HOLD UNTIL RELEASED
BY THE COMMITTEE

TESTIMONY OF

MR ALAN F ESTEVEZ

PRINCIPAL DEPUTY ASSISTANT SECRETARY OF DEFENSE

(LOGISTICS & MATERIEL READINESS)

BEFORE THE UNITED STATES SENATE

COMMITTEE ON HOMELAND SECURITY AND

GOVERNMENTAL AFFAIRS

OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL

WORKFORCE AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE

JULY 27, 2010

HOLD UNTIL RELEASED
BY THE COMMITTEE

High-Risk Logistics Planning: Progress on Improving Department of Defense Supply Chain Management

Mr. Alan F. Estevez
Principal Deputy Assistant Secretary of Defense
(Logistics & Materiel Readiness)

Chairman Akaka, Senator Voinovich and Members of the Committee:

Thank you for the opportunity to appear before you and discuss the current status of the Department of Defense's (DoD) supply chain management and logistics processes and to review with you the efforts we have taken to address areas of risk. Significant and measurable progress has been made over the past 3 years since the Department was last before this committee, and I am hopeful that my testimony today will show our continued dedication toward implementing a comprehensive, end-to-end logistics strategy that provides effective support for both our deployed warfighters and provides value to the American taxpayers who pay for that support.

Today I will give a comprehensive look at the current and future state of logistics, and the supply chain component of our logistics enterprise, by reviewing our recent actions and improvements since the last hearing in July 2007. I will also address the concrete actions taken to address the high risk designation by the Government Accountability Office (GAO) of the DoD supply chain and show how these process improvements and the associated oversight are institutionalizing a solid way forward for DoD logistics and the supply chain.

Before I address those areas, I would like to compliment your respective staffs, the Office of Management and Budget (OMB), and GAO who continue to work with the Department's staff in addressing supply chain management. I would also like to specifically acknowledge from GAO both Mr. William Solis and Mr. Jack Edwards. Our collaboration, together with the

professionalism and dedication of the entire governmental team, has contributed significantly to the successful improvements in the Department's supply chain and logistics support.

Scope of DoD Supply Chain

The DoD Supply Chain is unparalleled in its scope of operations and complexity of its mission. The over 1 million uniformed, civilian, and contract employees who support all aspects of the Department's supply chain manage over $90 billion in inventory and keep 15,000 aircraft, 300 ships, and 30,000 combat vehicles capable of fulfilling their mission.

The DoD logistics mission is to provide globally responsive, operationally precise, and cost-effective joint logistics support for the projection and sustainment of America's warfighters. Every day, DoD logisticians support troops forward deployed in some of the world's most demanding environments and are frequently called upon to support operations on short notice in parts of the world where we have little or no presence. Most notably, DoD logisticians are key enablers to simultaneously executing the drawdown of forces in Iraq and providing full spectrum support to our efforts in Afghanistan. Since the President announced the Iraq drawdown timeline, we have been systematically and responsibly drawing down the force in Iraq. To date, we have moved out 32,000 pieces of rolling stock, closed 369 bases and are on track to bring the force down to 50,000 troops by 31 August 2010. At the same time, we have moved the majority of the 30,000 troops and their equipment into Afghanistan as the President directed in December last year while providing the needed sustainment in food, fuel, medical, construction materials, clothing, and spare parts. I just returned two weeks ago from a visit to Afghanistan. At every place I visited, the troops and their commanders reported that for the most part, they are receiving the material they need when they need it. Since the troop increase was announced, we

have moved over 17,000 re-locatable buildings (RLB) to house the forces and purchased $10 million in other construction materials in advance to reduce the lead times and ensure the support was there as the bases were built up. We are meeting a 1.1 million gallons a day demand for fuel for the U.S. and coalition forces while feeding 435,000 meals a day to the U.S. Service personnel and civilians on the ground. In addition to moving the force, we have also moved approximately 4,000 M-ATVs and about 6,000 other MRAP variants to protect our forces as they perform their mission, and we are sustaining the readiness of these vehicles at over 90%.

Even with this enormous challenge on our plate, DoD logisticians were still able and ready to support the disaster relief effort earlier this year in Haiti.

DoD Logistics Strategic Plan

History, Key Elements and Goals

In 1990, GAO designated DoD inventory management as a high-risk area. In 2005, the title was changed to the much broader designation of supply chain management, although with no change in the underlying rationale. Substantial and measurable improvements have been made that have mitigated the high-risk designation. Since we were last before the committee, we developed and finalized the DoD Logistics Strategic Plan, incorporating our major supply chain initiatives. This Plan, which is synchronized and consistent with both the 2010 Quadrennial Defense Review (QDR) and the DoD Strategic Management Plan (SMP), published in July 2009, incorporates the logistics-related priorities, outcomes, goals, measures, and key initiatives depicted in the SMP while concurrently adding more detailed information relating to logistics strategy. The supply chain process falls under the overarching logistics enterprise in the plan.

Actual progress against each of the plan's top-level performance targets will be collected and reported via the DoD Chief Management Officer-level dashboard, and reviewed quarterly.

DoD established the framework for the Logistics Strategic Plan with the issuance of the DoD Strategic Management Plan (SMP) in July 2009. The SMP describes the steps the Department is taking to better integrate business with our strategic planning and decision processes and to better manage performance. The plan postures the Department to enhance productivity by focusing resources on the key levers that drive success and depicts outcomes, goals, and measures, and key initiatives linked to five DoD business priorities. Logistics is depicted under two of these business priorities: (1) Support Contingency Business Operations; and (2) Reform the DoD Acquisition and Support Processes. Those two priorities are supported by four separate goals and associated success indicators in the Logistics Strategic Plan. They are: (1) provide logistics support in accordance with warfighters' requirements; (2) institutionalize operational contract support; (3) ensure supportability, maintainability and costs are considered throughout the acquisition cycle; and (4) improve supply chain processes, synchronizing from end-to-end and adopting challenging but achievable standards for each element of the supply chain.

The Logistics Strategic Plan was the result of a series of evolutionary steps that focused on improving DoD supply chain management and mitigating the high risk designation. It incorporated the elements of the 2005 DoD Supply Chain Management (SCM) High Risk Improvement Plan and its 9 key initiatives for improving the supply chain focus areas of distribution, visibility and forecasting. Likewise, the 2008 DoD Logistics Roadmap formed the next governing document for our improvement efforts by documenting the range of major programs and initiatives. It defined DoD logistics in terms of initiatives and programs while

documenting specific actions underway to achieve logistics goals and supporting objectives. Additionally, the Logistics Roadmap began the process of linking logistics initiatives and program performance assessments to identifiable and measurable strategic outcomes, including those in the 2005 SCM Improvement Plan. Because of its usefulness as a management tool in tracking improvement progress, the plan continued to be updated quarterly as part of the overall Logistics Roadmap. The Roadmap contributed to the development of a more coherent and authoritative framework that ultimately became the 2010 DoD Logistics Strategic Plan.

Supply-Chain Operations Reference-Model (SCOR)

With the Logistics Strategic Plan as the overarching document directing our efforts, the Department is also institutionalizing an effective, efficient end-to-end supply chain by employing two models that promote process standardization, facilitate process integration, and define the enterprise framework. First, we have incorporated the industry standard Supply-Chain Operations Reference-Model (SCOR) in establishing our key, outcomes-based metrics. SCOR provides a unique framework that links business processes, metrics, best practices, and technology features into a unified structure to improve effectiveness of supply chain management. The Department uses SCOR processes as a framework for developing, improving, and conducting material management activities. The SCOR framework links logistics processes with integration and improvement efforts. Second, the Joint Supply Chain Architecture (JSCA) is a DoD-wide SCOR-based process model that clearly defines supply chain configuration elements and links them to driving precise and reliable outcomes. JSCA fosters a common understanding among stakeholders of supply chain objectives, terminology, and performance measures and provides a mechanism to improve unity of effort. Based upon five distinct management processes of plan, source, make, deliver and return, DoD added a sixth process of

dispose and then overlaid it on our extremely complex and dynamic supply chain to fully capture the framework.

Using this process model, we then focused on the primary metrics of Customer Wait Time (CWT), Perfect Order Fulfillment (POF), and Total Supply Chain Management Costs to track speed, reliability and overall efficiency of the DoD supply chain. Since 2004, we have seen a reduction in Customer Wait Time (CWT), the primary metric of our logistics and supply chain performance, from 22.9 days down to 16.1 days. POF is an emerging metric implemented at DLA that measures how well the end-to-end supply chain delivers the right part to the customer on time, in the correct quantity, and with no material deficiencies. The metric tracks multiple segments of the supply chain like system processing time, storage time, and receipt take up time. We are beginning to see improvements in POF through collaboration efforts. As an example, DLA and Army collaboration efforts have resulted in an 11% increase in POF for Army requisitions from DLA (from 72% to 83%) over the last two years. The Department is now defining a Total Supply Chain Management Cost metric that measures efficiency.

SCM Focus Area: Distribution

Joint Theater Distribution

With respect to distribution, the Department recognized the challenges it was facing in support of ongoing operations in Iraq and Afghanistan and took specific actions to improve material flow throughout the supply chain. In direct response to those challenges in the Central Command (CENTCOM) area of responsibility (AOR) and to streamline processes and provide

overall accountability of material distribution, the Deployment Distribution Operations Center (DDOC) was established in 2004. The DDOC supports the geographic Combatant Commanders' operational objectives by synchronizing strategic and multimodal resources to optimize force deployment and sustainment. A DDOC has been established at each of the geographic Combatant Commands, and evidence of the great value of this initiative was recognized in 2005 when USCENTOCM's DDOC earned the Supply Chain Council's Award for Operational Excellence. The DDOCs are maximizing combat effectiveness, disaster relief, and humanitarian support efforts through improved end-to-end (E2E) distribution and visibility. For example, the CENTCOM DDOC was able to decrease the overall delivery time for pallets of material moving via air in the theater by combining the processes performed at the Defense Logistics Agency (DLA) Distribution Depot in Kuwait (DDKS) and the commercial air carriers into a streamlined and efficient process that made the pallets available for movement in two days rather than the seven and half days it originally took. USPACOM's DDOC operated in Support of Operation UNIFIED ASSISTANCE tsunami relief operations in 2004, USNORTHCOM DDOC-Forward was used in 2005 in support relating to Hurricane Katrina relief efforts, and the USSOUTHCOM DDOC was instrumental in support to the relief efforts following the earthquake in Haiti earlier this year. Similar to the DDOC, USTRANSCOM developed a Joint Task Force-Port Opening (JTF-PO) capability, now mission ready, that provides Combatant Commanders a fast-reaction, initial theater distribution capability.

Northern Distribution Network (NDN)

As the force structure has grown in Afghanistan over the last couple of years, the Department used the lessons learned from Iraq to improve distribution flow into that vastly different country. Historically, logistics support to Afghanistan has been provided through

Pakistan from the Port of Karachi. In order to provide alternate routes, USTRANSCOM established the Northern Distribution Network (NDN) into Afghanistan for the deployment of the additional troops that began last year. The NDN is limited to the transit of non-lethal cargo over existing commercial routes, and consists of four routes that connect the Baltic and Caspian ports with Afghanistan via Russia and the Southern Caucuses/Central and South Asian States (SC/CASA). To date, DLA has booked more than 10,000 containers onto the NDN, accounting for 81 percent of all shipments. Initially utilized for shipping nonperishable items, DLA has since worked with USTRANSCOM and USCENTCOM to facilitate shipment of refrigerated cargo, both U.S. government and Prime Vendor-owned, on the NDN. In March of this year, we commenced booking the first such shipments.

Just as the Distribution Depot was established in Kuwait to support material distribution into neighboring Iraq, a similar effort is underway to support distribution into Afghanistan. In coordination with USCENTCOM, DLA is establishing a forward deployed warehouse in Afghanistan to improve access to parts and enhance readiness support as the U.S. broadens our operational footprint. On track to be fully operational this summer, the depot will establish a receipt, storage, and issue capability for selected DLA and Service items identified using an economic movement quantity model. A conservative estimate is that by establishing a depot in Afghanistan, we will reduce the related sustainment airlift requirement into Afghanistan by up to 38 percent.

Defense Transportation Coordinator Initiative (DTCI)

Similar to the successes with improving material distribution in theater, the Department's Defense Transportation Coordinator Initiative (DTCI) has produced measurable improvements

and savings with CONUS distribution. DTCI is an ongoing transportation reengineering effort designed to create an effective and efficient business model for the management of DoD's domestic freight program. Through DTCI, DoD is outsourcing the day-to-day management of its domestic freight to a world-class third party logistics (3PL) provider. In this new business model, the 3PL provider receives shipment requirements, identifies consolidation opportunities, prepares shipment plans for delivery, arranges for transportation providers, and performs carrier quality assurance functions. USTRANSCOM, in its role as the DoD Distribution Process Owner (DPO), designated DTCI as one of the DPO top 10 initiatives.

Prior to DTCI, hundreds of DoD shippers in the Continental United States (CONUS) initiated freight movements using commercial freight transportation providers destined for hundreds of receiving activities. Multiple information systems were employed to execute and manage shipment activity. There was no centralized planning, coordination, and control. DoD shippers acted unilaterally by independently selecting mode, level of service, and transportation provider. There was limited visibility of movement requirements and limited exploitation of DoD's considerable volume and optimization potential. With DTCI, the DoD is bringing about increased cost savings and better efficiency in shipping operations.

DTCI implementation is being rolled out to 125 of the highest volume shipper sites in phases. The original 3 phases consisting of 68 shipper sites have been implemented. Two more phases have subsequently been added — Phase IV consisting of 37 sites is currently in progress. Upon completion of Phase IV, another 20 shipper sites have been identified for implementation and will be completed by December 2011.

The roll-out has been progressing smoothly and the program is already producing better than expected results. To date, 85 of the 95 sites are covered and the savings are tracking close to 26% ($91M) of cost avoidance in 2nd destination transportation expenses rather than the expected 18-21% estimated in the business case analysis. Additionally, on-time delivery is running better than 96%, loss and damage is less than .01%, and the Department now has pick-up and delivery visibility over all DTCI shipments within 2 hours of their actual occurrence.

SCM Focus Area: Asset Visibility

Radio Frequency Identification (RFID)

As with distribution, the Department has achieved significant progress in the area of asset visibility to mitigate the high risk designation and improve support to the warfighting customer. The utility of Automatic Identification Technology (AIT) to the Department of Defense (DoD) logistics business area is just beginning to be exploited. Active Radio Frequency Identification (RFID) has already improved the ability to track and trace materiel through the supply chain. The Department has fully implemented active RFID to provide in-transit visibility of consolidated shipments destined for Combatant Commands overseas. The Services and DLA are implementing passive RFID to enable supply chain operational efficiencies and data accuracy to produce expected outcomes of improved materiel receiving, property accountability, inventory accuracy, decreased cost of conducting inventory, and reduction in duplicate orders, inventory shrinkage, and material order fulfillment time. Currently all 17 CONUS distribution centers, the two OCONUS distribution centers, and all three strategic aerial ports of embarkation have the capability to read and write passive RFID. Already, we are seeing a 62% decrease in receiving process errors for small parcel shipments on RFID enabled receiving lanes at DLA's Center of

Excellence at the Defense Distribution Depot San Joaquin from September 09 to January 10. At Pearl Harbor, we have seen a 10 day reduction in logistics response time for the most critical requisitions and a 30 day reduction in response time for less critical requisitions over 12 months. Likewise, there has been a 39% reduction in the average hours needed to process unit-level requisitions (3.1 to 1.9 hours) at the supply support activity in FT. Bragg. Additionally, the Department is implementing satellite tracking and container intrusion detection devices in hostile environments in Afghanistan to enhance real-time visibility.

We are leveraging AIT to improve the Department's ability to get the warfighter the right materiel, at the right place, at the right time, and in the right condition, at the lowest cost possible.

SCM Focus Area: Forecasting

Demand Planning

Similar to the results in distribution and asset visibility, the Department has realized significant improvements in demand forecasting and has developed a solid plan for enhanced inventory management. We are improving inventory management by reducing low-usage inventory and increasing availability of high-usage and critical inventory. We are also updating and improving the material requirements process to accurately identify required war reserve stocks. Likewise, we are updating our computer models to more rapidly and accurately forecast wartime demand items with long procurement lead times. To that end, we have made considerable progress in demand plan accuracy: the measurement of forecasted demand when compared to actual demand. DLA, which satisfies 95% of customer demands, has seen demand forecast accuracy improve by 24% for secondary items since 2005.

Readiness Based Sparing (RBS), like demand plan accuracy, is another example of positive improvements in Department forecasting and inventory management. RBS is the practice of using advanced analytics to establish spares levels and locations to maximize system readiness. At its core is an effective investment in inventory for designated weapons systems that provides higher levels of readiness at a reduced cost compared to conventional sparing models. As an example of success using a commercial RBS tool, the U.S. Navy is currently improving the system for determining aviation consolidated allowance lists for on-board spares on several of its aircraft carriers and has already noted both improved efficiency and effectiveness. From FY06-09, the Navy realized a 13% cost savings due to better allocation of spares per carrier for each of the six carriers in the program, an aggregate cost savings of approximately $216M. Additionally, the improvement led to a 50% reduction in hi-priority requisitions. All of this was achieved during a 7% increase in operational tempo flight hours. DLA has begun a phased implementation of a commercial RBS tool, incrementally establishing item support, and is working with the U.S. Air Force to provide item visibility through the sharing of demand and availability data from this tool.

Additionally, the Department began a systematic discovery of weaknesses in demand forecasting systems used for inventory management across the Department. The life cycle of a weapon system, and the items that maintain its readiness, as well as the items reviewed by GAO in its inventory audits, will provide the foundation for this comprehensive review. This life cycle approach will consider the forecasting processes, procedures, and metrics that are employed during provisioning, interim support, sustainment (at wholesale and retail levels), and system retirement.

At the heart of the Department's improvement efforts in the area of forecasting and inventory management is the DoD Comprehensive Inventory Management Improvement Plan to be submitted in October 2010. The plan incorporates our current strategy of continuously seeking ways to improve our inventory processes, which is evident in the number of ongoing efforts described within. The plan responds to Section 328 of the *National Defense Authorization Act* (NDAA) *for Fiscal Year 2010 which* established a formal requirement for the Secretary of Defense to submit "a comprehensive plan for improving the inventory management systems of the Military Departments and the Defense Logistics Agency with the objective of reducing the acquisition and storage of secondary item inventory that is excess to requirements." Section 328 identified eight specific areas of study for DoD: (1) demand forecasting, (2) total asset visibility and multi-echelon modeling, (3) on-order excess, (4) economic retention, (5) contingency retention, (6) storage and direct vendor delivery (DVD), (7) items with no demand, and (8) disposal reviews. The improvements embodied in the Plan extend beyond the eight areas cited in the legislation, addressing a broad range of improvements to better size the DoD inventory to meet the needs of the warfighter.

The Department's strategy is to improve inventory management processes and systems so the DoD Components can better size and manage their inventories to meet the needs of our forces. Along with meeting this commitment to support the materiel requirements, our objective is a prudent reduction in current excesses as well as a reduction in the potential for future excesses. Besides the need to balance investment and risk, a number of other factors contribute to the complexity of processes in our inventory management systems. Included among those is the volatility of wartime and contingency operations that results in ever-changing materiel requirements as well as unplanned demand that may occur due to changes in maintenance practices or new sources of demand, such as foreign military sales. The Plan builds on the ongoing efforts of the Service Components to address

the factors above, and identifies the appropriate actions and targeted objectives that support the eight individual plans required by Congress.

Conclusion

Last month Secretary Gates announced a major initiative within DoD to shift $100 billion from overhead activities into direct mission-related activities and equipment over the next five fiscal years. In that spirit, the Department remains committed at the most senior levels to supporting the warfighter at the best value to the taxpayer. As a matter of principle we must do everything possible to make every taxpayer dollar count. The real and measurable outcomes from our supply chain improvement efforts to date and those that are still in progress clearly offer tangible value to the warfighter and taxpayer by providing increasingly effective and efficient logistical services.

In closing, again I thank you Mr. Chairman for the opportunity to testify today on the important issues associated with the DoD supply chain and logistics. I trust my testimony has provided you with a clearer picture of the substantial progress that we have made to mitigate the high risk designation and justify its removal. More importantly, I hope my testimony has shown you the evolutionary nature of the improvements we have and continue to make in the effectiveness, efficiency and accountability of the DoD supply chain and how our focus remains on delivering the logistics support to our warfighters they justly deserve and need. I look forward to continuing to work with you in that effort.

Thank you and I would be happy to answer any questions you and the Members of the Committee may have.