. In reporting the value to Congress, DOD reduced the amount to \$9.5 billion, because excess inventory was valued at salvage value (3.2 percent of the last acquisition cost).

agencies, DOD field activities, and the military departments to look at ways DOD can consolidate functions, eliminate duplication of effort, and improve efficiency. The Task Force plans to consult with Congress and business executives who have streamlined their corporations in recent years. The Secretary has directed the Task Force to submit its findings and report by November 30, 1997.

BEST PRACTICES HAVE REDUCED PRIVATE SECTOR LOGISTICS COSTS

We have identified several best practices that have been successfully used in the private sector to reduce inventory levels and logistics costs. In general, these practices provide inventory users with a capability to order supplies as they are needed and then delivering those items directly to the customer within hours after the order is placed. Ordering supplies only as they are needed, combined with quick logistics response times, enable companies to reduce or eliminate inventory levels, buy only the items that are currently needed, reduce or eliminate the possibility of inventory spoilage or obsolescence, and reduce overall supply system costs.

Since 1991, we have highlighted three best practices--prime vendor, local distribution centers/supplier parks, and integrated supplier--that reflect the new business philosophy in the management of consumable items (see table 1). These techniques resulted in significant savings for the companies that have used them to improve their inventory management systems. We recommended that DOD test these concepts and expand them, where feasible, to other defense facilities.

Table 1: Best Practices Recommended by GAO

Concept	Description
Prime vendor	A single vendor (prime vendor) buys inventory from a variety of suppliers and stores the inventory in its warehouse. This concept is characterized by a close partnership between the prime vendor and customer. The customer orders supplies from the prime vendor, using electronic ordering systems that, in some cases, are provided by the prime vendor. The prime vendor delivers inventory items to the customer within hours of receiving the order.
Local distribution centers/supplier parks	One or more suppliers locate a distribution center within close proximity to their customers. From this location, the supplier delivers items to the customer within 24 hours or less of receiving an order. The supplier is linked electronically with the customer. In some cases, the supplier can perform the receiving function for the customer in the local distribution center before the inventory leaves the facility.
Integrated supplier	An integrated supplier assumes almost total inventory management responsibilities for a customer. This is the most aggressive form of a supplier partnership where a supplier representative works in the customer's facility, ordering supplies as they are needed, and replenishing storage locations. Inventory is stored by the supplier in the supplier's warehouse until ordered and then delivered on a "just-in-time" basis. An integrated supplier can also perform quality inspections, maintain data on usage, test the quality of parts, prepare parts kits, establish electronic data interchange links and bar coding, and provide vendor selection management.

The companies that have adopted these best practices have significantly reduced their logistics costs. For example, as we reported in December 1991, Vanderbilt University Medical Center reduced inventory levels by \$1.7 million (38 percent) through the use of a prime vendor program. In 1993 we reported PPG Industries eliminated \$4.5 million (80 percent) in maintenance and repair supplies and saved approximately \$600,000 in annual operating costs by locating 10 suppliers' activities at a supplier park about 600 yards from the PPG facility. In 1996, we found

that a leading distributor of aircraft supplies reported its integrated supplier program reduced one customer's inventory by \$7.4 million (84 percent), while filling 98 percent of the customer's orders within 24 hours.

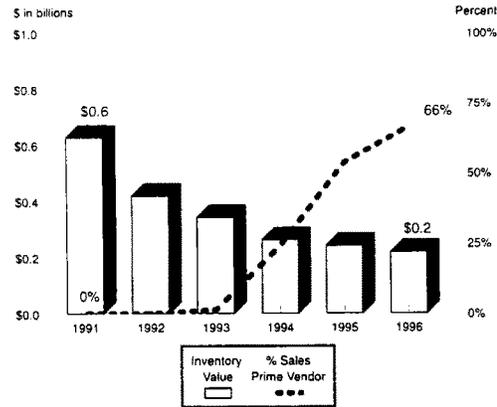
DOD HAS ACHIEVED SUCCESS WITH MEDICAL AND FOOD
PRIME VENDOR PROGRAMS

Starting in 1993, DOD has successfully applied the prime vendor concept to its management of medical supplies. The prime vendor, which delivers the items to the DOD hospitals when ordered, has enabled DOD to reduce the need to store and distribute medical supplies. As a result, DOD has been able to reduce its inventory and supply system resource requirements.

DOD implemented this prime vendor program within a relatively short period of time. The overall implementation strategy was to test and evaluate the concept first in one geographic region (the National Capital Area), and expand the concept nationwide to 20 other geographic regions. DOD began first with pharmaceutical items, such as aspirin and antibiotics, then followed with medical supplies, such as syringes and surgical gloves. According to DLA, nationwide roll-out of the pharmaceutical and medical prime vendor programs took a total of 20 and 40 months, respectively. Presently, DLA reported that almost 200 DOD medical facilities use a prime vendor to meet most of their pharmaceutical and medical supplies needs.

As the prime vendor program was established nationwide, inventory levels began to decline, and warehouses once filled with these items were being emptied (see fig. 1). At one of DLA's primary storage depots for medical supplies, DLA estimated that storage space requirements dropped by about 40 percent over a 3-year period.

Figure 1: DOD Medical Inventory Levels and Prime Vendor Trends 1991 - 1996



In addition, as a result of the prime vendor program, logistics systems at DOD medical facilities were shrinking. Walter Reed Army Medical Center officials, for example, estimate the prime vendor program reduced inventory lines stocked by the Medical Center from 4,342 to 534, reduced inventory levels from \$17.4 million to \$1.8 million, reduced personnel levels from 72 to 36 full-time equivalents, and closed 6 out of 7 warehouses. Walter Reed officials estimate that they save approximately \$6 million each year as a result of the prime vendor program. Table 2 summarizes our estimate of savings that have accrued DOD-wide from 1991 to 1996 as a result of the medical prime vendor program and other related inventory reduction efforts.

Table 2: Estimated DOD Medical Inventory Savings

Dollars in millions

Type of savings	Estimated Amount
Inventory reductions	\$409.5
Holding cost reductions	118.9
Product cost reductions	154.0
Distribution cost reductions	31.3
Total	\$713.7

As table 2 illustrates, this estimate includes realized savings from reduced inventory levels and the associated holding and distribution costs and realized reduced product costs. For example, in 1995, DOD estimated that the amount paid by medical facilities for the top 16 prime vendor pharmaceutical items was \$37.7 million lower than 1993 prices.

The medical prime vendor program has also provided a quicker pipeline between the manufacturer and end-users, which has moved procurement decision closer to the time the items are actually used. Under the traditional military logistics system, hospital warehouses would wait an average of 20 days to receive supplies ordered from DLA warehouses. DLA would take an average of 90 days to order and receive items from manufacturers. The prime vendor can deliver supplies directly to the hospital within 1 day of receiving the order and can order and receive supplies from manufacturers within 7 days. Therefore, the process that used to take an average of 110 days has been reduced to 8 days.

Food and Clothing Prime Vendor Programs

As with medical supplies, DLA's use of prime vendors for food has reduced DOD logistics costs and improved customer service. In 1994, DLA began testing the use of prime vendors to supply food to military dining facilities. By the end of fiscal year 1997, DLA plans to have prime vendors supporting all military dining halls in the continental United States.

Since fiscal year 1994, DLA has reduced peacetime food inventories by over 40 percent. In a demonstration test of the prime vendor concept in a four-state area (Florida, Georgia, South Carolina, and Alabama), DOD estimated that it saved \$16.8 million in food inventory reductions and related costs. Another location outside the test area using the prime vendor concept estimated that it saved about \$7 million. At one facility we visited, service officials were able to vacate two warehouses that previously were needed to store food items. Officials we spoke with were more satisfied with the delivery service provided by the prime vendor than that provided by the traditional DOD supply system. For example, the prime vendor can deliver food to dining facilities within 1 to 2 days instead of 30 days under the DOD system. DLA is projecting that the potential savings associated with this program could be as much as \$1 billion over the next 5 years.

DLA's adoption of the prime vendor concept for clothing items is not as advanced as the medical and food prime vendor programs. In April 1994, we recommended that DOD test the prime vendor concept to improve management of high-usage uniform items. In March 1996, DOD began testing a prime vendor program at the Air Force recruit induction center located at Lackland Air Force Base. This test is expected to continue for two more years. Since 1993, based on DLA's records, clothing inventory has decreased 12 percent, from \$1.7 billion to \$1.5 billion. According to our analysis, this inventory could meet DOD's requirements for the next 1.5 years, based on demands received in 1996.

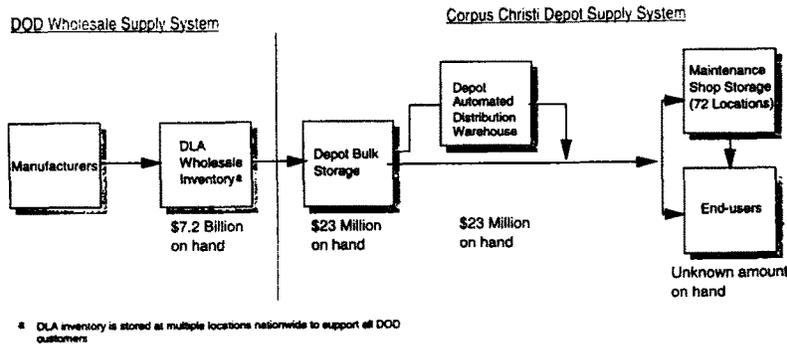
DOD USES INEFFICIENT AND INEFFECTIVE
MANAGEMENT TECHNIQUES FOR HARDWARE ITEMS

DOD's use of best practices is least advanced for hardware items (such as bearings, valves, and bolts), which represent 97 percent of DLA's inventory items. DOD continues to use outdated and inefficient business practices that require DOD to buy and store hardware items in DLA warehouses and base-level supply systems in an attempt to ensure that inventory will be available to customers. In some cases, DOD buys inventory years in advance of when the items are actually used. For example, based on our analysis of DOD records, over 60 percent of DOD hardware items, valued at \$2.7 billion, did not have a demand from September 1995 to August 1996. Despite this inventory investment, however, in many cases, hardware inventory is not available when needed by DOD customers. When hardware inventory is not available, the repair of costly weapon systems and components is delayed. Although DOD has taken steps to improve its logistics practices and reduce inventories, more aggressive steps could provide better customer service, enhance readiness, and reduce logistics costs.

During fiscal year 1996, DLA reported it purchased \$2.6 billion in hardware supplies and sold \$3.1 billion in supplies to the military services.⁵ When the services order hardware supplies from DLA, the supplies are sent from the DLA warehouses to the military services, which, according to DOD records, takes an average of 25 days. The services operate a base-level logistics system to deliver the inventory to the end user. This system usually requires that the inventory be stored in three separate locations--bulk storage warehouses, central distribution storerooms, and end user locations. When DLA and service-owned inventories are combined, the total inventory levels could meet current DOD requirements, in some cases, for several years. Figure 2 is an illustration of the traditional multi-layered logistics system, as highlighted in our April 1997 report on the Army's logistics system, and shows the millions of dollars of hardware inventory that a service facility can hold.

⁵DLA buys inventory using working capital funds. The services purchase inventory from DLA using operations and maintenance funds appropriated by the Congress.

Figure 2: DOD's Logistics System Used at Corpus Christi Army Depot



As of September 1996, DLA reported it stored \$7.2 billion worth of hardware items in distribution depots and warehouses. On the basis of inventory levels and past demands for items, we estimate that this inventory could satisfy DOD's requirements, on average, for the next 2.3 years.

Despite DOD's large investment in inventory, the supply system frequently does not meet the needs of its customers. As of September 1996, DLA reported it had over 574,000 customer orders, valued at \$843 million, that it could not fill because it did not have the right stock on hand. Customers had been waiting on these parts for an average of over 3 months. Also, the base-level supply system frequently did not meet orders placed by mechanics and other customers. For example, according to Army records, the base warehouse at one Army depot did not fully meet customer orders 76 percent of the time during 1996. At four other locations we examined, base-level systems did not meet customer needs between 30 and 72 percent of the time.

When hardware supplies and other parts are not immediately available to mechanics, it delays the timely repair of weapon systems and their components. For example, the Navy calculates that the lack of parts increases the repair time for aviation parts by as much as 74 percent. As of January 1997, the Navy reported it had stopped repairing over 12,000 broken aircraft components, valued at \$516 million, because parts were not available to complete repairs. The Navy had packaged and moved the partially repaired items to a warehouse next to the repair facility. At the time of our review, these items had been in storage for an average of 230 days. Also, according to Air Force records, mechanics at one Air Force depot location had stopped repairs on 2,748 items, valued at \$193 million, because necessary parts were not available.

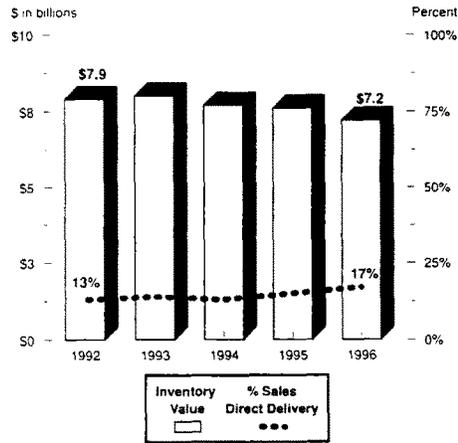
DOD COULD BUILD ON EFFORTS TO ADOPT BEST PRACTICES
FOR HARDWARE ITEMS

To its credit, DLA has tried new inventory practices for managing hardware items. However, the efforts are limited in scope and represent only a small part of its logistics operations. To attain the same level of success that DOD has achieved with the medical prime vendor program and to realize the dramatic inventory reductions and infrastructure savings we have seen in the private sector, we believe DOD should expand the prime vendor concept and fully use the services offered by prime vendor and integrated supplier programs.

DOD should move beyond direct vendor delivery concepts

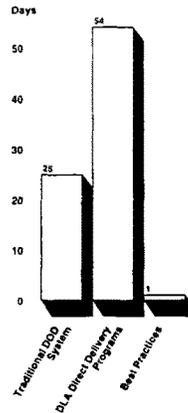
Since 1992, the use of a direct vendor delivery program has been one of DLA's main improvement initiatives. Under the direct vendor delivery initiative, DLA uses long-term contracts and electronic data systems to enable certain suppliers to deliver items directly to the military customers instead of having the items delivered to DLA warehouses. In fiscal year 1996, DLA reported that 17 percent of hardware inventory sales were filled using the direct vendor delivery program. This percentage has not varied much since 1992. Figure 3 shows the direct delivery sales and inventory levels from fiscal year 1992 through 1996.

Figure 3: DOD Hardware Inventory Levels and Direct Delivery Trends 1992 - 1996



Although the direct delivery program eliminates the need to store and distribute inventory from DLA warehouses, lowering the cost to the DOD customer, it does not provide a quick response to customer orders. For example, according to DLA records, the cost recovery rate for some hardware items is reduced from 46.6 percent to 7.4 percent under the direct vendor delivery program. However, under the direct delivery program, it took an average of 54 days for customers to receive items ordered, or twice as long as the 25-day delivery average for items stocked in DLA warehouses. As shown in figure 4, both of these delivery times are significantly longer than that achieved by prime vendors or integrated suppliers, which can often deliver parts within hours of receiving an order.

Figure 4: Delivery Time Comparison



DOD has applied a limited form of the prime vendor concept to hardware items.

In fiscal year 1997, DOD began using the prime vendor concept, called the virtual prime vendor program, for hardware supplies on a limited basis. One of the two testing areas was supply support of repair depot operations. In February 1997, DOD began using a prime vendor program to support the C-130 propeller repair shop at the Warner-Robins Air Logistics Center. By the end of fiscal year 1997, the Air Force, the Navy, and DLA plan to have prime vendor demonstration projects at three other repair facilities. We estimate these demonstration projects will account for about 2 percent of DLA's \$3.1 billion annual sales of hardware items.

Also in February 1997, DLA began using the prime vendor concept for facility maintenance supplies, such as plumbing, electrical, and lumber items. Under this concept, a prime vendor will

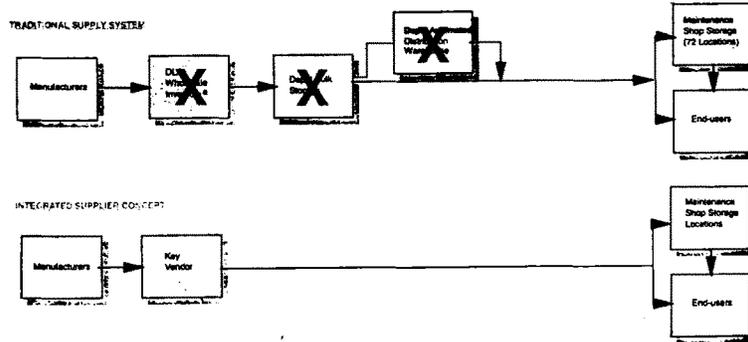
serve a geographic region where all military facilities within the region can elect to order maintenance supplies from the vendor. In the first test region, four military facilities have elected to use the prime vendor, representing about \$8 million in annual sales. By the end of 1997, DLA plans to have a prime vendor under contract for 10 geographic regions.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer endorsed these initiatives in June 1997 and asked the DLA Director, along with each of the military services, to develop a regional implementation blueprint for the facilities maintenance supplies prime vendor program. He asked that the blueprint identify the critical events and site designations for regional implementation within 12 months and nationwide availability by the middle of fiscal year 1999. This blueprint is critical to the success of this particular prime vendor program because it will demonstrate top management support and encourage military units to use the prime vendor services once they are established.

DOD could use prime vendor and integrated supplier programs to a greater extent

DOD's prime vendor programs for hardware items are similar to the best practices we observed in the private sector. We believe, however, that DOD can build on this concept to achieve greater savings and improve service. For example, neither DLA's direct delivery nor prime vendor programs streamline the service's base-level logistics systems to the extent that we have seen in the private sector. DOD personnel still perform the function of ordering, receiving, storing, and distributing material to the end users. If DOD was more aggressive in its approach to streamlining its system and transferred these functions to a prime vendor or to an integrated supplier, it could achieve substantial reductions in resource requirements and improved service to its customers. For example, at Walter Reed, the prime vendor program resulted in a 50 percent reduction in full time equivalents associated with the supply system within the Medical Center. Figure 5 illustrates the potential impact an integrated supplier program could have on the traditional DOD supply system for hardware supplies.

Figure 5: Potential Impact of an Integrated Supplier on DOD's System



As the illustration shows, the integrated supplier concept could by-pass the DLA wholesale system and two of the three primary storage points in the base-level supply system. The integrated supplier would deliver inventory directly to either maintenance shop storage points or end user locations. In the private sector, having the supplier deliver inventory directly to these locations has improved the availability of inventory and has actively involved the supplier as a "partner" in the customer's operations. The supplier also becomes involved in testing parts for quality, monitoring part usage, and ordering supplies as they are needed.

Our discussions with DLA and Air Force officials indicated that the main reason that a more aggressive approach has not been adopted is that a cost comparison of the prime vendor and DOD systems may be required. A prime vendor program that would replace the base-level supply system (considered a commercial activity) and involve more than 10 government personnel generally may not be contracted out without a cost comparison in accordance with

Office of Management and Budget Circular A-76. According to the Air Force, the Warner-Robins Air Logistics Center has approximately 219 government personnel involved in supply operations. Air Force officials stated that, if these positions were eliminated through the prime vendor program, a cost comparison would first be required that may take 2 years to complete. We agree that A-76 could be a significant issue in implementing these programs. Our work has consistently shown, however, that outsourcing is cost-effective because competition generates savings--usually through a reduction in personnel--whether the competition is won by the government or the private sector.

OBJECTIVES OF RECENTLY INTRODUCED LEGISLATION
CAN BE MET THROUGH THE USE OF BEST PRACTICES

Several legislative proposals have been introduced this year in Congress relating to inventory management and the adoption of best commercial practices. For example, the proposed Defense Reform Act of 1997 (H.R. 1778) was a legislative initiative introduced in June 1997 that related to defense personnel reforms, defense business practice reforms, and additional miscellaneous defense reforms. We generally agreed with many of the aims of this particular legislation. Pertinent provisions of H.R. 1778 were incorporated into the recently passed House version of the proposed National Defense Authorization Act of 1998 (H.R. 1119). We believe that two specific sections of H.R. 1119--one dealing with a reduction to the acquisition work force and another with a reduction in overhead costs of inventory control points--can be addressed by DOD to a certain degree by adopting best practices.

Section 1302 of H.R. 1119 would require DOD to reduce its acquisition work force by 42 percent by October 1, 2001. If DOD were to aggressively pursue best practices in the form of an integrated supplier concept for consumable items, DOD could reduce its work force involved in procurement, storage, and distribution of consumable items. For example, the prime vendor program at Walter Reed resulted in a 50-percent reduction in full time equivalents associated with the medical supply system.

Section 1421 of H.R. 1119 would require DOD inventory control points to reduce their overhead costs to 8 percent of net sales by the end of fiscal year 2000. This goal is a very aggressive goal, considering that the current cost recovery rate (the rate applied to the cost of goods to recover overhead costs) for some DOD hardware items is as high as 41.4 percent. However, DOD has accomplished the goal for medical supplies through the use of the prime vendor program in that DLA reduced the rate for medical supplies from 21.7 in fiscal year 1992 to 7.9 percent in fiscal year 1997.

We also support several requirements of the recently passed Senate version of the proposed National Defense Authorization Act of 1998 (S.936), that relate to the application of best business practices at depot-level activities and the expansion of best inventory management practices of DLA commodities. For example, section 312, which deals with the designation of depot-level activities as "Centers of Industrial and Technical Excellence," contains provisions requiring DOD to establish a policy to encourage the military services and defense agencies to reengineer their processes and adopt best business practices in connection with their core competency requirements. The section also allows the services to conduct pilot programs to test practices they believe will contribute to the efficiency and effectiveness of depot-level operations, improve support to the military users of such activities, and enhance readiness by reducing the time it takes to repair equipment.

Section 366 of the act deals with the implementation of best inventory practices for DLA-managed supplies and equipment. This section requires the DLA Director to develop and submit to Congress, not later than 180 days after enactment of the act, a schedule for implementing practices that the Director defines as the best commercial inventory practices applicable to the acquisition and distribution of medical supplies, food and subsistence, clothing and textiles, commercially available electronics, construction supplies, and industrial supplies. The act requires that the schedule for completing implementation of such practices be completed not later than 3 years after the date of enactment.

SUMMARY

In closing, we have identified the specific practices that warrants DOD's consideration and recommended that DOD test best practice concepts and expand the most successful ones to its logistics operations, where applicable. However, DOD has not applied these best practices to the majority of DOD consumable items, and inefficiencies in DOD's logistics systems remain. In this regard, proposed legislative initiatives, if enacted, would help encourage DOD to change its inventory management practices. In addition, congressional oversight will continue to be a critical element as DOD establishes plans, goals, objectives, and milestones for addressing its inventory management processes.

Mr. Chairman, this concludes our statement. We would be happy to answer any questions you or the Subcommittee may have.

RELATED GAO PRODUCTS

Inventory Management: The Army Could Reduce Logistics Costs for Aviation Parts by Adopting Best Practices (GAO/NSIAD-97-82, Apr. 15, 1997).

Defense Inventory Management: Problems, Progress, and Additional Actions Needed (GAO/T-NSIAD-97-109 Mar. 20, 1997).

Defense Logistics: Much of the Inventory Exceeds Current Needs (GAO/NSIAD-97-71, Feb. 28, 1997).

High-Risk Series: Defense Inventory Management (GAO/HR-97-5, Feb. 1997).

Defense Inventory: Spare and Repair Parts Inventory Costs Can Be Reduced (GAO/NSIAD-97-47, Jan. 17, 1997).

Logistics Planning: Opportunities for Enhancing DOD's Logistics Strategic Plan (GAO/NSIAD-97-28, Dec. 18, 1996).

1997 DOD Budget: Potential Reductions to Operation and Maintenance Program (GAO/NSIAD-96-220, Sept. 18, 1996).

Defense IRM: Critical Risks Facing New Materiel Management Strategy (GAO/AIMD-96-109, Sept. 6, 1996).

Navy Financial Management: Improved Management of Operating Materials and Supplies Could Yield Significant Savings (GAO/AIMD-96-94, Aug. 16, 1996).

Inventory Management: Adopting Best Practices Could Enhance Navy Efforts to Achieve Efficiencies and Savings (GAO/NSIAD-96-156, July 12, 1996).

Defense Logistics: Requirement Determinations for Aviation Spare Parts Need to Be Improved (GAO/NSIAD-96-70, Mar. 19, 1996).

Best Management Practices: Reengineering the Air Force's Logistics System Can Yield Substantial Savings (GAO/NSIAD-96-5, Feb. 21, 1996).

Inventory Management: DOD Can Build on Progress in Using Best Practices to Achieve Substantial Savings (GAO/NSIAD-95-142, Aug. 4, 1995).

Defense Inventory: Opportunities to Reduce Warehouse Space (GAO/NSIAD-95-64, May 24, 1995).

Best Practices Methodology: A New Approach for Improving Government Operations
(GAO/NSIAD-95-154, May 1995).

Defense Business Operations Fund: Management Issues Challenge Fund Implementation
(GAO/NSIAD-95-79, Mar. 1, 1995).

Defense Supply: Inventories Contain Nonessential and Excessive Insurance Stocks
(GAO/NSIAD-95-1, Jan. 20, 1995).

Defense Supply: Acquisition Leadtime Requirements Can Be Significantly Reduced
(GAO/NSIAD-95-2, Dec. 20, 1994).

Reengineering Organizations: Results of a GAO Symposium
(GAO/NSIAD-95-34, Dec. 13, 1994).

Commercial Practices: Opportunities Exist to Enhance DOD's Sales of Surplus Aircraft Parts
(GAO/NSIAD-94-189, Sept. 23, 1994).

Organizational Culture: Use of Training to Help Change DOD Inventory Management Culture
(GAO/NSIAD-94-193, Aug. 30, 1994).

Partnerships: Customer-Supplier Relationships Can Be Improved Through Partnering
(GAO/NSIAD-94-173, July 19, 1994).

Commercial Practices: DOD Could Reduce Electronics Inventories by Using Private Sector Techniques
(GAO/NSIAD-94-110, June 29, 1994).

Commercial Practices: Leading-Edge Practices Can Help DOD Better Manage Clothing and Textile Stocks
(GAO/NSIAD-94-64, Apr. 13, 1994).

Defense Transportation: Commercial Practices Offer Improvement Opportunities
(GAO/NSIAD-94-26, Nov. 26, 1993).

Defense Inventory: Applying Commercial Purchasing Practices Should Help Reduce Supply Costs
(GAO/NSIAD-93-112, Aug. 6, 1993).

Commercial Practices: DOD Could Save Millions by Reducing Maintenance and Repair Inventories
(GAO/NSIAD-93-155, June 7, 1993).

DOD Food Inventory: Using Private Sector Practices Can Reduce Costs and Eliminate Problems
(GAO/NSIAD-93-110, June 4, 1993).

Organizational Culture: Techniques Companies Use to Perpetuate or Change Beliefs and Values
(GAO/NSIAD-92-105, Feb. 27, 1992).

DOD Medical Inventory: Reductions Can Be Made Through the Use of Commercial Practices
(GAO/NSIAD-92-58, Dec. 5, 1991).

Commercial Practices: Opportunities Exist to Reduce Aircraft Engine Support Costs
(GAO/NSIAD-91-240, June 28, 1991).

(709285)

Mr. HASTERT. I thank the gentleman.

Let me ask you a question. You talk about the great advances in health care inventory. One of the things that I've been doing around this Congress for the last couple years is health care. We've found that the increasing cost in health care, that was basically 15 percent a year, both on the private side and the public side, has been reduced down to almost 2 or 3 percent, in some cases, in the private sector, and down around 5 to 10 percent even in the public sector, except in the cases of some issues in Medicare, where it was almost still at 12 percent.

One of the ways that you squeeze down the price, of course, is to put caps on costs for procedures, but also in the inventory. Most hospitals that you walk in today, when a patient checks in, there is a computerized situation where the substance that goes at bedside is punched in. So the health care industry, because of managed care and other things, has been revolutionary in their management of hospital equipment and supplies.

So let me ask you a question. In your opinion, is the military's ability to control this a result of the trend in the industry, or is it real innovation inside DOD?

Mr. WARREN. Specifically as it relates to?

Mr. HASTERT. Health care.

Mr. WARREN. Inventory management?

Mr. HASTERT. Yes.

Mr. WARREN. I guess, if I'm understanding correctly, I would have to say it's a combination. In other words, the actions that the department has taken are very consistent with the innovative practices that were being implemented in the private sector.

What they did was to take a look at what was happening there. They instituted pilot programs. They have a rather long schedule, or a longer schedule, for the implementation. They saw early on that that was working very well, and they said, "Hey, this is going to work for us. Let's expand that out and get the full benefit." I believe they are up to 200 hospitals now.

So I think it would be a combination. In other words, the innovation—I think the practice came from the private sector, but the department was willing to accept that practice, embrace it, move out, and get the savings that were available, and improve services.

Mr. HASTERT. So the technology was basically there in the private sector, and it was the willingness of DOD to accept it and go forward with that.

Mr. WARREN. Yes, sir. What we've seen in this area, the logistics inventory area, improvement is heavily dependent on information technology advances that, again, principally have been made during the 1980's and now are going even further during the 1990's. That's what they were able to latch on, along with business concepts and philosophies.

Mr. HASTERT. Well, also in the private sector, when you say that this hasn't been followed or hasn't been the savings in the hardware and inventory levels, in that area, those types of things, valves and fasteners and all that stuff.

Mr. WARREN. Yes, sir.

Mr. HASTERT. Our private sector has gone to just-in-time philosophy or just-in-time procedures that were adapted from the Japa-

nese, who adapted from American know-how philosophy. But, anyway, it's come full circle.

Is that tougher because the private sector is not willing to forward that? Is it because of the unique properties of those things that we have to have; it's one of a kind? What's the nature?

Mr. WARREN. Our general assessment is that we do not think it would be tougher. In other words, we think it is feasible. However, as in the past, our recommendation has been to let's pilot this to make sure, and just as you mentioned, that we're not going to do anything here that's going to harm readiness.

One of the things in our studies, we can only do a hypothetical, in essence, assessment of feasibility, so we think we need those pilots to make sure they are directly transferable. The pilots have been the key to assure that that transfer feasibility is there and that readiness is not harmed. That's been the vehicle.

What we have encouraged the department—and, again, as they did in the medical area—is to establish a pilot schedule that you feel is reasonable, but that if you see the results are working very well, move forward as quickly as possible to expand that.

Mr. HASTERT. Let me ask you a question: How long should it take the DOD to expand the practices highlighted in your testimony, especially to cover the majority of the consumable inventory items?

Mr. WARREN. I cannot give a precise answer, but I can give some information around that.

Mr. HASTERT. General.

Mr. WARREN. It took 20 to 40 months, in the pharmaceutical and medical area, to accomplish this. So you're talking 2 to 3 years plus. We have had information from private sector companies that they are able to do this in 1 year; however, I think it's important to point out that many of those companies are not as large as the Department of Defense. There may be special problems.

Also, the Senate bill recommends that this be done in about a 3-year timeframe. So based on that information, I would say it's not unreasonable to look at a 3-year pilot program. All we would ask is that there be a process where you can check as the program goes along.

If it looks like you've got all the information to expand in an aggressive manner, go ahead and do that. If you feel you need the entire cycle to assure yourself that you're going to be able, in fact, to meet all your requirements, and again, particularly toward readiness, then that would seem reasonable to me.

Mr. HASTERT. Mr. Warren, to be clear on the numbers, the GAO asserts that there's \$7.2 billion worth of hardware items in DLA's distribution depots and warehouses. Is it feasible for the department to try to employ virtual prime vendor and direct vendor delivery for all these items?

Mr. WARREN. Yes, I certainly think it's feasible to test. I think our indications are that there ought to be opportunities to go across the entire spectrum. Yes.

Mr. HASTERT. Your statement discusses DOD's progress in adopting best practices. What have been the keys to DOD's successes, and in what areas does DOD need to make more progress?

Mr. WARREN. Clearly—and it's similar to what happens in the private sector—you need top-level management commitment. In other words, the senior leadership, for any major change in an organization, whether it's Department of Defense or the private sector, the senior leaders have to be committed and say, "We're going to stick with this and do it."

Then another key to success is that you need to have success stories that you can relate to your middle manager, your rank-and-file people, who are ultimately going to have to embrace this, to convince them that, in fact, these things will work. I mean, those two are critical to making that happen.

Mr. HASTERT. Well, one of the things this subcommittee is intending to do is to get in the field and actually take its members to walk through the warehouses and the bone yards and places that we want to look and see actually what's happening, and look at the successes, as well.

What actions, other than that, either legislatively or regulatory, can this subcommittee take to encourage DOD, in your opinion, to become more aggressive in the adoption and implementation of the best practices you point out in your testimony?

Mr. WARREN. I think, No. 1, holding oversight hearings of this nature is critical, not only to hear, obviously, the testimony of the General Accounting Office, but also to talk through with the department what they see as the true impediments or obstacles, or things that are going to take them a little bit longer. Then that would help to provide an agenda of things that perhaps can be taken care of to help facilitate.

Second, I do believe the legislation that has been proposed on the Senate side is important, in terms of providing the department the authority, in the depot area, for example, to go in and do pilot programs to look at innovative ways in which to improve the economy and efficiency of their operations.

I think it's those types of things and, as well, setting milestones for DLA to lay out a plan to fully implement these programs. I think those types of things are critical. The department needs to be given the legislative authority and sometimes direction to get them going toward the full implementation.

And again, I would say testing of these, and I can't emphasize that enough. There may be some spots, because of the nature of the Department of Defense, the unique nature of the Department of Defense, contingency requirements and rapid response requirements, where some of this may not just fit, and we ought to know what that set of things is before we say "one size fits all."

Mr. HASTERT. I appreciate that, because that's something, as you go through this, I'm thinking to myself. You know, there's a lot of things that come off the shelf of a hardware store or other places, there are other things that are certainly unique needs. So what we're talking about here is not the special equipment that can only fit in a military widget of some type.

Mr. WARREN. I think, clearly, those items are the ones that best lend themselves to this practice, and particularly because, with the prime vendor, where you have a very hot bed of competition, they can work to drive down the cost, which then is passed on to the military.

In the military-unique items, you have, typically, a less competitive situation. So my thought would be that you would likely not get significant reductions in cost. You still may have some opportunity to reduce warehouse space, things of that nature. But, again, those are the things that should be looked at in a pretty rigorous way as they go through the testing of this.

Mr. HASTERT. There's a lot of, quote, unquote, things, we can just say, without being descriptive, that some of them are outmoded, some of them are parts that the equipment they were intended for isn't necessarily in prime use today, or it's somewhat discarded or less used, some parts that people say we have a 100-year inventory.

How, in your opinion, is the best way to start to work that inventory down or dispose of it, or is there a way to do that?

Mr. WARREN. Yes, I think there is.

It would be a pretty straightforward management analysis of taking a look at those items; in other words, understanding what they are, understanding what requirements they are associated with, from a weapon system standpoint, and determining, first, the likelihood that those items might be needed at some point in time, then doing an analysis of what it's costing you to hold those pieces of equipment, and move from there to, I think, a prudent decision about whether we should keep these items, in view of the fact that we may need them and we don't want to run out and purchase them again, or sit down with a good management judgment and say, it really does look like the right thing for us to do is to dispose of those items.

Mr. HASTERT. Is this activity in progress now or beginning?

Mr. WARREN. The department has entered into a process similar, I believe, to what I've described, and that's part of the reason the overall inventory, in fact, has come down, say over the last 5 years. And that's part of the inventory reduction effort.

I think it would be inappropriate to say the department has not been mindful of this. They have been working toward that issue. Could we go a little bit faster? I would say, maybe; perhaps we can.

Mr. HASTERT. One of the bright spots that you and your staff have seen firsthand is the implementation of the practices at Warner Robbins Air Logistics Center. Can you describe both the positive and the negative aspects of the program as it's currently being implemented? And what additional changes, from your perspective, are needed to improve the system further, or is it too early to make any recommendations at all?

Mr. WARREN. I think it's a little bit early for us to make recommendations, but I think we can make some general observations about what we've seen. No. 1, I would clearly say it's very important that that program, in and of itself, that it's underway, because that's the type of thing that's needed.

I'd like to ask Mr. Repasky to expand a little bit on that, because he was actually down there recently and visited, and has some firsthand knowledge on discussions with the people working the program.

Mr. REPASKY. First of all, the overall observations of the pilot program at the Waner-Robbins Air Logistics Center are, No. 1, the depot commander is very aggressive and very much a supporter of

best practices and using best practices to improve logistics operations.

In fact, he made some statements basically along the lines that he wanted to lead the Air Force in adopting these best practices for that organization. So, in that sense, it's very similar to the top-level support we've seen in the private sector.

Overall, the initiatives that he has underway there are limited, and they are limited in the sense that it represents only a small portion of the hardware sales to that organization. Mr. Warren mentioned earlier that it represents about 2 percent of DLA sales of hardware items.

In addition, the initiatives that they have underway do not really address the entire logistics supply chain for those items. In particular, they don't look to reduce the retail supply system as much as it does the wholesale supply system, or the need to store hardware inventory at the wholesale level.

The depot commander also mentioned that he would like to take that prime vendor program further down into the organization and expand it. He highlighted during our visit that there were some requirements or potential requirements under OMB Circular A-76 that would require cost comparison analysis of that operation.

His main concern there was that it would take approximately 2 years to complete that analysis. He would prefer to have the initiatives or the improvements under way before then. He was a little bit frustrated in that sense.

I think, as far as additional changes, as Mr. Warren mentioned, it's too early to really give a complete assessment of that program, but we did talk, I think, extensively with the depot commander about the need to expand the prime vendor services to their fullest extent, to maximize the savings that could be accomplished by having an integrated supplier concept in place there. I think, in general, he agreed with us on that point, but again recognized that there would be some time involved in the cost comparison, if that issue came up.

Second, I think that it's also important that Warner Robbins be held as an example to the Department of Defense, or for the Department of Defense, as a success story, if these initiatives prove to pan out the way we think they would. Along those lines, we suggested to the commander that a track of the cost savings be prepared, basically to baseline the system as it today and compare it to the cost savings or the more efficient process under a prime vendor or an integrated supplier program.

So those were two areas that we discussed with the depot commander related to ways that the initiative could be expanded.

Mr. HASTERT. Thank you.

I would now like to turn, for questioning, to the chairman of the full committee, Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman. I'll just ask a couple of questions.

Chairman Hastert and I have both been very interested in the war against drugs in Colombia and the support for the people in the police force down there who are fighting so diligently. With regard to our support efforts, I wonder about one of the problems

that has occurred, that appears to be a procurement problem and a management problem.

We requested that mini guns be sent down to the Colombian police so they could put them on the helicopters that we supplied. When the guns were delivered, they delivered the barrels, but they didn't deliver the mechanism that makes the gun fire.

You said earlier in your testimony, as I recall, that about 25 percent of the deliveries, there is a shipment malfunction of some kind. What I wanted to know is, in the case I just alluded to, was that caused by the mismanagement of the supplies that the military has? If so, how do we correct that? Because in a time where we might be in a conflict, this is something that would be intolerable.

Mr. WARREN. The answer is that I think I would actually have to look at that individual situation in the same way that we looked at the activities of the repair depot, and I do not have any direct knowledge on that. It's possible, but I would have to go in and see the circumstances.

There are a variety of things that could have happened. In other words, the item could have very well been, in fact, in the inventory system. There could have been just simply a paperwork foul-up and a misunderstanding about what was actually to be shipped. It could have been, in fact, the item had not been purchased. There would be a myriad of things, and I would have to look at that one to give you a good answer.

Mr. BURTON. Well, is the problem that you alluded to earlier endemic to the entire system?

Mr. WARREN. Yes, I would say that is a systemic problem as it relates to the repair depots. In other words, many of the items that are needed to fully perform the repair function at the major depots in the department, our work is finding that oftentimes that full complement of items is not there when requested to accomplish the repair.

Mr. BURTON. OK. One other question, Mr. Chairman. One of the problems that we've talked about for years in the Congress is the procurement process. We have the different branches of the service ordering supplies independent of one another that could have been ordered collectively and maybe saved the taxpayer a lot of money.

Does that leach over into the management problem at depots you're talking about?

Mr. WARREN. Not so much, because these items that we're talking about today, the consumable items, actually, in fact, are centrally procured through DLA, what they call inventory control points. So that is actually the system that's occurring today for these consumable items.

Mr. BURTON. OK. Thank you very much, Mr. Chairman.

Mr. HASTERT. Thank you, Mr. Chairman.

The gentleman from Florida, Mr. Mica.

Mr. MICA. Thank you, Mr. Chairman. I've got a couple questions for, I believe, Mr. Warren.

Is there any portion of the \$7.2 billion worth of hardware that is excess to the current and future requirements, and how soon will that be disposed of?

Mr. WARREN. My understanding is about \$1.5 billion of that amount is currently excess, or is excess to needs, and the department is in the process of moving that through the disposal process.

That process is defined through law, through the Property Act. Those items have to be made available first to the military services that might be able to use them, then to other users in the Federal Government, then to State and local communities, and finally, if there is not a need there, then they would go into the sales program and either be sold, depending on whether or not there are military technology implications, as is, or if, in fact, that's the case, then they would be destroyed in certain ways and sold as scrap.

Mr. MICA. Can you please discuss the impact that successful implementation of prime vendor for hardware items may have on repair times in our maintenance depots?

Mr. WARREN. In general, the answer is that we think what this is going to result in is much quicker repair times. The availability of items is going to be more prevalent. And the overall result or the biggest effect is, obviously, improved readiness. In other words, equipment that's needed for the troops is going to be available on a much quicker cycle than we experience now.

Mr. MICA. Let me ask you about the application of the best practices approach that you advocate. How will it help DOD sustain its operations in peacetime and meet its readiness requirements in the event of a contingency?

Mr. WARREN. Well, consistent with what we've seen in the medical area, and again, assuming that the pilots would be successful, we think this is going to be a win-win situation. In other words, the department will ultimately spend less dollars for the inventory that they need to do their job. It will be available in a more timely manner than it is today. Again, when you put those factors together, that should equal better readiness.

Mr. MICA. Well, I was just going to ask you about readiness. How do you think this will impact readiness because of, again, a different approach here?

Mr. WARREN. Our indications are that, again, if it works properly, it probably should be a readiness enhancer. But as I mentioned earlier, I think that's why the pilots are important. There very well could be some set of items where this concept, for whatever reason, could be detrimental to readiness; in other words, it would be less effective. Again, that's why we support taking a look at that.

But, in general, we believe that that will be the case. I do not believe, and the next panel can speak better to this than I can, that in the medical area, for example, that has been an issue of concern. It seems to me everybody is pretty satisfied that the readiness needs are being met.

Mr. MICA. From what I've been able to gather, your testimony and comments seem to indicate that the current model DOD uses to manage hardware items, compared to the private sector, is based on logistics systems, processes, and capabilities that really date back some years to the 1950's.

Given the amount of work GAO has done in this area, what should the so-called "new" model look like, in your opinion?

Mr. WARREN. OK. If we could put up one more chart here that helps to describe that. In general, it would look like a system that relies much more heavily, obviously, on the private sector and reduces significantly existing components of the logistics supply system that exists today, from the standpoint of warehousing.

Yes, the chart would indicate, basically, you would be able to make reductions in wholesale depots, military warehouses, and in storage location at bases or other facilities. In essence, the prime vendor would become the holder of your inventory.

As I understand from dealing and talking with private sector and the Council on Logistics Management, that is the approach that many companies are going to. They refer to this as third-party logistics or outsourcing logistics functions. So, kind of a familiar phrase today, what you would have is a streamlined system that would depend heavily on technology, information data exchange between the end user and the prime vendor to accomplish the inventory function in a timely manner.

Mr. MICA. Let me ask you another question on a more sensitive issue, and that's relating to defense jobs, employment. At Walter Reed, you noted that 50 percent of the positions in materiel management were eliminated. Such reductions, applied department-wide, would result in the elimination of thousands of jobs.

Do you have an estimate as to how many jobs would be at stake, and can you discuss the challenge of getting workers to implement changes that could also lead to elimination of their jobs?

Mr. WARREN. We do not have a precise estimate on the number of jobs that would be affected, but I think it is fair to say that they could be substantial. There are about 30,000 personnel working in this area, just in the Defense Logistics Agency. What portion of that might ultimately be affected, again, I can't give you a good estimate, but it could be tens of thousands or more, if you go to a totally streamlined fashion.

Typically, again, what private industry has done is to substitute technology for manpower. As a result, many of the streamlining savings that have occurred during the 1980's and again during the 1990's have been a result of using that technology to replace personnel that were formerly performing some of these functions.

So, clearly, there is the potential for a personnel impact, and I think it's fair to say that it could be high. The department may have a better estimate on that, or perhaps even a different view.

Mr. MICA. Do you expect some of these positions to be absorbed by private sector activity, or are they going to be permanently eliminated positions?

Mr. WARREN. The work I'm most familiar with in that regard is in the depots, where some of the depot work has been privatized in place, a commercial contractor has taken over the work. Typically, what we've seen is, a portion of the work force is, in fact, retained. However, typically, along with that is some reduction.

So while there would be an opportunity for some transfer, I don't think it would be appropriate to assume that you're going to have a one-for-one transfer. Again, the reason for that is the enabler for achieving these logistics reduction costs is the substitution of technology for manpower in performing these logistics functions.

Mr. MICA. Now, in closing, I wanted to ask you: DLA, as primary manager of DOD's consumable items, acts as custodian of all these military ship and vehicle parts. What is the total value of the inventory that they purchase and control?

Mr. WARREN. The total value of inventory that they control is \$11.1 billion.

Mr. MICA. You have 30,000 people in materiel management operations in 1996.

Mr. WARREN. Yes, sir.

Mr. MICA. And then this report says the materiel management costs, excluding the management of fuels, was reported at \$8.3 billion. Of that amount, \$5.5 billion was spent to purchase consumable items, and \$2.8 billion was spent to manage and distribute inventory.

Is that almost—I mean, it's not a one-to-one; it's a 0.8 to 1 ratio. Is that what we're looking at?

Mr. WARREN. In terms of personnel to purchases?

Mr. MICA. It costs us \$8.3 billion for materiel management costs, to purchase and to oversee an inventory of \$11.1 billion, or is there more?

Mr. REPASKY. Let me just clarify that a little bit. The \$8.3 billion, as you mentioned earlier, is comprised—\$5.5 billion of that were obligations to buy new materiel. The supply management costs and depot operations costs amounted to the \$2.8 billion. And that's to manage consumable items.

Mr. MICA [presiding]. What's the total figure of the consumable items?

Mr. REPASKY. The total figure for consumable items, DOD-wide, is \$18.6 billion.

Mr. MICA. What I'm trying to get just a handle on is how much it's costing us to manage acquisition and this whole activity, compared to, you know, the management cost.

Mr. REPASKY. I understand. The details that I can provide today relate primarily to DLA's costs. And that, again, is the \$8.3 billion, including the \$5.5 billion to buy new materiel. Again, DLA stores and distributes all of DOD's inventory, including the repairable parts.

Mr. MICA. That's part of the cost in here?

Mr. REPASKY. And that total inventory is the \$68.4 billion.

Mr. MICA. It still seems awfully high overhead cost. If you were in the private sector, you would be out of business.

Mr. WARREN. If I could mention, as I mentioned earlier in the statement, part of that is high overhead cost at the inventory control points where the purchasing function actually occurs. Again, in an LMI study, and we went in and took a look at that, and we think it's a pretty solid number, talked about the opportunity for \$3 billion in savings through consolidation of that.

So I think that's very consistent with your point, Mr. Mica.

Mr. MICA. The other thing, in closing, I chair Civil Service and have dealt with downsizing. I must say that DOD has taken its licks and picked itself up and moved forward without a lot of whining and coming to Congress, like some of these agencies. Also, you have had to bear the brunt of downsizing. About 80 percent of any downsizing in government is actually in DOD, in the last 4 years.

If we're going to eliminate these positions, the other thing I am asked is, do we have in place adequate protections, soft landing transition? DOD has been pretty good at this, but this is something that we are preparing for or anticipating and can handle?

Mr. WARREN. Again, I'm most familiar with the depot situation where, as you say, there have been a number of reductions. From the work that we did, we believe that the department does, in fact, have one of the best programs to try to address what is a very difficult problem, in terms of people's separation.

They have a priority placement program. They have an excellent program for assisting personnel that want to move from one location to another when an activity is closing, and have done several other things to avoid the number of persons that they have to RIF. So from where I sit and the work that I've seen, I would give the department high marks on that. But I would also share your concern that it's still not easy.

Mr. MICA. I thank you.

I will yield to the gentleman from Texas.

Mr. SESSIONS, you are recognized.

Mr. SESSIONS. Thank you, Mr. Chairman.

Mr. Warren, if I could, I'd like to take just a few minutes. You and I have met before, and I have somewhat of an idea of what we're talking about. We have always dealt with and all the reports deal with numbers and the things that are out there.

Can you take just a minute with me, knowing, as you know about me, I'm process oriented, and I'm not asking for you to do a flow chart or a food chain type of a flow chart, but I'm interested in knowing how decisions are made. From the world that I came from, we had decisionmakers, we had logistics, we have the customer. We have all these people that are involved in this, kind of like this schematic you've got.

What I'm interested in knowing is, how is the decision made, for instance—and you can pick any item that you choose, whether it's raincoats, whether it's jet fuel, whatever it is, whether logistics is the person that does the ordering, or is it the person who's responsible for inventory, where they all of a sudden look, and they have a little marker there that says, when we get to here, we order Z number more.

Kind of go through it with me, if you can, in several different areas, that let me understand who is the responsible party for ordering these items that we're talking about, and how that process works.

Mr. WARREN. In a general sense, the process works the same for all the items. The department sets up acquisition objectives. Those objectives, in general, are based on demands and requirements that they have for inventory. An item manager is the responsible person for making the buy decision, but that demand information is coming in to him or her from the user. So it is, in fact, an integrated—it's kind of a partnership.

Mr. SESSIONS. Probably, what I call for my business, a forecaster, inventory forecaster?

Mr. WARREN. Yes, they are forecasting what the demands are. Their job is to make sure that, when the phone rings, they can provide that item, in a very simplistic way.

They built into that process—and Mr. Emahiser can give you more detail on this—but there are safety levels. There's an economic order quantity quotient. Necessary war reserves are in there. I think, typically, a 30-day supply of war reserves. If a surge has to occur, we've got those in. You have lead times built into the computation.

So there's a whole series of factors that are built in, that reflect all of those things that need to go into consideration about how far in advance of the need for an item do I actually, as an item manager or a forecaster, go out and purchase that.

Mr. SESSIONS. Now, what you have described would seem and appear to be normal and regular, to me. Is it that these inventories that we have may never be used, as we've heard from testimony that has been given here today, is that because there was a change in equipment, because of update in technology, or what would precipitate us having, not only buying, but keeping around these types of items? So that's a two-part question.

Mr. WARREN. OK. Let me go to the second part of the logistics process. We just talked about how items are bought. Part of what we've been discussing and in our reports is that the logistics system, once you've purchased an item, looks a lot different in the military system than it does in the private sector system.

The military system—and, again, it was built largely in the 1950's and 1960's—was built on a multilayered system, to avoid shortages of items, very well intended, and had multiple layers of warehousing, prime warehouses, main warehouses at bases, then shop stocks, and then some level of items at the user. And that was the way a lot of companies operated during the 1960's, during the 1970's, and into the 1980's.

The change that has occurred, and it's principally on this chart to your far right, is that, in the private sector, many of those types of things have gone away because technology now allows the inventory manager to have total visibility over the items and be more responsive to buys. So the concept of having to layer items in order to assure that they are available—again, it was a good concept, and that was what was needed—is the piece of the process that's becoming outdated through technology.

But you also raised, are some of these items a result of the downsizing of the force? Clearly, that is the case. We've had a substantial reduction in military force, from about 2.1 million military members, in around 1991, down to 1.4 million, I think, will be by the year 2000. And then there have been corresponding force reductions with that. The inventory managers were buying in good faith up until the point that decision was made, so some of that, obviously, is a result of those circumstances.

What we're advocating and would like to see tested is, let's try to get that buy decision closer to the point in time we're really going to use the item, so that some of these unforeseen things that are going to happen—I can't tell you what the next one will be, but they are going to happen—will have less impact on the amount of inventory that we actually end up holding after that event.

Mr. SESSIONS. I do understand that difference, and thank you. In other words, we've got to make sure the system works. I'm just trying to make sure, also, that the decisionmaker in this process is

aware of, has information at his fingertips, his or her fingertips, that tells them, before they think they are going to order something, the reason why they are ordering it, what's available, and then what those timeframes would be.

Mr. WARREN. Yes, clearly, that system is in place. We do have some questions about how well it operates. We think it could be tweaked and run a little better. There's no question about that. But, clearly, there's a very elaborate system for doing that.

One area where we think there would be—and, again, I think the department would agree with this—is a concept called “total asset visibility.” The department has been working on that very diligently here over the last several years.

Those item managers or forecasters are in a case of sometimes not being able to have total visibility of all the items that, in essence, DOD owns, that they are responsible for. Our work has shown, from time to time, that then that causes unnecessary buys. But, again, the department is working toward getting a total asset visibility system in that fully meets their needs.

Mr. SESSIONS. Last, let me say this, Mr. Warren. It's probably really to anybody that's from DOD that's in the room. You've expressed to me, not only confidence but appreciation, at least what you've said to me in my office, privately to me, that you feel like the Department of Defense is very professional and that they deal with you on an up-front basis, not only sharing of information, but availability of the things that they have.

So I would like to publicly thank you and the Department of Defense, because I feel like what you're doing is an attempt to get closer to making sure the readiness of our men and women is there. And I want to pat you on the back and congratulate you also, because you're part of that participatory team, and the other men and women who work with you.

Mr. Chairman, thank you.

Mr. MICA. Thank you.

I thank the gentleman from Texas, who indeed has been a leader on bird-dogging some of these issues and making certain that the interests of the taxpayer and also the best interests of the Congress are served in overseeing, again, this area for some of the leadership. I thank the gentleman from Texas again in his pursuit.

We all get off on different activities, but your role is very important, Mr. Sessions. We thank you.

I have just a couple of final questions, either for Mr. Warren or anyone else. Do you see any problems with inner service or inter-agency conflicts within DOD that could be obstacles to reforming defense inventory management?

Mr. Warren.

Mr. WARREN. The general answer is yes, and hopefully they can be solved.

Mr. MICA. Can you tell me, just real briefly, what they are?

Mr. WARREN. Well, it's just by the nature of the organization of the department. Army, Navy, Air Force, each of them own certain processes in the logistics system. They manage some of their own inventory. DLA manages a portion of that inventory.

Mr. MICA. Jurisdictional disputes?

Mr. WARREN. Absolutely. If you think about it in terms of the way the private sector talks about it, they talk about supply chain management, and they talk about managing an item from the time that it comes into the door till the time it goes out the door. And they are trying to think of that as an integrated, seamless process.

The department is attempting to move in that direction.

Mr. MICA. So the nature of the beast, the disjointed structure, et cetera, is a problem.

Mr. WARREN. It requires a high premium on cooperation.

Mr. MICA. Any other interagency conflicts or problems? The other question that I would ask, are there any legislative impediments, anything that we need to do legislatively to move this process forward? Or do you have the tools and authority and legislative flexibility to move?

Mr. WARREN. Again, I think, particularly in the Senate bill—the department—and they would be better positioned than me—they need the opportunity where they have an innovative practice that they want to attempt to do, they need to be given the authority to do that in such a way that they can make a good faith analysis of that.

Mr. MICA. And they don't have that?

Mr. WARREN. In some cases, that's not there. Partnering comes to mind, and that's included in the Senate bill. I think part of the discussion will have to be, well, what do we mean by "partnerships" between public sector depots and private sector entities? What does that mean, and how do we, in fact, operationalize that?

That would be the only area I'm aware of.

Mr. MICA. OK. Did anyone else want to comment?

Mr. KNOUSE. Mr. Mica, as the department goes through implementing some of these legislative proposals, in terms of accountability and oversight, there may be a need, if the committee so deems it appropriate, for our organization to act in maybe an evaluative mode to see just exactly how well those proposals are being achieved and whether there are any additional impediments that we're not aware of that are surfacing as they try to implement these best business practices.

Mr. MICA. This question may have been touched on before about excess inventory being purchased. It's about \$1.3 billion, according to this report; is that correct?

Mr. WARREN. \$1.6 billion was the estimate that we provided to the committee at the end of the last hearing.

Mr. MICA. \$1.6 billion?

Mr. WARREN. Yes, sir.

Mr. MICA. Do we have sufficient actions being taken to reduce the amount of excess inventory, in your opinion?

Mr. WARREN. We provided that information to the department. The answer to that, I firmly believe, is really in what we've been talking about this morning. The true key to reducing excess inventory to kind of its most reasonable level is to implement best practices that allow people to succeed in what they are doing. That's the key.

Mr. MICA. The other question was disposing, and that's \$1.1 billion of excess consumable materiel, in 1996. And you feel we have

adequate plans and there will be an attempt to bring that figure down, too, Mr. Warren?

Mr. WARREN. Yes, I believe those plans are there. Over time, there have always been, because of the volume of materiel that's moving through the disposal process, there have been concerns here and there. But the department has put in a fairly aggressive program to move the disposal process along.

Their concern, and it's very legitimate, is that they do not want to be sending things out the door that, 2 weeks later, all of a sudden, they have to buy. Obviously, that's not a good situation for the taxpayer; it's not a good situation for the department.

Mr. MICA. It says \$1.1 billion in consumable materiel. Is that based on the cost of purchase or depreciated?

Mr. WARREN. \$1.1 billion is in the acquisition cost.

Mr. MICA. Acquisition cost?

Mr. WARREN. That's what it cost to buy those items.

Mr. MICA. It's not coming in at \$2.2 billion, then, and going out at \$1.1 billion. Right.

Finally, many of the defense inventory problems that have been discussed here today have been with us for at least three decades. Why has change been so difficult, Mr. Warren?

Mr. WARREN. I guess, first of all, change is difficult for any institution. I think, first of all, the department had in place, during the 1960's and 1970's, a system that worked pretty well for them. They felt it was responsive; they felt it looked pretty close to what was being done in other places.

As time moved on, I really believe that cultural resistance to change—in other words, the system was working OK, we were being funded sufficiently to operate it, and it's kind of—you ask the question: Why change?

You could take it back, the same thing, to the U.S. private sector. It was really not until the 1980's, when we felt we got into a very noncompetitive situation in a world market, that we had to decide, boy, we've got to do something different, and then that spurred change.

DOD now is at that point where they are getting that incentive to say, "We need to look carefully at how we're going to change. Our budgets are being severely squeezed. We need money for modernization. We think this is an area to do it." So you've kind of had this action-forcing event that was not there previously.

Mr. MICA. I want to thank all of our panelists for their participation today, and also for their examination of this issue for the General Accounting Office. It's important that we move forward with trying to reform our inventory management through innovative best practices, and you can help us make it happen.

We may have additional questions to submit to you in writing. At this time, we will thank you again for your participation and good work.

We will excuse this panel, and I will call our second panel.

Thank you, gentlemen.

Mr. WARREN. Thank you.

Mr. MICA. Our second panel consists of representatives of the Department of Defense. Dr. Edward Martin is the Acting Assistant Secretary of Defense for Health Affairs; James Emahiser, Assistant

Deputy Under Secretary of Defense for Materiel and Distribution Management; and Mr. Jeff Jones, Executive Director for Logistics Management, the Defense Logistics Agency.

Mr. Emahiser and Mr. Jones have testified before this subcommittee last March, and I appreciate your coming to update our subcommittee today.

In accordance with our House rules and, as you know, this is an investigation and oversight subcommittee, gentlemen, if you will stand, I will swear you in.

[Witnesses sworn.]

Mr. MICA. Thank you.

As you know, we welcome your condensed opening oral statements, and lengthy statements will be made part of the record. I will recognize each of you for 5 minutes.

You are welcome. To our panel, again, several of you have been here before. I will recognize first Dr. Edward Martin, Acting Assistant Secretary of Defense for Health Affairs.

Welcome, and you are recognized, sir.

Mr. MARTIN. Mr. Chairman, if it would be all right, I would like, actually, Mr. Emahiser to be the lead witness, and then I will followup.

Mr. MICA. All right. That's fine. Then I will, in fact, recognize James B. Emahiser, Assistant Deputy Under Secretary of Defense for Materiel and Distribution Management.

You are recognized, sir, for 5 minutes.

STATEMENTS OF JAMES B. EMAHISER, ASSISTANT DEPUTY UNDER SECRETARY OF DEFENSE FOR MATERIEL AND DISTRIBUTION MANAGEMENT; EDWARD D. MARTIN, ACTING ASSISTANT SECRETARY OF DEFENSE FOR HEALTH AFFAIRS; AND JEFFREY A. JONES, EXECUTIVE DIRECTOR FOR LOGISTICS MANAGEMENT, DEFENSE LOGISTICS AGENCY

Mr. EMAHISER. Thank you, Mr. Chairman, members of the committee, and staff.

Thank you for the opportunity to appear before you today to discuss the Department of Defense's use of innovative business practices to reform our inventory management and the program and the initiatives we have underway to increase efficiency while maintaining support to the war fighters' needs.

I would like to enter into the record my written statement responding to the issues raised in your letter of invitation and make a brief oral statement.

Mr. MICA. Without objection, your entire statement will be made a part of the record.

Mr. EMAHISER. You have already introduced the gentlemen who are with me here today. The Department of Defense is implementing a series of wide-ranging initiatives to adopt best business practices. As I testified in March 1997, our inventories have, in fact, decreased from \$107 billion in 1989 to currently \$67 billion, with a target of \$48 billion in the year 2003; overall, a reduction of 55 percent.

The initiatives that we have are enabling us to move toward buying many commercially available items at the local bases, using the Internet and the government purchase card to obtain delivery di-

rectly from a vendor to a user in a few days, rather than maintaining multiple levels in inventory of such items within the department.

A key indicator of our success in this area is the rapid expansion of DOD usage of the government purchase card, the GSA International Merchants Purchase Authorization Card [IMPAC] card. I testified in March that DOD use of the card increased by nearly 80 percent from fiscal year 1995 to fiscal year 1996, from just under \$800 million to more than \$1.4 billion. I can now report to you that DOD use of the purchase card is projected to exceed \$2.3 billion in fiscal year 1997, an increase of more than 60 percent.

The purchase card and Internet ordering are two key elements of the menu of innovative practices the department is using, along with prime vendor, virtual prime vendor, and direct vendor delivery. The goal of this menu of practices is to improve services while lowering costs.

Customers of the Defense Logistics Agency can already use online Internet ordering to obtain commodities as varied as clothing and textile items, maintenance and repair items such as electrical, plumbing, and refrigeration supplies, through a hardware prime vendor in the Southeastern United States.

The success of these various initiatives can be seen in the bottom line numbers for the portion of DLA sales provided directly from a vendor to a customer without going through a DOD warehouse. That portion was 24.5 percent in fiscal year 1992. It increased to 33.2 percent in fiscal year 1996.

In the medical prime vendor program, 98 percent of the orders are delivered by prime vendors within 24 hours, as opposed to the 30 days it used to take from government stocks. The response time and fill rate of this program enabled DLA and the military hospitals to drastically reduce their inventories, resulting in significant savings in their cost of operations.

Walter Reed Medical Center reduced its medical on-hand inventories by 83 percent and closed six warehouses in this process. They also reported over \$7 million recurring annual savings by converting to prime vendor. We anticipate further increases as we use lessons learned from this successful application of innovative practices in the medical and food commodities to the more complex area of hardware items.

The Department of Defense is proud both of the progress we have made in adopting innovative business practices to improve our inventory management processes and committed to further improvements. We are confident that management improvements and ambitious deployment of technological advances will continue to enable us to expand our use of innovative business practices.

I would also like to confirm what Mr. Warren said earlier, that he and I have agreed that our folks will try and work the inventory issues together, and we should be meeting over the next several weeks.

We appreciate the interest of the subcommittee in defense inventory management reform and look forward to working with you in

the future to ensure success in this crucial area. Thank you for your interest and support. I will be glad to answer any questions that you may have.

Thank you.

[The prepared statement of Mr. Emahiser follows:]

Mr. Chairman, Members of the Committee, and staff, thank you for the opportunity to appear before you today to discuss the Department of Defense's initiatives to reform inventory management through innovative business practices while maintaining support to the war fighter's needs. In response to your specific requests in the letter of invitation, I will discuss: (1) the success that DoD has had in using direct vendor delivery practices for the acquisition and delivery of medical and pharmaceutical supplies to over 150 medical facilities nationwide, as well as the use of innovative business practices for food and clothing items; (2) the feasibility of using virtual prime vendor and direct vendor delivery for other types of inventory items, such as hardware items and other readily available commercial products; and (3) how provisions contained in the House National Security Committee's 1997 authorization bill may improve inventory management, as well as any other legislative or policy reforms that would allow DoD to aggressively implement business best practices. To put these issues in the proper context, I will first provide an overview of the Department's initiatives to implement best business practices. With me today to assist in responding to questions are Mr. Jeff Jones, Principal Executive Director, Materiel Management, Defense Logistics Agency, and Dr. Edward Martin, Acting Assistant Secretary of Defense for Health Affairs.

OVERVIEW OF DOD BEST BUSINESS PRACTICES INITIATIVES

The Department is implementing a series of wide-ranging initiatives to adopt best business practices. One such initiative, the Defense Logistics Agency's business automation initiative termed Fuels Automated System (FAS), will provide a fully integrated financial, acquisition, and inventory management system that meets all Congressionally mandated requirements. The field level source data collection process used throughout the commercial oil industry has been implemented at over 200 bases worldwide and will be implemented at over 600 bases when fully implemented. FAS will be the DoD prototype for commercial-off the-shelf (COTS) efforts and is planned for full deployment in FY98. As I discussed in my previous testimony on March 20, the Department is relying upon a series of initiatives to increase the use of commercial practices and distribution systems to satisfy our materiel requirements. These initiatives are enabling us, as I testified in March, to move toward buying common-use, commercially available items, such as office supplies and base maintenance items, at the local base using the Internet and the government purchase card to obtain delivery directly to the end user in a few days rather than maintaining multiple levels of inventory of such items within the Department. A key initiative in this area is expanded use of the government purchase card (the International Merchant Purchase Authorization

Card, issued by GSA) for buys of commercially available items up to \$2500. I testified previously that DoD use of the purchase card increased by nearly 80 percent from FY 1995 to FY 1996—from just under \$800 million to more than \$1.4 billion. I can report to you that we now project that DoD use of the purchase card will exceed \$2.3 billion for FY 1997—an increase of more than 60 percent from FY 1996.

The importance of this increase is indicated by the August 1996 GAO Report entitled "ACQUISITION REFORM: Purchase Card Use Cuts Procurement Costs, Improves Efficiency." That GAO report pointed out that purchase card use enables Federal agencies to improve efficiency and service delivery, and that the purchase card program has significant growth potential. In relation to the DoD materiel management system, increased use of the purchase card for small purchases of commercially available items offers substantial administrative savings and reduced response times to customers. We intend to continue to pursue these advantages through expanded use of the purchase card. Toward that end, the Deputy Secretary of Defense issued a memorandum on June 16, 1997, approving the recommendations of a purchase card program reengineering team. Those recommendations are intended to provide the policies and procedures necessary to promote and streamline the Department's use of the government purchase card.

Furthermore, the Under Secretary of Defense (Comptroller) has issued four Purchase Card Reengineering Implementation Memoranda, with two more in coordination. Through this series of initiatives, the Department is moving out vigorously to take maximum advantage of the government purchase card as a method of reengineering our business practices. Those of us in the DoD materiel management community are fully committed to enhancing the Department's application of this tool in order to reduce administrative costs and improve responsiveness to users.

INNOVATIVE PERSONNEL SUPPORT MATERIEL PRACTICES

Your first question requested an overview of the success that DoD has had in using prime vendor and direct vendor delivery practices for the acquisition and delivery of medical and pharmaceutical supplies to over 150 medical facilities nationwide, as well as the use of innovative business practices for food and clothing items. As the Department's commodity manager for nearly all consumable items (defined as those items which are normally expended or used up beyond recovery in the use for which they are designed or intended), the Defense Logistics Agency (DLA) plays a crucial role in our efforts to adopt best business practices for these commodities. A key measure of DLA's success in using alternatives to the traditional "stock, store, and ship" method of meeting customer

requirements is the portion of sales shipped directly from a vendor to a customer without going through a DoD warehouse. This portion increased from 24.5% of total sales in FY 1992 to 33.15% in FY 1996. This increase is important to note since it includes all forms of innovative business practice aimed at using commercial distribution systems instead of DoD warehouses—whether these practices are labeled prime vendor, virtual prime vendor, direct vendor delivery, or something else. The key point here is that while the specific method of increasing our use of commercial logistics capabilities may vary, the trend toward greater use of these capabilities is clear. I will now provide an overview of the Department's application of innovative business practices to the medical, food, and clothing commodities—what we refer to as personnel support items.

MEDICAL PRIME VENDOR PROGRAM

The Medical Prime Vendor Program provides that private firms will supply a wide range of pharmaceutical and medical/surgical items directly to geographically clustered groups of customers. Prime Vendors deliver 98% of their orders within 24 hours as opposed to the 30 days it used to take from government stocks. The response time and fill rate of this program enabled DLA and the military hospitals to drastically reduce their inventories, resulting in significant savings in their cost of operations, because they order only what they need. Prime

Vendors invoice electronically with summary billings that reduce the administrative cost of handling a massive amount of paper invoices. Payment to the vendors is also made electronically.

Prime Vendor must satisfy customer orders by obtaining the required items from manufacturers/dealers that have Distribution and Pricing Agreements. In general, those prices are substantially less than customers used to pay for products. More importantly, increased use of this program has allowed customers to reduce their inventories by up to 80% which saved considerable storage space and avoided additional construction or modernization of warehouses. The program likewise reduced the need for warehousing and transportation at DLA facilities. Additionally, the program helped to eliminate supply backorders, stockpiles, depot disposal, and miscellaneous handling charges. Initiatives under this program are estimated to have allowed inventories to be reduced by over 29.1% (\$143.5 million) and to have achieved \$95.7 million in cost avoidance for FY 1995.

We estimate that the program will permit further inventory reductions and will save customers an additional \$353 million over the next five years. Walter Reed Medical Center reduced its Medical on-hand inventory by 83%, and closed six warehouses in the process. They also reported over \$7 million in recurring annual savings by converting to Prime Vendor.

Medical Prime Vendor has expanded beyond the continental United States with the award of a pharmaceutical fleet Prime Vendor contract to Tennessee Wholesale Drug Co. This contract covers support for the fleet as well as contingency support for two hospital ships.

SUBSISTENCE PRIME VENDOR

For decades, the Defense Logistics Agency relied primarily on its own depot distribution system to store and distribute food to the armed forces. The Agency intends to cut its costs further and improve service by reducing the need for storage of food items. DLA has applied the Medical Prime Vendor approach discussed above to food as well in order to maximize its use of private-sector distribution capabilities. Under Subsistence Prime Vendor, a contract is awarded to a supplier to ship food directly to military activities, on an as-needed and when-requested basis, within a specific geographical area. This process reduces delivery lead time to the customer and, by utilizing the private sector's storage and distribution system, reduces the Agency's associated warehousing and redistribution costs. It also facilitates reductions in local inventories held by food preparation activities. This, in turn, reduces the costs borne by the U.S. taxpayer. Due to the unique requirements of Navy vessels, some food requirements may be more effectively met through government-owned but contractor-operated warehouse facilities.

The Subsistence Prime Vendor Program was tested during FY 1995 in the southeastern United States, and was determined to be a feasible and viable method of providing high quality food for DoD stateside garrison feeding. With lessons learned during the demonstration, the potential for optimizing the use of commercial food systems will continue to be realized. DLA estimates a \$20 million reduction in wholesale inventory alone during FY 1996. In conjunction with the Services, DLA is aggressively expanding the Subsistence Prime Vendor Program throughout the continental United States. As of the end of 1996, 95% of all proposed subsistence prime vendor contracts had been awarded. As of June 1997, all Army, Navy and Marine Corps bases in the U.S. were receiving their food from commercial food distributors. All Air Force installations will be under this initiative by September 1997.

Subsistence Prime Vendor is being expanded beyond fixed bases in the United States. In December 1996, two contracts valued at \$75 million were awarded for the support of nearly 140 ships in the Norfolk area. By the end of 1997, contracts are scheduled to be awarded for all West coast ships. Prime Vendor support to Europe and the Pacific is also being planned. After Subsistence Prime Vendor is completely implemented, the only subsistence stocks in DoD warehouses will be operational rations such as Meals Ready to Eat.

Finally, it should be noted that the U.S. General Accounting Office, in a May 1997 report entitled "SCHOOL MEAL PROGRAMS: Sharing Information on Best Practices May Improve Programs' Operations," selected the U.S. Department of Agriculture/Department of Defense Fresh Fruits and Vegetables Programs as a "best business practice." This program allows school food authorities to order fresh fruits and vegetables through the Defense Logistics Agency for deliveries to state warehouses, local central kitchens or directly to schools. A wider variety of higher-quality fresh fruits and vegetables at competitive prices is available through the Defense Logistics Agency Produce Business Unit. A total of 32 states now participate, with further expansion planned for the 1997/1998 school year.

INNOVATIVE CLOTHING AND TEXTILE PRACTICES

The Defense Personnel Support Center's (DPSC) Clothing & Textiles Directorate has accepted the challenge of establishing the textile commodity on the "information superhighway." Using home grown talent and commercial off-the-shelf software DPSC created a Home Page on the World Wide Web and developed what may be the most sophisticated electronic catalog with on-line ordering capabilities in the Department of Defense - ASCOT (Automated System for Cataloging & Ordering Textiles).

The system can be accessed through the Clothing & Textiles Home Page on the World Wide Web using any industry-standard web browser that supports forms. Customers without direct access to the Web will eventually be able to dial into the Clothing & Textile commodity center via modem and gain access through a dedicated server. The system allows customers to search the complete catalog by various methods, including key word descriptions (shirt, trousers, boots, etc.), national stock number or specification. When a customer scans by description, a list of all matching items is displayed. The catalog includes full screen digitized photos for all items, various item-specific information (including price and sizes), and a point of contact for any additional information or questions the customer may have. Hypertext allows the customer to send E-mail to the point of contact without exiting from the catalog. After identifying the item or items desired, customers then have the option to place an order via the Internet by filling in a few fields on a user-friendly screen. Although anyone can browse the catalog, a security check restricts ordering to registered customers.

Requisitioning on-line through this system saves customers from hours to days, depending on the previous method utilized. The search capability greatly facilitates the requisitioning process for our customers. The system allows the user to get to the right item and provides all the information necessary to submit

an order. This eliminates manual research on the part of the users and reduces the possibility of submitting a requisition for the wrong item. The system also provides necessary controls by allowing requisitions only from authorized customers. The system went "live" in December 1995 and has been well received by those who have visited the Web site. A growing number of customers submit their clothing and textiles orders through this system.

INNOVATIVE BUSINESS PRACTICES FOR HARDWARE ITEMS

The second question in your invitation letter asked that we address the feasibility of using virtual prime vendor and direct vendor delivery for types of inventory other than personnel support items, such as hardware items and other readily available commercial products. As I discussed in my March testimony, the Department is now moving to maximize use of commercial logistics support capabilities for maintenance depot requirements for weapons system repair support. Known as Virtual Prime Vendor, this initiative solicits private sector proposals for enhanced supply support to depot maintenance activities by employing best practices from the commercial world. The pilot site is the Avionics/Electronic Warfare Shops at Warner Robins Air Logistics Center (Robins Air Force Base, Georgia), which initiated Virtual Prime Vendor in January 1997. Contractor proposals are being requested for other air logistics

centers as well as Army and Navy maintenance activities. Virtual Prime Vendor offers the department the opportunity to thoroughly test and assess the most advanced commercial logistics practices and determine their applicability throughout the DoD logistics system.

As we pursue the Virtual Prime Vendor approach for maintenance depot requirements, we are also using a variety of other innovative practices to increase our use of commercial logistics support capabilities. For example, the Defense Logistics Agency's Defense Supply Center, Columbus (Ohio) has established contracts with four major commercial heavy equipment vendors for all items in their parts catalogs. These contracts offer discounts off the retail list prices ranging up to 23 percent—and in some cases more—when orders are placed using the government purchase card (IMPAC) that I discussed previously. Furthermore, response times to customers are being reduced to between 24 hours and 5 days—a substantial improvement over delivery times averaging 30 days when ordering through the DoD warehouse system.

Another initiative established a Prime Vendor for maintenance, repair and operating (MRO) materiel support to Department of the Navy activities in the Southeast. The contract was established in March 1997 with Strategic Procurement Services Inc., and involves support to the Marine Corps Recruit

Depot, Parris Island (S.C); Camp Lejeune Marine Corps Base, N.C.; and the Marine Corps Air Station and the Naval Hospital both located in Beaufort, S.C. Instead of these activities placing requisitions and receiving shipments from a DoD warehouse, orders will be placed over the Internet directly to the vendor, with delivery within 72 hours. If this pilot is successful, the MRO Prime Vendor concept will be expanded to all 73 military installations throughout the southeastern region of the United States, with the potential dollar value as high as \$200 million annually. In the pilot, Strategic Procurement Systems will provide brand name commercial items ranging from electrical, plumbing and refrigeration supplies to small tools and small hardware items. Since all ordering occurs over the Internet, orders can be placed 7 days a week, 24 hours a day, with emergency orders available within 24 hours.

The Navy has recently awarded a contract for direct vendor delivery of repairable components. The Naval Inventory Control Point has contracted with Litton Guidance and Control for the Replacement Inertial Navigation Unit used on the P-3 and C-130 aircraft. This contract is estimated to save \$200 million over 20 years. Litton manages the inventory, will ship replacements for failed units within a day, and has guaranteed reliability improvement to 9000 hours Mean Time Between Failure versus the 200 hours Mean Time Between Failure experienced by

the current system. If the improved reliability is not achieved, Litton is required to provide additional units to meet Navy demand at no cost to the Government.

Your invitation letter asked about the approximate dollar value of hardware items and other readily available commercial products. For Fiscal Year 1996, sales by the Defense Logistics Agency's hardware centers were \$3.09 billion at item cost, with \$529 million (17 percent) of that total provided directly from commercial vendors.

In summary, the Department is aggressively pursuing the implementation of innovative business practices for hardware items. In so doing, we are using a complete menu of innovative practices, including prime vendor, virtual prime vendor, direct vendor delivery, Internet ordering, and use of the government purchase card. I would also like to note that within the contractual relations we have entered into, we have also negotiated surge and sustainment clauses to ensure uninterrupted support during contingency or wartime situation. We anticipate substantial increases in the application of these innovative practices over the next several years.

LEGISLATIVE PROVISIONS

Finally, your invitation letter asked for a discussion of how provisions contained in the House National Security Committee's 1997 authorization bill may

improve inventory management, and for any other legislative or policy reforms that would allow DoD to aggressively implement business best practices.

Section 102 of the authorization bill would require annual reductions in the number of defense acquisition personnel (excluding civilian employees at a maintenance depot) of 40,000 by October 1998; 80,000 by October 1999; 102,000 by October 2000; and 124,000 by October 2001. The impact of such reductions on the DoD materiel management system would be extremely negative. Since the civilian depot maintenance workforce is excluded, the reductions would largely come from the Military Service Inventory Control Points, and, in particular, the Defense Logistics Agency. The Department is in the process of reducing its materiel management workforce in a meaningful fashion while avoiding undue disruption with the negative impact on mission accomplishment such disruption entails. As previously stated by other DoD officials, the Department opposes the adoption of Section 102. In terms of its impact on materiel management, I can state it would be extremely disruptive to mission accomplishment.

Section 221 of the authorization bill would require a reduction in the annual overhead costs of the Department's Inventory Control Points to not more than eight percent of annual net sales at standard price. Section 221 excludes military and civilian personnel related costs from overhead costs. The Department agrees

with the intent of Section 221 to reduce overhead costs at DoD Inventory Control Points. However, we are concerned that Section 221 as written may have the unintended effect of causing a reduction in services that are outsourced by our Inventory Control Points. The most recent Inventory Control Point data available (FY 1996) show that 89.1% of annual net sales pays for materiel costs and civilian/military personnel costs. The remaining 10.9% of annual net sales pays for transportation and other outsourced services, in addition to payments for services performed by other parts of DoD, such as distribution and disposal. Limiting payments for costs other than materiel and military/civilian personnel to no more than eight percent of net annual sales would not only prevent additional outsourcing where appropriate, but would require a reduction in the current level. Such action would contradict the DoD initiative to make greater use of private sector capabilities where appropriate.

As to other legislative reforms that would allow us to aggressively implement best business practices, the Department views existing legislative authority as sufficient to continue to appropriately implement innovative private sector practices. This view is borne out by the series of policy initiatives in the areas of prime vendor, virtual prime vendor, and direct vendor delivery I have

described, taken together with the dramatic increase in DoD's use of the government purchase card and Internet ordering.

SUMMARY

The Department of Defense is both proud of the progress we have made in adopting innovative best business practices into its materiel management process and committed to further improvements. The increase in the portion of Defense Logistics Agency sales shipped directly from a vendor to a customer without going through a DoD warehouse from 24.5% in FY 1992 to 33.15% in FY 1996 shows a clear trend toward greater use of commercial logistics support capabilities. Furthermore, the initiatives I have outlined that aim to apply private sector practices that have proven successful for personnel support commodities to hardware items offer the potential for substantial increases in the future. We appreciate the interest of the subcommittee in defense inventory management reform and look forward to working with you in the future to ensure success in this crucial area.

Mr. MICA. Thank you, Mr. Emahiser.

Dr. Martin.

Mr. MARTIN. Thank you, Mr. Chairman.

I would like to submit my written statement for the record.

Mr. MICA. Without objection, so ordered.

Mr. MARTIN. Thank you, sir.

My comments, I think, are from the perspective of running that integrated business, Mr. Sessions, you were alluding to. I mean, we've basically got a \$15 billion health care delivery system. We take care of about 7 million people, 150,000 employees, 130 hospitals.

So when we look at what these questions you're asking have done for us, from the business point of view, there have been any number of changes, in addition to the efficiencies that have been well articulated in the written testimony submitted. It fundamentally changes how we are able to do business within our facilities.

When you have one warehouse instead of seven, and when you are able to free up staff, and you have 95 percent of your orders there within 48 hours, the way your system runs is dramatically impacted, particularly in regard to the providers. This has been an extremely popular effort on the part of us in the Defense health program, with DLA and DPSC.

A couple questions that came up before that I'd just sort of like to proffer my thoughts on: First of all, the difficulty within DOD or any department—I spent the bulk of my career in Health and Human Services—doing things that are different or making changes is well known, both to this committee and particularly to Mr. Mica.

The fact of the matter is, we would not have been able to do this, the success story that is, in fact, part of the testimony, if it had not been for DLA and DPSC. Without their help, pushing through a fairly complicated bureaucracy with many, many rules, we simply could not have done something that I think we jointly believe is one of the great success stories in this area.

The second which needs to really be pointed out, and I think we touched on it in a couple of questions, is that it takes the business area manager's commitment to make it happen, and not just DLA and DPSC. The example was given, which is a good example, of the depot commander or the base commander, when they really want to do these kinds of things, or a hospital commander, like they did at Walter Reed, it's much, much easier for DLA and DPSC to make it work.

The flip side would have been, if we had this example at Walter Reed, and the commander at Walter Reed didn't want to make it work and wanted to continue the old business practices, little that prime vendor could have done could have made it work. I think that's important to put into perspective since you've got a lot of business areas that are going to need to take the leadership, like I believe my predecessor did in health.

A very important point in the differences between health and some of the other business areas, we were very lucky to have universal product numbers in pharmaceuticals, of course, because of the regulation by the Food and Drug Administration, and also for many of the other areas like food, where that's also regulated by

Agriculture and FDA. So we already started out with an enormous advantage, as did the private sector.

In the area of medical-surgical where our statistics are less, we have actually been in the position of being the industry leader trying to get medical-surgical universal product numbers used by the industry so we can implement prime vendor. Without that consistent approach to identification, it becomes very difficult in those kinds of markets.

The fact is, the industry has been very receptive, and we are moving aggressively with the private sector and industry. In fact, many of the real savings of our efforts now in med-surg will be in places like Medicare, Medicaid, and in the private sector. Because, indeed, they have problems with the ability to use prime vendor effectively.

The last thing I think I would like to point out was made a couple times during the testimony. In order to effectively implement these programs, you fundamentally have to redo your current automation. I think it is very clear, in the hospital industry, automation was changed most of the hospitals to the AIS systems in the mid- and late 1980's.

The government, unfortunately, takes a little longer to get changes made, but we had advantages in that we would rapidly be able to develop the automation and to get products that helped us move this aggressively forward. Without an automated infrastructure, this particular approach simply does not work, especially in regard to the electronic commerce part.

So the success that we feel that we have had I think has been more to us been amply repaid in the impact, positively, on our business. Again, the point that I don't think that we could have done it without DLA and DPSC assistance, because it's not an easy job at all.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Martin follows:]

Mr. Chairman, and Members of the Committee:

Thank you for the opportunity to appear before you today to discuss the Department of Defense's Medical Prime Vendor related initiatives. The offices of the Deputy Under Secretary of Defense (Logistics) (DUSD(L)) and the Assistant Secretary of Defense (Health Affairs) (ASD(HA)) are partners in a joint wholesale and retail initiative to reduce the total cost of healthcare to our beneficiaries. We have made great strides over the last five years and have affected not only the Military Health Services System but the way the entire US Healthcare industry manages, procures, transports and distributes medical supplies and equipment. The key element, the Prime Vendor Program, managed by the Defense Personnel Support Center (DPSC), was identified by former Secretary of Defense William Perry in his report to the Vice President and President on the National Performance Review as the best example of outsourcing in the Department. This reference is backed by numerous awards including the Superior Management Award (Electronic Commerce) 1992; Gold Medal, Federal Executive Board 1993; Public Service Excellence Award 1995; Innovations in American Government, Ford Foundation/Harvard University 1995; Vice President Gore's "Hammer" awards for 1995/96/97; plus personal recognition for members of the DPSC staff.

The overall goals of the DoD Prime Vendor Programs are to: (1) reduce Defense Logistics Agency (DLA) depot stocked items by half; (2) reduce wholesale inventory by two thirds; (3) reduce military treatment facility (MTF) inventory levels by half; (4) achieve a 5% price reduction on at least half of items purchased; (5) reduce the time spent by clinical staff in ordering and managing supplies; and, (6) enhance medical readiness enabling a seamless transition from peace to war.

The Pharmaceutical Prime Vendor program alone exceeded expectations for every goal. Order and receipt time was cut from 20 days to one day, DoD-held inventories were reduced from 380 days to 10 days, and cost of materials was reduced by 15%. Specifically, depot items were reduced by 81% from 16,000 lines to 3,000, with a revised target of 95% by FY2000. The DLA inventories were reduced from \$629 million to \$200 million. MTF inventories were reduced from \$160 million to \$70 million. The program goal of 5% or \$40 million reductions in pharmaceuticals was actually exceeded by an additional \$40 million in FY96. The Pharmaceutical Prime Vendor program proved successful because there was an industry-wide numbering system, the National Drug Code identifying all products, and a classification system managed by the Food and Drug Administration which identified therapeutic equivalencies. Our joint initiative with the DUSD(L), the Defense Medical Logistics Standard Support Program was able to obtain commercial data bases and develop tools which facilitated product and price comparison at the MTF level. Service personnel have been very aggressive in using these products to effectively reduce their expenditures.

The Medical Surgical Prime Vendor Program was established using the same format. Although the Medical Surgical Prime Vendor program proved much harder to implement than initially expected, many MTFs are achieving significant benefits with up to 40% of medical surgical items being covered. Our target goals of \$256 million in sales and \$25 million per year in savings for the Medical Surgical Prime Vendor program have not been obtained. The Medical Surgical Prime Vendor program is severely hampered by the lack of an industry-wide numbering and classification system to enable product comparison. Without these it is nearly impossible to identify products being used in the MTF or to effectively accomplish product and price

comparisons. As a result, implementation has been limited, with success often determined by the experience level at the local medical activity. Even with these constraints, Medical Surgical Prime Vendor sales continue to increase consistently.

Perhaps our greatest asset is our people, from both medical and logistics communities, who recognize the importance of these initiatives. The DPSC is the recognized pace setter and a champion for change in US Healthcare. Not content with our past achievements, our joint endeavor is changing the face of the entire healthcare distribution and transportation industry as well as direct providers of healthcare. Our current initiative to implement the Universal Product Number (UPN) throughout US Healthcare is the key to the future for cost reductions and efficiencies for medical and surgical products.

The UPN with barcode technology is a derivative of the Universal Product Code commonly used throughout the retail industry within the United States and Europe. The importance of this initiative cannot be overemphasized. For instance, the Efficient Healthcare Consumer Response (EHCR) report, *"Improving the Efficiency of the Healthcare Supply Chain"*, states that adoption of the UPN throughout US Healthcare will reduce annual distribution costs for \$60 billion in US healthcare medical surgical sales from \$23 billion to \$12 billion, a full 48% reduction. To the Department of Defense this transition will also support peacetime, wartime, and humanitarian support missions using the US industrial base rather than the Defense Depot based system. At the same time, we will continue our work with both the General Accounting Office and the Healthcare Financing Administration of the Department of Health and Human Services to adopt the UPN as a National Standard, assisting in efforts to preserve Medicare and Medicaid funding.

The Prime Vendor Programs are also being modified to better meet the needs of the military facility clinical staffs. Many of the changes being made are new to industry as well as the DoD, but they follow three basic principles: (1) increased product coverage; (2) better pricing; and, (3) innovations in automation as an enabler for all Services. Initiatives such as DoD and regional formularies, committed volume contracts, tiered pricing based upon regional commitment, a National Mail Order Pharmacy Program, Pharmacoeconomic clinical based formulary decisions, mandated use of the Federal Electronic Commerce and Electronic Data Interchange conventions and standards, and fully integrated logistics systems common to all Services are currently being implemented.

Initiatives building on the Prime Vendor concept require our full attention to make these exceptional programs even better. The Pharmaceutical Prime Vendor and Medical Surgical Prime Vendor programs have evolved several times during their implementation. Benefits derived from summary billing, single source procurement at the MTF, reduced warehousing and distribution costs, and reduced manpower requirements are well understood. We look forward to the future working with the DUSD(L) in our joint partnership with the US Healthcare industry. The continued support of this Committee and the Congress will have significant impact on our ability to achieve continued cost reductions and efficiencies for all Americans, whether military or civilian.

Mr. MICA. Thank you.

Mr. Jones, you are recognized.

Mr. JONES. Thank you, Mr. Chairman.

If there is no objection, I would like to enter into the record an article from the Navy Times which came out this week, called "Believe It or Not, Food in the Navy is Getting Better."

Mr. MICA. Without objection, we will make that part of the record.

Mr. JONES. Thank you, Mr. Chairman.

The reason is, we've been able to expand our prime vendor experience and what we've learned in the process of doing it to the point now where we're able to put commercial items directly from vendors onto ships. We have awarded a contract to do that for the Norfolk, VA, area and we're going to do that in other places, as well.

We have talked a lot about specific techniques today. I want to add to the list of things we are doing, so the committee isn't left with the impression that we are sitting on our hands.

No one is more impatient to implement best commercial practices than we are at DLA. I say that because the devil is in the details in implementing these programs. As hard as we try to push a program, as Dr. Martin said, you have to have a customer that's ready to move with you. When customers have not seen evidence of success in areas that have been traditionally hard to penetrate, such as aircraft spares, their confidence isn't there with you. So you have to work as a partner over a fairly long period of time.

I would also agree with Dave Warren's assessment that pilots are very important, pilot programs, to build confidence in areas where there hasn't been demonstrated success in the past.

I want to point out that while GAO does say that only 2 percent of our items are covered, it is a third of our sales. The reason that we bring up the difference is that the maturity of the industry, the ability of the industry to participate in something like a prime vendor type arrangement, is key to being able to do it. The last thing the Department of Defense wants to do, or the Defense Logistics Agency, is impose another new, unique defense business practice on the industry.

So in the case of medical-surgical, the industry wasn't exactly where pharmaceuticals have been, for the reasons Dr. Martin mentioned. The universal product numbering system wasn't there. Other things weren't there. So we had a more difficult time, but we are making progress and we will get there.

We have, in fact, awarded contracts now, as Mr. Emahiser said, for facility maintenance and repair type items: civil engineering supplies, 8,000 stock numbers are being supported by prime vendors at southeastern bases in the United States. The comptroller of the Department of Defense has directed that we roll that program out as quickly as possible, and we are in the process of working out a schedule, once again, with our customers, for doing that.

That takes us out of the business of stock-store-issue of all items that are used in the process of maintaining facilities. So we will be completely out of that business within a couple of years.

But we had some false starts, because first we looked at individual commodities. We looked at plumbing, we looked at electrical,

and then we found that there was no industry practice there to meet us. Finally, the industry had matured. We found that there was an industry practice that dealt with the entire range of items that we were looking at, and that's the industry that we went to.

The procurement process is very difficult. I have to caution the committee on one point, that although we are, as I said, impatient to roll out these practices, we have to be very mindful that, as we do, we observe all of the rules and the regulations which uniquely apply to the government. We cannot and will not walk away from small business. We cannot and will not walk away from disadvantaged businesses. On top of that, we have to make sure that what we do in pricing is what the committees in the Congress would expect us to do, and rightfully so.

I would point out very briefly that the commercial practice in aviation spares and in automobile spares, and in a lot of other commodity areas that have been discussed today, is basically to provide a full-service product at a price which the market will bear. That's the American way. That's competition, and that's exactly what the industry is about, and there's nothing wrong with that. But when it comes to the Defense Department, when we buy spares, all the market will bear is not good enough.

So I would remind the committee that, as we progress down this path of looking at prime vendor and other types of direct vendor delivery processes, we have to be very cautious, because the oversight functions that are rightfully performed here will catch up with us if we aren't as careful as we need to be. So we can't move quite as fast as we would like to for a number of those reasons.

I will say one last thing, that it has been a pleasure working in this environment. The GAO, I think, has made a substantial contribution to a change in our relationship. Dialog is much more productive, and I want to thank the gentleman on my right for exerting leadership in that area. We look forward to continuing to work with the committee on this and other related subjects.

That concludes my oral remarks.

[The Navy Times article referred to follows:]

COVER STORY



Believe it

IT'S RIGHT THERE ON THE TABLE in the cadet mess, the familiar bottle labeled "A.I." As in the mess stateroom. The same name brand found in restaurants and homes across the land.

The fact that there's a bottle on every mess deck's table aboard *Leyte Gulf* represents a quiet revolution in the way food is getting to Mayport, Fla.-based ships, and is likely to get to the whole fleet now that a two-year pilot program is finished.

The food doesn't come from Defense Department storage depots so far away as Memphis, Tenn., as it did two years ago. Almost all of it is delivered now by *Bosser Street Foods*, a multimillion-dollar commercial supplier based in Jacksonville, Fla., just 20 miles from Naval Station Mayport, Fla.

In March 1995, *Bosser Street Foods* was designated the Navy's "prime vendor" for the 21 surface ships homeported in Mayport.

The agreement with the Defense Personnel Support Center in Philadelphia, which ran the bid, calls for *Bosser Street* to deliver food to ships within 48 hours of receiving an order, processed through an on-base unit set up to be a clearinghouse for a program.

The order comes by message, fax, computer disk or even by hand. The deal will save *Bosser Street Foods* about \$40 million over a four-year period, delivering more than 2,000 different products to five Navy facilities as well as the ships.

Taste of reform

The deal's importance was lost on much of the public at first, even that part of the public wearing Navy uniforms.

But there's little but praise today on the waterfront for the new way, which has grown out of the Pentagon's effort to simplify its convoluted process for buying all sorts of stuff.

The Navy laid for it is "acquisition reform," and it's having a huge impact on programs as involved as buying millions of dollars worth of spare parts for airplanes. Not in Mayport, and at mess tables aboard ships, the benefits of the prime vendor system are much more fundamental.

"It's A.I. Now we don't have 20-cent-a-bottle generic products that has nobody caring, 'What's this stuff?'" said Rear Adm. James Ferguson, commander of the Western Hemisphere Group. Of 18 ships under Ferguson's command, 13 are based in Mayport.

Not only are products "quality, not generic," Ferguson said, "the ordering system is

Leyte Gulf crew members (left) sit down to a mess. A.I., Bellman's and other quality brands they recognize — and prefer — are steadily showing up on the ship's mess tables, delivered by "prime vendors" located at or

COVER STORY

Prime vendors stock Navy ships with good chow

SOON CREW from previous page

The Defense Personnel Support Center, Navy manager of the system, that gets food into military eating facilities worldwide.

Probably anyone spends dollars to eat. That's important to the Pentagon's new "open market" menu program.

Going worldwide

First, said the Pentagon's program will have to be changed. But that had worked so well overall, he said, that officials have undertaken a worldwide program.

It has just returned to Norfolk, Ford said, with a single price index for the 30 major vendors in part as a given that and two to show-based contracts. Each vendor is within 25 miles of their Navy stations. On the West Coast, the last two stations are ships and stations in San Diego and Pearl Harbor. Each major vendor is in an area from 25 to 100 miles, and the system will be expanded overseas later next year.

With the change, the Pentagon will share at least 50% of a basket of 30 food storage facilities and five central processing plants across the nation. Half a half-century of having food by "government order" will be history.

Why level a government military in the way private firms are doing when its people are located, and the number of people dedicated to running the military supply system is being reduced sharply.

"All the services need to eat," Ford said. Food products "are a major part of lives of one for entering into the private sector to do it."

Perhaps the last reason for the change, however, was noted by Lt. Cmdr. Kirk Leedy III, of the Naval Association from Leedy is a "buyer" or supply officer, or even that the Navy's office for a two-year tour in Mayport and at working at non-Naval service offices for the Naval Industrial Support Center, the Navy's logistics agency for Mayport.

Leedy called the Navy's needs warships full of food when the Navy's office was the bigger Navy issue.

"The great work getting ready to fight a major war on a number of different continents," he said, with immediate access of massive numbers from almost a year. Making those ships equipped with food was a huge undertaking as a result.

But there's no longer a worldwide Navy. Long to be a political adversary. Since the Navy's shrinking from 600 to 300 ships, bringing in the shore and safety because a fraction of "non-naval" — connecting with civilian firms to do the job.

The result is Mayport.

■ The main multipurpose behind food to fill out. Shipboard food stores are set in William Beedling, a vice admiral who works for Leedy, the primary mission is to convert the government language will used by ships into a form Navy Order Food can understand, in all its interesting problem. The Navy will reduce language by the word, but business the vendor follows by the ship.

■ The main government bureaucracy is related with Beedling and an associate are the only points of contact, and he has one article for helping keep deliveries at hand. That makes sense to him also.



Crew members load trays and stacks of food aboard the Leyte Gulf. These days, Mayport's ships are looking for local operations with four storage spaces at least 20-percent full — much better than they remember average of about 15 percent.

Next course: Pharmaceutical supplies

When the amount of food being stored aboard ships drops, the Defense Personnel Support Center has a way to get its food vendor around the world.

It's a matter of food being stored aboard ships. The Defense Personnel Support Center has a way to get its food vendor around the world.

It's a matter of food being stored aboard ships. The Defense Personnel Support Center has a way to get its food vendor around the world.

Initially, making those ships safe in health. But Beedling's results with a much have to open an hour on the phone with the Mayport-based center Allen E. Satterfield, taking an order by hand because the center's electronic communication system was down.

■ And so have 1,000-mile-wide deliveries of food products needed by sailors because they're produced according to government specifications that often emphasize safety instead of good taste.

Try it, you'll like it

Getting the Navy to try new foods, however, has been another challenge. "We noticed the ships weren't ordering

junk chow," Beedling said. "We asked why not. They said the junk chow they had been getting was being fed to the ship's animals." The resulting program has made those animals so healthy.

Beedling offered to send and email orders of quality junk chow. Now the Navy buys them in quantity, he said.

But the Navy's been able to increase shipment supply officers they should order food products that are guaranteed, because "they want to keep their people pleased for me," when they need food for crew.

He said the Navy probably will have to accept more convenience foods, however, because there are so many on the sea-

son. For some business is increasing. Programs, who routinely checks the prices aboard the Western Hemisphere Group ships, and the key to the success of price index in Mayport is based on the consumer's confidence and the up-to-date market price.

"I don't know what's been done on this issue over time. I've been coming to Mayport, 20 years," he said, as the company leaves the way around.

But now "the business is more complex. The Navy needs to make money. They've got to please the customer. So what the customer wants, the customer gets," Beedling said. "What a concept."

Mr. MICA. Thank you, Mr. Jones.

I yield now to the gentleman from Texas for questions.

Mr. SESSIONS. Thank you.

My questions would be for any of the three of you that wish. Just a couple observations. I heard the words, "The devil is in the details," and I heard the words that you're dealing with a bureaucracy with many, many, many rules. Let me tell you, I have not walked a mile in your sandals.

I know this is difficult, but please tell me, have any group of you, meaning even individually, been out to a depot in the last 2 years? And if you could, please tell me where you've been and what your observations were. A depot, as opposed to a military operation—Walter Reed wouldn't count—but a depot.

Mr. EMAHISER. Let me go ahead and respond first.

Mr. SESSIONS. Please.

Mr. EMAHISER. I've been to Jacksonville and to Warner Robbins.

Mr. SESSIONS. What were your observations when you were there?

Mr. EMAHISER. The observations were that, first of all, the folks were extremely energetic and extremely proud of the products that they were producing at those depots, were proud to be employees of the services responsible for the depot, and thought they were doing a quality job, producing a quality product.

Mr. SESSIONS. Did they provide any feedback to you, or are there any observations that you made that—and I don't know which depot—I don't know what Jacksonville handles. I don't know what they did, but was there any feedback. You were there to look and hear people, and you've heard they were proud of the job, felt like they were part of the mission, were pleased to be there.

Mr. EMAHISER. I would just follow that on by saying that at Warner Robbins they were excited about the virtual prime vendor, that is the thing that was going to be put in to help support the propellers and hubs and rotors, and that kind of thing.

They recognize that they are under the watchful eye of not only the department but of the Congress, in all honesty, to assure that they are producing quality products. They recognize they've got to have a handle on costs, particularly at those two depots, they are very cognizant of that. And that permeates from the commander on down for both those installations.

Mr. SESSIONS. Are these depots run by the military with the assistance of civilian employees, or what was the nature?

Mr. EMAHISER. Those both are military depots. They are not run by contractors. They are both military depots with, I would say, 95 percent, 98 percent being DOD civilian employees. There are some contractors there that may be on board that do provide some support, but they are primarily DOD civilians.

Mr. SESSIONS. Mr. Jones, could you please discuss with me, have you been to any depots at all?

Mr. JONES. Yes, Mr. Sessions, I have, although, in my current capacity, most of the depots that I visit are distribution facilities that are co-located with maintenance facilities. That's my primary responsibility now. I have been to Warner Robbins, Kelly Air Force Base, McClellan, Sacramento, numbers of places. Of course, our

primary distribution depots are in San Joaquin, CA, and Susquehanna, PA.

So I have seen quite a bit of change in all of those locations and an eagerness on the part of our customers for us to bring new solutions to them; again, a combination of some frustration in how long it takes, and some caution that they want to see demonstrated results before they jump in all the way with this.

Mr. SESSIONS. Can you tell me, in this case or in any case that you choose, in your testimony, who is a customer? Who are they expressing this concern to, and how do you find out about it?

Mr. JONES. Yes, I would be pleased. In the case of Warner Robbins, we have a number of channels. No. 1, we work directly with the commander, in some cases. A gentleman who used to work for me in uniform is now one of the change advocates down there. We have a direct line.

We have an interchange of people, basically, that know what's going on, who are also facing new pressures from their commander at Wright Patterson to reduce costs, control and manage costs. They know what we have tried to do and want us to partner with them, and we're just itching to do it. So it's a communication that works that way.

We also have customer representatives on the ground, permanent employees of the Defense Logistics Agency who are there, field a lot of the direct input, attend the commanders' staff meetings, so we have a third direct channel that way.

Mr. SESSIONS. Would you describe, in your capacity as the executive director for logistics management, the people who are in your organization? Can you describe how they are appraised? In other words, what part of their performance evaluation would deal with effective use of resources, these sorts of things? Is that included within their appraisals?

Mr. JONES. Yes, it is, Mr. Sessions. By law, it's in mine, and it's also in theirs. There are, as a matter of fact, several elements that they are rated on. We are also moving toward giving higher marks to those that spend more time solving customer problems. We have both an emphasis on solving customer problems and accountability, which is a requirement of FNFEA.

Mr. SESSIONS. Would you say that this is—and I know we've heard it's just a matter of time till we get to zero, it may be the year 2050, but at some point we're working that number down—would you say that you are well on the road or that there are a good number of bureaucratic rules that are getting in the way of you performing it better?

Mr. JONES. Well, if you mean inventory being zero.

Mr. SESSIONS. I do mean inventory and proper management. I'm not trying to get to zero; I'm trying to get to where you feel better about what that level is, proper management.

Mr. JONES. I think we're within a very short time. The main problem that we have is something that will never go away, and I think the GAO would agree with this, is that there is a pattern of demand in a lot of our materiel which is highly irregular.

It's not like manufacturing. Inspect and replace causes demand to fluctuate wildly. When you have equipment that's 50 years old, there are problems in trying to maintain low balances and antici-

pate and forecast correctly. Those will always be with us as long as we're in the environment we are.

If you talk about the vast bulk of our items, our dollar sales, I'm comfortable that within 3 to 4 years we'll have a much better handle on having the right stuff at the right place at the right time.

Mr. SESSIONS. Really, what I'm in reference to is management. Are you making good judgments about what is there, that's on an appraisal; you feel like you're cutting through rules and regulations, and that your management structure and decisionmaking is good?

Mr. JONES. Yes.

Mr. SESSIONS. I hear you say you feel good about it.

Mr. JONES. Absolutely. We've overhauled the whole agency, reorganized it, reshaped it from the bottom up, changed the incentive process, changed the management structure. We've done an awful lot in the last 3 years to change the culture. I'm not going to say it's done. It's never done. We have to change it every day.

Mr. SESSIONS. Good. Well, hopefully as a promise, not as a threat, I'd like to join any of you someday out at a depot and go learn more about it, and see those kinds of things that you walk through. So if either one of you three, as you have those opportunities that are coming up this year or early next year, I would welcome that opportunity when you do that same evaluation yourself.

Mr. EMAHISER. Sir, we would be glad to do that for you.

Mr. SESSIONS. Good. Thank you.

Mr. MICA. I yield to the ranking member, Mr. Barrett.

Did you have any questions?

Mr. BARRETT. Thank you, Mr. Chairman. No, I unfortunately have been in other hearings all day. I may submit some written questions to the panel, but at this time I have no questions.

Mr. MICA. I thank the gentleman.

Mr. Emahiser, in your testimony, you say that in 1996 DLA sold about \$3 billion worth of hardware. What is your estimate of the total value of hardware inventory? Do you agree with the GAO that DLA has a \$7.2 billion inventory of hardware items in its distribution warehouses and depots? Is that correct?

Mr. EMAHISER. Yes, sir.

Mr. MICA. It is?

Mr. JONES. With one exception, Mr. Chairman, that's the way GAO is computing the value of inventory we have declared to be potential excess. They value it at full acquisition cost, and the government's own Federal Accounting Standards Advisory Board rule says that we have to value that at recovery cost, which is essentially scrap value. That takes about \$1.1 billion to \$1.2 billion off of that total. So we're closer to \$6 billion in assets.

Mr. EMAHISER. That's an ongoing discussion that we've had with the GAO, how to, in fact, value that inventory once it appears that it's going to be excess.

Mr. MICA. The GAO, again, asserts this \$7.2 billion worth of hardware items in DLA's distribution depots and warehouses that you have agreed to. Is it feasible for the department to try to employ virtual prime vendor and direct vendor delivery for all of these items?

Mr. JONES. Let me break that answer, if I can, Mr. Chairman, into two parts. One, the first answer is no, not all items. But the more important answer to the question is, we're going to try. We have plans in place now to try avionics components. As I said, we have a potential breakthrough in bench stock prime vendor that's in a very sensitive procurement stage now. I can't really talk about it, but that's a huge potential change in our business practices if we're able to get that to work.

We are working in the hardware areas intensively, but the way we're doing it is, we're looking at how the industry does business. I have to say again that if the industry does business one way, and Defense tries to direct them another way, we're not going to make it work. We have to go find what's working and capitalize on that. That's why we did so well with pharmaceuticals, and that's kind of a pacing factor in some cases.

Mr. MARTIN. Mr. Chairman.

Mr. MICA. Yes, Dr. Martin.

Mr. MARTIN. Just let me add, because this is important, there are, given the industry practices, some important exceptions. Even in medical, where our organizational philosophy is to reach toward 100 percent, there are clearly hundreds of items that, no matter what happens, we will not be able to use prime vendor for.

Second, we have to always be concerned—and I think Mr. Warren touched on this very, very clearly—for surg requirements. To the extent that our prime vendors can't meet our surg requirements, all of a sudden we need very large numbers of things when we deploy, we have to work a different arrangement than prime vendor.

Prime vendor works very well for those consumables where there is a through-put within our facilities that's very predictable. It does not work very well when the item is not an industrial standard and/or we have unique needs that are substantially different than the industry. I can think of one immunization right now where we constitute 95 percent of the requirement for the industry. Those kinds of things are very, very difficult to fit into the prime vendor system, and sometimes they are fairly sizable in number.

I think that is consistent with what Mr. Warren alluded to in regard to the process of going through and figuring out which are those things. We want all, of course, in medical, but we are very cognizant of the fact that there would be another oversight hearing if, all of a sudden, we needed 150,000 of something and we didn't have it and couldn't get it, and we went to war and we only had 40,000. So we have to worry about that in those cases, particularly with surg.

Mr. MICA. Mr. Emahiser, you had indicated in your testimony that one of the problems in obtaining inventory and maintaining inventory is some of the materiel, et cetera, is, I think you said, 40, 50 years old, that you're storing parts and acquiring materials for. How much of a problem is this with outdated military equipment? Is this a small part, or is this major? I don't know if you could give me a percentage or some estimate. Are we dealing with this as the major problem or just one of the problems?

Mr. EMAHISER. There's no doubt that the age of our inventory, that is the age when we procured equipment, whether it be tanks,

personnel carriers, helicopters, or airplanes, is a problem, because as the age of the inventory grows, we still have to maintain parts. Conversely, as we do technology insertion to upgrade that equipment, we find that we have parts on the shelf that are no longer applicable to that equipment.

That, in fact, causes us some problems. I believe the example that GAO used in the 100 years of supply is, in fact, an item like that, that was caught up in a technology upgrade, and therefore there was not basically a requirement for that after that was done.

I can't give you a number. It has an impact. Rather than to quantify that off the top of my head, I just would prefer not to do that.

Mr. MICA. Well, the department has implemented prime vendor practices at Warner Robbins Air Logistics Center. Did you say you visited there?

Mr. EMAHISER. Yes.

Mr. MICA. If this pilot program proves successful, will it be implemented nationwide or on a broader scale?

Mr. EMAHISER. Well, when we see that the pilot program proves out, and the program really has just started, it certainly provides a basis for further implementation, not only in the aviation commodities like at Warner Robbins, but in other commodities to support the depot maintenance program. Mr. Jones alluded to the avionics expansion that was being looked at now. That certainly would be a case that could be made for that.

Mr. MICA. Where do you anticipate that these practices would be implemented in the future?

Mr. EMAHISER. I could see where programs like this could be issued across the entire depot community; again, either under a pilot or on a case-by-case basis. Certainly, Corpus Christi Army Depot, where we're doing helicopters, is a prime case where something like that could be put into place. Anniston Army Depot, where primarily we do tanks and heavy combat vehicles, would be another place that we could take a look.

So I think that the time would be ripe, as this case down at Warner Robbins proves out, to expand that.

Mr. MICA. Does the department have any estimate, based on the experience with medical supplies of how much money could be saved by adopting prime vendor for all hardware items currently held by the department? Is there any indication from that experience?

Mr. EMAHISER. Sir, I don't know of any number that's been projected out.

Mr. MICA. Mr. Emahiser, it's my understanding that you made this point in the subcommittee, in our hearing in March, that the department could not aggressively adopt these practices without conducting thorough testing first to ensure that changing practices would not affect readiness. What effect do you think the prime vendor practices, like those employed—the example we've used here is Warner Robbins—is having on readiness, and can you make such a determination or evaluation yet?

Mr. EMAHISER. Based on the limited test that's going on at Warner Robbins, I would say that it's had a positive impact on readiness, and it's had a positive impact on throughput for the depot for

those items. I think my comments, which I don't really remember from the last time, in that area would have been caution in that there may be some commodities or some areas that it just would not fit. Again, the idea would be not to create a new business entity, but rather be able to follow on what industry would currently be doing, to make sure that that fits.

Mr. MICA. So, so far, also, you are not able to provide the subcommittee with any estimate of saving from implementation of the virtual prime vendor at Warner Robbins? You're still in that position?

Mr. EMAHISER. I couldn't provide those now. We could go back and look and provide that for the record, if it's available.

Mr. JONES. Mr. Chairman, if I could just add one thing.

Mr. MICA. Yes, Mr. Jones.

Mr. JONES. Thank you. The virtual prime vendor at Warner Robbins is different from prime vendor that we practice in other commodities. The virtual prime vendor is essentially an integrator, providing a service, and has access to our contracts for parts or his own parts chain and parts supply.

What we are attempting to do there is to demonstrate the capability to provide an integrated logistics support service for a particular weapon system. There are 1,400 weapon systems that we manage parts for in DLA. I don't think that the method we're going to use is going to be to go system by system. What we're probably going to do is to go commodity by commodity, and in certain cases where the customer wants us to take on a particular problem involving an air frame or something like that, we will then look for an integrated service.

So one of the reasons it's hard to answer your question is, we're not sure what service our customers will want us to provide. When they do, then we can make the estimates on the point cases for the materials that will be involved in those cases.

Mr. MICA. Real quickly, it's my understanding that at Walter Reed the prime vendor for medical supplies procedure has resulted in the reduction of about 50 percent of the materiel management personnel, somewhere in the 70's to 30's. Is that correct?

Mr. MARTIN. It's about a 50 percent reduction from the mid-70's to about half of that.

Mr. MICA. It's my understanding that this prime vendor for medical supplies has been extended to over 200 DOD medical facilities. Are there similar results in reductions of personnel anticipated or underway?

Mr. MARTIN. I think it's fair to say that within the health care delivery system that the results at Walter Reed are being seen pretty consistently throughout. And it's not only the savings in the personnel, particularly for us, which was warehousing and managing the inventory, that is a large responsibility that has changed, but also, it's freed up a great deal of space.

I mean, when you visit the Brooks Army Hospital, the new hospital in San Antonio, for example, there is a vast amount of space that we used to have to dedicate, within the hospital, for storage, that this new approach has essentially freed up for other uses, which has been also a big factor in its popularity at the hospital level. Again, there was the point I made before, this is very popular

with our hospital commanders and doctors and administrators, because it makes life a lot easier in the hospitals.

Mr. MICA. Well, gentlemen, we're getting into the meat of some of the issues I wanted to discuss with you, and look at, again, savings and how we can best pursue practices that, again, will aid us. We're all up against a budget crunch. We're trying to do more with less and also transition folks who may lose positions as a result of our actions.

I won't be able to get into all of those questions. We have a vote and a series of votes coming up. However, I am going to submit to you additional questions, and I'd like a response. I'm going to leave the record open for 2 additional weeks. They will be submitting them to you, and if you could respond to the subcommittee.

We appreciate your cooperation in this endeavor and our oversight obligations. I would like to thank each of you for being with us. The record will remain open, as I said, for 2 weeks.

There being no further business to come before the subcommittee this afternoon, this meeting is adjourned. Thank you.

[Whereupon, at 2:15 p.m., the subcommittee was adjourned.]

