THE NATURE AND FUNCTIONING OF THE
ARMY AND AIR FORCE POST EXCHANGE SYSTEM

DISSERTATION

Presented in Partial Fulfillment of the Requirements for the
Degree Doctor of Philosophy in the Graduate School
of The Ohio State University

BY

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* * * * *

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Organization
This study of the post exchange system was begun in January, 1959, shortly after the writer entered the United States Air Force for a three year active service tour. It was undertaken because little is generally known about military exchanges and considerable confusion exists as to their real nature and significance, as well as to the best solutions of the many problems confronting them. There was an opportunity, therefore, to clarify this entire area and, on the basis of the analysis, to make suggestions which would serve to improve current exchange operating practices.

In an undertaking of this type, my obligations are of course manifold. I cannot begin to enumerate the names of all of the individuals who assisted me in the course of the study, but it is gratifying to state that there was not a single instance where I did not receive their full cooperation.

It is necessary to express my special appreciation to Colonel Donald J. Green, Dean of the Air Force School of Logistics, who in a very real sense was the sponsor of this research effort. It was his early recognition of the potential of such a study that permitted me to have the time and resources necessary to bring the work to completion. His constant encouragement and assistance will not be forgotten.

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Finally, I would like to state my obligation to my wife, Anne Goetz Doody, not only for typing and retyping the manuscript, but more than that, for tolerating and sustaining her husband during the course of composition.

ALTON F. DOODY, JR. 

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CHAPTER I

INTRODUCTION

Historically there has almost always been some type of marketing system established to meet the soldier's personal needs and wants. In the United States military service this has gradually evolved into what has come to be the exchange system. Briefly, this is a loose confederation of retail establishments that sell a limited variety of goods and services to a restricted market comprised primarily of persons engaged in active military service and their dependents.

PURPOSE AND SCOPE OF STUDY

The general purpose of this study is critically to analyze the development and present status of the military exchange system as it is operated in the Army and the Air Force. This is done primarily from a marketing viewpoint, but military, managerial, and economic factors are also necessarily considered. At the present time, there does not exist in the literature a comprehensive analysis of the significance of military exchanges. Instead, fragmentary information pertaining to this subject is scattered throughout various governmental publications as well as trade and business publications. This study is an attempt to draw together this information in order to clarify the role or function of the military exchange and to determine, through original research, more accurately its importance in the marketing structure and the economic system generally.
More specifically, the following objectives are considered in this dissertation:

1. A study of the origin, growth, and development of the military exchange in order to understand its present role in the military organization.

2. A study of the legal status of the Exchange System in order to uncover the organic laws, derivative laws, and regulations which govern its existence.

3. An analysis of the nature and functioning of the Army and Air Force exchange system in order to determine why exchanges operate the way they do. This will involve an examination of qualitative and quantitative factors relating to exchange activities with a view toward suggesting improvements in the efficiency of operations wherever practical.

4. An examination and evaluation of the controversial aspects of the exchange system, the major criticisms of exchange activities and the military views defending the system.

These topics form in a general way a skeleton outline of this dissertation. Emphasis is placed on these factors because it is felt that an understanding of them will help clarify this little known and often misunderstood retailing activity.

NEED FOR STUDY

Information that is available about military exchanges reveals that considerable confusion exists as to the purpose and significance of this military support operation. This can be seen by examining
pertinent congressional hearings, Hoover Commission Reports, complaints by retail merchants, statements made by the press, and conflicting statements of purpose even on the part of the military organization.

Congressional hearings are replete with testimony by trade associations and local business groups which protest the existence of military exchanges as they are now operated. These groups claim that the exchange is discriminatory and contrary to our whole system of private business enterprise based on workable competition. On the other hand, military leaders testify that the exchange is an integral logistics support operation and that the undermining of the system would seriously injure the morale of the soldier and airman.

The need for further study in this area is effectively pointed out by the Hoover Commission which states:

It is evident that the entire organizational structure, as well as the operations, of these non-appropriated fund instrumentalities must be thoroughly studied; and appropriate legislation must be enacted and administrative action taken to remedy the confusion which exists, and to deal with the many substantial problems which result from it.¹

In 1957, Mr. Rowland Jones, representing the view of the American Retail Federation, recommended to a special Congressional subcommittee that:

A thorough study of military stores be made, with ample opportunity for both sides to state their basic philosophy on the subject. Such a study might well provide permanent answers to many of the questions which now recur constantly. As well as stating definitely the Congressional intent as to the function of a military store, it could provide more precise definitions as to what actually does constitute an item of necessity, or comfort, or convenience. It could define questions of hardship and what constitutes an isolated location. These questions are presently unanswered in any satisfactory manner. These questions, and many others, might be settled once and for all by a thorough study of the functions, scope and operations of military stores.²

Even if this controversy did not exist, there would still be a need to investigate the present organization and operation of the military exchange system. This inquiry should be undertaken to determine exactly the kind of marketing organization the exchange is, what marketing functions it performs and how well it performs them, how important the exchange system is from a military as well as a marketing viewpoint and whether or not it operates within the spirit of the law. An attempt will be made to answer these questions.

LIMITATIONS TO THE ANALYSIS

This undertaking is subject to a number of pertinent limitations. The following appear to be the most significant.

1. The study is restricted primarily to military exchange operations as they operate in the Army and the Air Force. No attempt is made to analyze other service organizations that are operated by the military in a manner similar to the exchange. Therefore, little mention is made of commissary sales stores (food stores), officers' clubs, base restaurants, base theaters, base swimming pools, and other such organizations.

2. The study is almost altogether confined to analysis of the domestic activities of the exchange system as it operates in the Army and the Air Force. Thus, the Navy Ships Stores System, Marine Corps exchanges, and the activities of exchanges as they operate abroad are not considered in detail. These matters are considered only when pointing out important differences that exist between them and the domestic Army and Air Force exchange system.

3. The effectiveness of the exchange system as a logistics support operation undoubtedly would be greater if it were not for the limitations and restrictions placed upon it by Congress. This study does not deal with any changes which would not be allowed by present legislation because exploration of such changes may well be considered to be an impractical and unrealistic approach.

4. This dissertation is a general study which analyzes the exchange system from an over-all viewpoint. Consequently, it does not attempt a detailed evaluation of such specific management problems as warehousing or inventory control. These are intricate subjects in themselves; many of them would be appropriate topics for further research.
DEFINITIONS OF TERMS

To facilitate understanding of the subject herein discussed, the following terms are defined because of their importance and frequent appearance.

Headquarters Army and Air Force Exchange Service

This agency, located in New York City, is a joint activity of the Army and the Air Force. Within the continental United States, its purpose is to provide important services and assistance to installation commanders and their exchange managers. This headquarters acts primarily in a staff advisory capacity by prescribing over-all policies and procedures for accounting, auditing and control, operations, merchandising and personnel. These policies and procedures are submitted to the Department of the Army and Air Force for dissemination through command channels. With regard to overseas operations, this headquarters also serves as the central procurement agency for goods manufactured in the United States and sold in exchanges abroad.

Regional Service Centers

These offices are under the supervision of Headquarters Army and Air Force Exchange Service. There are four and they are located in Atlanta, Baltimore, San Francisco, and San Antonio. The purpose of these offices is twofold. First, they perform on a centralized basis the accounting and financial function for all exchanges within their respective region. Second, they assist in liaison between Headquarters Exchange Service and the individual exchange on the
operating level, and they help the exchange implement the policies established at the Headquarters level.

Post or Base Exchange

The exchange is a broad term that includes a number of retailing activities on an operating level. It refers to a complex of retail establishments at a particular installation that sell a limited variety of goods and services to authorized patrons for personal consumption purposes. Most exchange facilities are directly owned and operated by the military service. However, a number of service activities, such as barber and dry cleaning shops, are sometimes operated on a concessionaire basis similar to leased departments in a department store. Generally speaking, the "post" exchange or the "PX" refers to an Army exchange whereas the "base" exchange or "BX" refers to an Air Force operation. Both Army and Air Force exchanges are operated in the same manner and under the same basic regulations.

The Exchange System

This term, as it is used in this study, refers to the over-all exchange operation as it exists at the present time in the Army and the Air Force. It embraces all of the various groups mentioned above.
SOURCES AND METHODS

This study is based in part on an investigation and analysis of data available in published form. The following are included among the important sources of information of this type:

1. Congressional hearings and committee reports.
2. The Hoover Commission Reports.
3. Public Laws and court cases applicable to the exchange operation.
6. Census of Business data.
7. Trade and business newspapers and periodicals.
8. Authoritative texts in the field of marketing, particularly wholesaling and retailing.

In addition to the above published data, the following primary sources of information have been utilized:

1. Interviews with executives of the exchange system at the headquarters level, the service center level, the command level, and the installation level as well as with other individuals having knowledge of exchange operations.
2. Internal records and reports prepared at various levels in the exchange system, particularly purchase orders, retail inventory records, and financial records.
3. Specialized studies related to some segment of the exchange system.
The study is a serious attempt to understand the nature of the exchange system and the manner in which it functions as a unique type of marketing institution. Exchange operations will therefore be evaluated against certain well-established marketing principles or fundamentals. Historical aspects and the specific types of goods sold in exchanges are considered to the extent that they facilitate understanding of the over-all system.
CHAPTER II

THE ORIGIN AND DEVELOPMENT OF THE
ARMY-AIR FORCE EXCHANGE SYSTEM

Throughout military history the itinerant trader has followed
the army wherever it has gone. History records the activities of
such traders during the days of ancient Rome when the legionnaires
would purchase items of ordinary need from vendors located along the
Via Quintana. In fact, the word "Quintana" means the market or busi­
ness place of the camp.¹ This Latin word is believed to be the gene­
sis of the word "canteen" in English language.²

THE PERIOD BEFORE 1890

Early History of the Post Traders in the United States

In the military history of the United States, the need for a
marketing system which would satisfy the troops' needs was recognized
during the days of the Continental Army in 1776. Under the Articles
of War, 1776, the need for official action to authorize such a system
was acknowledged and civilian traders were given sales concessions to
supply General Washington's army with chewing tobacco, snuff, blan­
kets, knives, and other items of "ordinary use."³

¹Webster's New International Dictionary, Second Edition


³"Background Information on Exchange Service," Headquarters Army
and Air Force Exchange Service, 8 West 14th St., New York, N. Y., no
date, p. 1 (mimeographed).
These itinerant peddlers and camp followers were known as "sutlers" or "hawkers," words defined as those "who follow an army and sell to the troops provisions, liquors and the like." For almost a hundred years the sutler was the primary supplier of non-military type goods to army troops.

The reputation of these early traders was almost always unfavorable. They operated independently of one another and were not a true part of the military establishment. For this reason their business practices could not be satisfactorily restrained. The lack of controls led to the sale of inferior merchandise, usurious credit, and exorbitant prices. By the end of the War Between the States it became apparent that soldiers were being victimized by camp followers who not only sold shoddy goods but whose activities included corrupt, unsavory enterprises as well.

Reform Following the War Between the States

Following the War Between the States, Congress on July 28, 1866, gave consideration to the questionable practices of the existing sutler system and abolished the Army Sutlers' Office by an act of Congress. In an effort to assert some military control over sales outlets servicing the soldier, Congress in 1867 instituted the Post

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3. 14 US 366 (1866).
Trader System. The system provided for post traders who were permitted to locate small stores within the military camp itself. This method of operation was more permanent and effective than the wagons of sutlers, but there was still little supervision by military authorities and many of the abuses persisted.

Besides questionable practices, the post trade system suffered from another serious limitation— incomplete coverage. The post trader operated successfully at the larger, well-established military installations where sales were relatively high, but services to smaller posts were very unsatisfactory. With continued westward expansion the situation did not improve. Some of the newly established frontier posts often had no trading establishments of any kind. As a result, the officers assigned to these outlying posts frequently found themselves inadequately supplied with daily necessity requirements. Although enlisted men also lacked these requirements, it was a more serious problem for officers as they earned a higher income and were accustomed to a higher standard of living. Also, many of the officers had families which would accompany them even to these outlying posts.

The Canteen— A Cooperative Venture

In order to rectify the situation, the officers faced with this dilemma joined together to form cooperative "canteens" out of their own funds. These organizations were in the nature of social clubs,

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7Senate Joint Resolution, SR 35, 40th Congress, Session I, 1867.

voluntarily formed by a regiment or other unit of command and conducted independently of official duties. In addition to their social function, these canteens sold articles of everyday use and consumption to members and their families. The entire venture was operated on a nonprofit basis. These canteens were not an official function of the Government and they were required to pay the internal revenue tax the same as any other social club selling tobacco, cigars, and liquor to its members.  

During the latter part of the nineteenth century, the canteen idea spread rapidly throughout the U. S. military service. The War Department recognized the benefits derived from the operation of canteens and gave the idea official sanction. It then proceeded to extend the canteen system for the benefit of enlisted personnel. 

An insight into the success of the canteen system can be gained by a consideration of marketing fundamentals. A well-established marketing principle states that "when the need for a new type of (marketing) institution is apparent, it will tend to be evolved." As shown by the foregoing discussion, there was a definite need in the isolated army post for some type of establishment which would


serve jointly as a social club and a store which could provide items of ordinary use to the soldier and his family. Obviously, the need was not being adequately met by the post trader who usually operated only at the more permanently established and the larger military installations. This led to the institution and gradual development of an alternate system which could perform the needed social and marketing functions.

Toward the turn of the century, the canteen idea had become so popular that it spread even to the larger installations which were already being served by post traders. On the surface, this would appear to be a contradiction to the principle stated above. Why could the canteen prosper when the post trader was already doing the job? The facts were that the canteen was not merely a duplication of the post trading store but something else again. The canteen system had certain inherent advantages which explain its growth and success.

In the first place, the post trading store met only part of the soldiers' needs. It provided certain goods but did not serve as a social and recreational center for the officers and their men.

Second, in spite of the fact that the post trader system was an improvement over the corrupt sutler system, many of the abuses of the former system continued to exist. The honesty of the merchant could not be assured merely by having him transfer his wares from a wagon to a more permanent facility. The military still did not have any direct control over the variety, price or quality of the merchandise handled by the post traders.
Evidence of continued corruption in the post traders system reached all the way to the cabinet level during President Grant's Administration (1868-1872). This scandal involved Secretary of War Belknap, who appointed merchants as post traders at army posts and Indian reservations. Congress discovered that the post trader at Fort Sill was paying on the side $12,000 a year for this privilege and that part of the money was going directly to the wife of Secretary Belknap. It was also discovered that the Fort Sill post trader was selling "shoddy blankets and bad food." Although Congress moved to impeach Secretary Belknap, Grant quickly accepted his resignation in order to avoid further scandal to his already tottering administration.

Finally, the canteen was a type of cooperative venture that possessed many of the qualifications found necessary for the success of this type of establishment. Another marketing principle states:

The success of a consumers' cooperative rests, in addition to efficient business management, upon its proximity to a sufficiently large, homogeneous, economy-minded membership willing to subordinate individual tastes and actions to group welfare.

A modest review of American history clearly points out the existence of a strong community of interest within the military situation

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13 Ibid.

14 Beckman, *op. cit.*, p. 15.
during those earlier years. In fact, in many of the sparsely popu—
lated frontier areas there simply was no logical alternative to sur-
vival. The welfare of the soldier and his family depended upon the
ability of the military post to provide for almost all needs—social,
religious, economic, as well as physical protection. Even today
military leaders attest to a strong community of interest within the
military establishment. Frequent job rotations and the assignment
of personnel to relatively isolated areas tend to strengthen this
feeling of common interest.

The modest income of the soldier, particularly in those earlier
years, meant that he and his family had to be interested in economiz—
ing wherever possible; consequently, they had to be content with a
limited variety of basic commodities to satisfy their wants. These
factors, taken together, suggest that the military market was suf-
ficiently homogeneous and economy minded to make a cooperative venture
work.

EMERGENCE OF THE POST EXCHANGE

By 1889, the post canteen system had become so successful that
the War Department carried its endorsement a step farther by publish—
ing rules and regulations for the operation and management of these
canteens. The first of these was General Order No. 10, Adjutant

15"Hearings Before Special Subcommittee on Military Exchange
Matters," No. 52, House of Representatives, Special Subcommittee for
p. 3338.
General's Office, February 1, 1889. Three years later, in 1892, Congress accorded recognition to post canteens by authorizing them to use public transportation and public buildings.

The following year, on January 28, 1893, Congress passed a law which would eventually bring to an end the post trader system. The significance of this law is that it reveals the intention of Congress to support the canteen system as a more effective means of meeting the soldier's personal needs than the post trader system. This law has been subject to a considerable degree of misinterpretation in that it is often stated that Congress "abolished" the post trader system in that year. This implies that all post trading stores were closed as of 1893. This is not the case, however. The intention of the law as stated by Congress is as follows:

That where a vacancy now exists or hereafter occurs in the position of post trader at any military post it shall not be filled, and the authority to make such appointment is hereby terminated.

Thus, it can be seen that all post trading stores were not closed in 1893. The law merely required that no more of them be established after the act became effective.

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17 S. Doc. No. 149, 72nd Congress.
18 "Hearings Before Special Subcommittee on Retail Activities of Armed Services," 1949, op. cit., p. 3473.
19 27 US 426 (1893).
On July 25, 1895, under Army regulations adopted by the War Department, post exchanges were officially established. This regulation (General Order No. 46) required that every commander, where practical, establish an exchange and "set apart, rent, or construct" a suitable building or rooms for this purpose. The rent or expense of erecting such a building was to come out of the exchange fund of which the post commander was the custodian. This regulation further required the commander to appoint an officer in charge of the exchange whose responsibility would be to manage its affairs under the supervision of a council of three officers also appointed by the commander.

This regulation, in the beginning paragraph, outlined the purpose of the exchange, the core of which is essentially the same today:

The Post Exchange will combine the features of reading and recreation rooms, a cooperative store, and a restaurant. Its primary purpose is to supply the troops at reasonable prices with the articles of ordinary use, wear, and consumption, not supplied by the Government, and to afford them means of rational recreation and amusement.

With the adoption of this regulation the marketing system which provided for the needs of the soldier was significantly changed. Although the canteen idea provided the basis for the post exchange, there were essential differences between the two. These differences had to do with matters of official recognition, support, regulation, and ownership. Whereas the canteen was an informal type of cooperative

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store supported originally by funds of individual members, the post
exchange became an instrumentality of the government with correspond­
ing privileges and restrictions.

Under the new system, funds needed to support the exchange were
contributed by organizational units assigned to the post. These units
had what amounted to a pro-rata stock interest in the exchange. If
the exchange was profitable, the profits were distributed to these
units at the end of the year. If it was unprofitable, each unit
would contribute an additional amount of money in support of the ex­
change. Money contributed to the exchange came from the organization's
fund which was indirectly derived in turn from appropriated money from
Congress.

Today the exchange system is generally categorized as a "non-ap­
propriated fund" instrumentality. The distinction is made because
exchange activities, for the most part, are not directly supported
from appropriated money approved by Congress. At the turn of the
century, however, a much larger part of the capital needed to operate
an exchange came from appropriated funds, a fact which is not widely
understood.

The roundabout method that was used to finance the exchange from
appropriated funds is explained in the following way. Under the post
exchange regulation of 1895, individuals ceased to be cooperative
members of the exchange as they were under the canteen system.

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21 Public Law 397, 82nd Congress, 66 Stat. 138-139.
Membership was now restricted to the various military organizations that were attached to the army post. These organizations were of different sizes and took a variety of forms, such as companies and detachments. The exchange council, composed of three officers designated by the post commander, had the responsibility of determining the contribution that each organizational unit had to make toward the support of the exchange. Each unit had to pay its "proportionate part of the expense attending the fitting up and stocking the establishment." This held true at posts establishing an exchange for the first time and for units newly assigned to a post that already had an exchange. It is at this point that the exchange became indirectly supported by Government money in those earlier days, inasmuch as the individual company's fund was derived from Congressional appropriations.

By law every soldier in the army is entitled to a monthly subsistence (food) ration. In those earlier days, this ration was not issued, as a general rule, to the individual soldier. Rather, an aggregate ration was issued to the commander of a unit. This enabled him to form a "mess" or common table for all members of the organization. As the combined subsistence ration was almost always in excess of what was needed for consumption, there was a surplus food ration each month. The unit commander was then required by law to sell this surplus back to the commissary department at invoice prices if

22"General Orders, No. 46," op. cit., paragraph 19.
it was needed for reissue; if it was not needed, the unit commander was authorized to sell it to "any person." It was in this way that each organization was able to acquire a working fund which could be used for other activities, one of which was the support of the post exchange.

If the exchange was profitable, the unit commander could use exchange profits for any activity designed to improve the morale of the organization. On the withdrawal of the troops from an army installation, under paragraph 20 of General Order 46, the exchange stock was to be reduced as far as possible and converted into cash for the equitable distribution among the member organizations. This was to be done under the supervision of the exchange council. Funds were not distributed to the individual soldier.

These facts are presented here because they explain how the various organizational units obtained the fund they were required to contribute to the exchange. No mention is made of this in the existing literature concerning the genesis of the post exchange.

Today, exchanges receive only minor support from appropriated funds, principally in that they pay no rent nor do they pay the salaries of the few military personnel assigned to exchanges. This support has been traditional and has been given since the early days of the system in 1895.

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2318 US 410 (1875).

The Period Between 1900 and 1941

The operational framework of the post exchange was left almost unaltered from the turn of the century until 1941. While there was some variation, reflecting the specific needs of a particular period, the general pattern that evolved was one of independent operation on an army divisional level. As a result, at large posts each division was authorized to establish a separate post exchange to serve that unit. Frequently, there were several completely unrelated exchanges at the same installation, with no uniformity in merchandising, accounting, pricing, or assortment of goods. Direction from higher echelons was almost non-existent and there were few controls over exchange activities.\textsuperscript{25}

The marketing and organizational weaknesses of the post exchange system, as it was operated during this period, became readily apparent during World War I. During that war, it was discovered that the exchange system was totally inadequate because it could not handle the needs of a greatly expanded armed force. General Pershing, Commander-in-Chief, recognized this difficulty and sought the aid of civilian welfare agencies to provide expanded canteen service. The principal agencies involved were the YMCA and the U. S. Red Cross Society. Unfortunately, these agencies, although willing, were not experienced or equipped to meet the needs of the military on such short notice, particularly in combat.

In spite of the ineffectiveness of the post exchange during World War I, no effort was made to modify the existing system following the war. This can be explained in large measure by the generally complacent attitude of the Congress and the American public toward the military after the war was won. After all, it was the war to "end all wars" and little attention needed to be given to military problems when there was to be lasting peace. This attitude prevailed for the next twenty years. Consequently, there was no significant change in the post exchange system during this period. This corresponds closely to the retrenched and dormant position of the United States Army in general through 1939.

Beginning of a Centralized Exchange System

In 1940, with the majority of Europe and Asia once again embroiled in war, public policy and official action toward the military services underwent rapid change. It was during this year that the Selective Service Act mobilized an unprecedented peace-time army under the command of General George C. Marshall, Army Chief of Staff. General Marshall was aware that the existing post exchange system could not adequately meet the needs of this much larger citizens' army. Hence, he asked Donald Nelson, who was later to become Director of the War Production Board and who had experience in merchandising at Sears, Roebuck and Company, to appoint a committee of merchandising executives to study the exchange system and to make recommendations which would enhance its effectiveness.
After a thorough study and inspection of various post exchanges throughout the country, this advisory committee submitted its report to General Marshall on April 4, 1941. The investigation of this committee served two purposes. First, it clearly pointed out the major difficulties that were inherent in the existing system. Second, it provided the basis for recommendations to the War Department calling for a reorganization of the exchange system. Since the policies and organization of the present system stem in large measure from these findings, they are restated below:

1. That there is a general agreement among officers of the Army, with which this committee concurs, that exchanges are second only to the soldier's mess as a factor in building morale.

2. That there is greater efficiency in the operation of exchanges where there is a central post or camp exchange, with branches, rather than individual exchanges operated by each division or other organization.

3. That insufficient attention has been given to the selection of post exchange officers with respect to their ability, aptitude, inclinations, or training for this duty.

4. That exchange officers are given practically none of the aids for successful operation which would be expected by a person entrusted with similar responsibilities in the business world. The same fundamental principles of sound civilian retail store management are applicable to the management of exchanges.

5. That exchange employees are generally untrained, inefficient and lacking in personality and sales appeal. Wages are low and hours indefinite. No thought has been given to fundamental personnel policies relating to security, health, accidents, old-age, disability, promotions, vacations and employee relations. Transportation, housing, sanitation and eating facilities are particularly inadequate in isolated camps.
6. That under the present system, operating policies are on occasion influenced unwisely by the commanding officer and the exchange council by their desire for dividends.

7. That no capital is available to purchase the necessary equipment, the initial stock of merchandise, or to meet the payrolls of the exchange employees in new exchanges, or for the expansion of established exchanges.

8. That stock ownership in exchanges by organizational units overemphasizes the profit and dividend phase of exchange operations and is not to the best interests of the soldier.

9. That the selling of food and other merchandise that should be a part of exchange operations is frequently handled through concessions with the result that the soldiers do not receive as great a value for their money as they should.

10. That a wide variation exists in exchange operations, personnel policies, purchasing, accounting, fixtures, store lay-outs, varieties of merchandise, prices on essentials, markups, profits, attractiveness and cleanliness.

11. That the principal cause of the defects in the present exchange system is the lack of centralized control.  

In short, the exchange service, as it was operating in 1941, was entirely inadequate to meet the needs of a greatly expanded armed force. Its operations were badly disorganized in that the exchange violated many sound merchandising and management practices and policies.

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On the basis of the above findings, this advisory committee summarized its recommendations as follows:

Because efficient operation of exchanges is such an important factor in building morale, the organizing and operating of exchanges require the management of a central organization in the War Department to initiate policies, provide methods for procuring funds, and provide uniform methods of operation, personnel, audit and control. The head of the central organization must have the authority to carry out policies and enforce rules and regulations.

Reorganization During World War II

Based upon the findings and recommendations of the Nelson Advisory Committee, several efforts were made to improve the exchange service during the war.

The first measure taken was the establishment of the Army Exchange Service in 1941. This was a separate agency in the Morale Branch of the War Department. It served in a technical staff capacity to the individual post exchanges. Its mission was to render advice on such matters as merchandising, accounting, and finance, personnel practices, and other information pertinent to the effective operation of an exchange. It also provided a plan whereby a new or expanding exchange could finance its operations by borrowing money from the Army Exchange Service.

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27 Ibid., p. 4.
28 War Department Circular 124, June 28, 1941, and Army Regulation 210-65, July 1, 1941.
29 General Joseph W. Byron, Director of Special Services, Testimony before Senate Committee Investigating the Nation's Defense Program, July 10, 1945, United States Senate, From a mimeographed copy of the testimony, p. 3.
In 1943, the Army Exchange Service was removed from the Morale Branch of the War Department and became part of the Special Services Division in the Office of the Director of Personnel, Armed Service Forces. This move did not change the function of the Army Exchange Service in that it remained essentially a staff agency acting in an advisory capacity.

During World War II, each post exchange was still an autonomous unit whose activities were the responsibility of the installation commander. Each exchange could still operate very much like an independent store so long as it did not deviate radically from the general policies established by the Army Exchange Service. When it did become necessary to enforce such policies, this was done through regular command channels and not directly by the Exchange Service.

One of the most valuable contributions made by the Army Exchange Service was in the way it handled overseas exchange operations. Unlike the domestic exchange setup, the Army Exchange Service was the central purchasing headquarters for a large number of items sold in overseas exchange stores. Some standard items, such as razor blades and toothpaste, were sold to the exchange directly from the Quartermaster Corps but almost everything else was procured by the Exchange Service from its New York office.

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30 Colonel Treusch, Testimony before the Senate Small Business Committee, Feb. 24, 1943, United States Senate, From a mimeographed copy of the testimony, pp. 3-12.

31 Ibid.
In discussing exchange operations during this period it is important to emphasize that the War Department did not adopt the Nelson Committee findings altogether. Statements are frequently made to imply that these findings were implemented fully. It is true that many of the recommendations were adopted, including:

1. A more careful selection of exchange officers.
2. A system whereby exchanges could obtain financial assistance.
3. More careful procedures for accounting, auditing, and control.
4. Abandonment of organizational ownership in exchanges.
5. Revision of some merchandising aids from the Exchange Service.\textsuperscript{32}

The Committee's major recommendation, however, was not adopted. This was the suggestion that exchange operations be centralized for purposes of control and that the "head of the central organization must have the authority to carry out policies and enforce rules and regulations." The fact is that during the war the Exchange Service acted primarily in a staff capacity and that it relied on command channels for policy implementation. Exchanges, for the most part, were still independent operations. To a lesser degree, the same situation prevails today.

\textsuperscript{32} General Joseph W. Byron, Testimony before Senate Small Business Committee, Feb. 24, 1943, United States Senate, From a mimeographed copy of the testimony, pp. 5 and 37.
This does not make the findings of the Nelson Committee unim­
portant, however. More than anything else, this committee's work
served to dramatize to high ranking officials the condition of the
post exchange in 1941. The findings are significant not only because
of the reforms that were made during the war but also because the
study has provided the basis for further modifications in the post­
war period to be discussed in the pages immediately following.

POST WORLD WAR II DEVELOPMENT
OF THE EXCHANGE SYSTEM

The years following the Second World War saw a gradual trend
toward greater centralization of the exchange system. By the end of
the war, it became apparent that a number of revisions were in order
if the services offered by exchanges were to be improved. In the
first place, certain alterations were necessary because of the
greatly reduced peacetime army. Second, the exchange system was
still far from being an efficient, well run retailing organization.
During the war exchanges were still for the most part autonomous, in­
dependent retail establishments. Each exchange maintained its own
accounting records and bookkeepers and each established its own
merchandise policies. Drastic differences were found among exchanges
relative to prices, quality, services offered, and merchandise depth,
breadth and assortment. Although many of these differences can be
attributed to varying local needs and conditions, the extent to which
exchanges varied from post to post made the over-all situation
undesirable. Military personnel were discouraged to observe the
contrast that existed between exchanges—some offering a wide variety of merchandise and services and others offering very little of anything. Under the existing system, almost all operating decisions were made by local exchange officers, the majority of whom had little if any merchandising experience prior to the war. To make matters worse in 1945, exchange personnel who did have retailing experience were now leaving the service since the war had ended. These individuals were now returning to civilian merchandising organizations.

A third important difficulty noted during the war was the manner in which exchange profits were distributed. In keeping with the tradition of the earlier exchange system, these profits continued to be distributed to welfare funds for the benefit of the soldier and airman and were used for a variety of activities such as recreation and entertainment. These funds were to provide for the comfort, pleasure, and contentment of military personnel and to improve their spiritual, mental and physical well being. The problem that arose was the unequal distribution of these welfare funds. Under the wartime system, each exchange supported welfare activities primarily at the particular installation at which it was located. As would be expected, exchanges located at large military installations did a flourishing business whereas small exchanges, because of insufficient volume, did not. In addition, due to the system that was used to determine profits, the newly established installations were also without welfare funds as practically all of their resources were being used for capital expenditures and investment in inventory. This
frequently left large profits available to support welfare activities at the larger, well established installations and practically nothing at the newer and smaller ones.\textsuperscript{33} This was an obviously unfair situation because the soldier had little control over his assignment and because many soldiers had contributed to the prosperity of the larger exchanges where they had previously been stationed.

At a conference of exchange officers in New Orleans in 1945, the main problems in the exchange operation were discussed and it became clear that some changes in existing operations should be made. Accordingly, a recommendation was submitted to the War Department proposing that the exchange system be further centralized to give the Army Exchange Service greater control over operations. Due to the large number of exchanges involved, the proposal also called for the setting up of regional offices to work directly with the individual exchanges. These offices, established on a geographical basis corresponding to the major Army areas, were to assume completely some of the functions heretofore performed at the operating level and provide the individual exchanges with expert advice and assistance on other matters. The exchange at the post level was no longer to be responsible for its own bookkeeping and accounting work as these tasks were to be shifted to the regional offices. A variety of

\textsuperscript{33}During the war, provisions were made to provide some welfare funds for every installation, regardless of exchange profits, but the soldiers stationed at the installations with the more profitable exchanges continued to fair better.
services, such as merchandising and procurement aids, were now to be made available to the local exchange officer on a continuing basis. This was attempted during the war but the program was sporadic and not organized in a way to be of important assistance to the individual exchange. Although actual buying of merchandise was still to be handled at the installation level, purchases were now to be screened through the regional offices to determine whether or not merchandise was being procured in accordance with established merchandising policies and procedures.

An important part of the proposed reorganization concept had to do with the collection and distribution of exchange profits. Under the new system, exchange profits were to be turned over to the Army Central Welfare Fund for administration and distribution. This organization, in turn, was to redistribute the funds through command channels to the various organizational units in need of them. The result was that the soldier was now to receive the benefit of these funds at every installation, regardless of the size or profitability of the local exchange.

The War Department accepted the recommendations of this exchange conference and directed that the proposed reorganization of Army exchanges be put on trial in the Third Army Area. As might be expected, there were many difficulties with the new system at first. Many complaints were received by exchange officers and installation commanders who were quick to recommend that exchanges
should be returned to their former method of operation. In spite of these difficulties, the Commanding General of the Third Army realized there were real benefits being derived from the new system and recommended that the concept of centralization be extended to all Army Areas within the country.

During this trial operation, two important studies of exchange operations were conducted. The first, made at the request of the Secretary of War, was undertaken by George Fry and Associates, Chicago, Illinois, between September, 1946, and March, 1947. The study was essentially a survey covering all business phases of Army exchange operations throughout the world. Upon its completion, the firm recommended that the trial program of centralization, already in operation within the Third Army Area, be extended throughout the country as rapidly as possible.

The second study was made at the request of the Army Chief of Staff to explore questions of military policy pertaining to the Army Exchange Service. The study was undertaken by the War Department.

Colonel Cordes F. Tiemann, USAF, conducted a survey in 1947 to determine the attitude of exchange officers toward centralization and other operating problems. He discovered that most exchange officers were opposed at that time to the new system. For further reference see: Tiemann, Cordes F., "Air Force Post Exchange System," an unpublished thesis submitted to the Air War College, Air University, 1948.

As late as 1954, in a survey conducted by Mr. Tony B. Hall for the Committee on Fiscal Organization & Procedures, Department of Defense, it was found that many commanders were still desirous of returning to the pre-war type of operation but that preponderance of commanders were in favor of some type of centralized control of PX operations. Taken from a thermofaxed copy of the report.
Policy Committee, which was chaired by Brigadier General Joseph W. Wood. In essential agreement with George Fry and Associates, the committee recommended in its report, dated March 7, 1947, that all domestic exchanges be centralized under the regional office concept.35

On the basis of the test in the Third Army Area and the recommendations mentioned above, the concept of centralization was extended in 1947 to include the First, Second, Fourth, and Fifth Army Areas along with the military district of Washington. In February, 1948, with the expansion to the Sixth Army Area, the reorganization of all Army exchange operations in the United States was complete. The pattern that developed involved the establishment of a regional office for each of the Army Areas. These offices, in turn, served all exchanges within the area and acted as a coordinating agency between the operating exchange and Headquarters Exchange Service in New York.

The Army Exchange Service Becomes a Joint Army and Air Force Activity

Prior to 1948, there was no separate branch of the military service which concentrated primarily on air power. Rather than this, each military service—the Army, Navy, and Marine Corps—had its own air arm which has been traditionally used as a tactical support weapon in ground and sea warfare. However, between 1941 and 1945 air power became a strategic force capable of tremendous destruction.

a role far greater than its traditional one as a support weapon for
ground and sea maneuvers. This new role of aircraft in military
defense was acknowledged in 1948 with the establishment of the Air
Force as an autonomous service branch.

Concerning exchange operations, the Air Force recognized that
it was scheduled to lose the services which heretofore had been
provided by the Army Exchange Service. In order to avoid this, the
Army and Air Force worked out a plan whereby the exchange service
and its regional offices would become a joint activity utilized by
both services. This led to the redesignation of the Army Exchange
Service as the Army and Air Force Exchange Service.

The Period From 1949 to 1957

Based on the reorganization following World War II, the domes-
tic exchange system shifted more and more toward a centralized
system whereby the Headquarters in New York and the regional offices
assumed a large share of the operating responsibility for the local
exchanges. Technically speaking and in terms of military organi-
ization theory, the local commander continued to have operating
responsibility. In practice, however, most of the important matters
were being decided by individuals within the exchange system itself.
These included such matters as personnel policies, budgetary controls, profit objectives, pricing policies, and many aspects of merchandising. The existence of this situation was verified by the "Robinson Report" which stated:

A tendency was noted on the part of Headquarters and regional office personnel to think and talk in terms of highly centralized operations and complete control over the Exchange Operations, while giving only lip service to the principles that the Post Commander and his Exchange Officer have the operating responsibility. There is no question but that a large measure of practical control over the operations of the Exchange is exerted by the Headquarters, AES (now A & AFES) and the Regional Officer nor is there any question but that, technically, command jurisdiction still follows Army lines.36

This type of operation resulted in considerable confusion and conflict between 1949 and 1957. In essence, the difficulty was that no one really knew where the responsibility for each phase of exchange operations rested. The installation commanders, by virtue of traditional military organization and responsibilities, felt that they had final authority over exchange operations. On the other hand, as a result of the centralized merchandising organization that had evolved, the Headquarters and the regional offices exercised jurisdiction over many exchange matters.

By 1956, the confusion was felt to be sufficiently serious that a joint Army and Air Force exchange management survey was undertaken in an effort to clarify the responsibilities of the

respective parties involved. This survey recommended drastic curtailment of the activities of the Headquarters and the regional offices and the transfer of dominant operating responsibilities and technical supervision to the major Army and Air Force commands.  

Although it was recognized that some modifications in the existing organization structure were necessary, the majority of Army and Air Force major commanders did not concur with the recommendation as proposed by the management survey. These commanders recognized that there were important services being provided for them by the Headquarters and the regional offices, services which they might not be in a position to perform effectively for themselves. Accordingly, the Board of Directors, Army and Air Force Exchange Service, was requested to devise an alternative plan—one that would retain the basic exchange structure, but would clarify command and staff responsibilities and one that would be more responsive to individual command requirements.

The plan that was finally devised became known as the "Command Concept." Basically, it was a compromise plan which attempted to clarify lines of authority and responsibility without drastically

37 Major General Jacob E. Smart, Assistant Vice Chief of Staff, U. S. Air Force, in a letter to the Commander, Air Material Command, January 28, 1957.

38 Ibid.
curtailing the services provided by the Headquarters Exchange Service and the regional offices.\textsuperscript{39} This plan of reorganization was put into effect in 1957 and provides the basis for the organization structure existing in the exchange system at the present time.

\textsuperscript{39}By 1957, the number of regional offices had been reduced to five and redesignated as "Service Centers." In 1958, the number was reduced to four, which constitutes the number presently operated.
CHAPTER III

ORGANIZATION AND MANAGEMENT OF THE EXCHANGE SYSTEM

In Chapter II the origin and development of the Army and Air Force Exchange System was discussed. In it was pointed out that there has been a gradual trend toward greater supervision and control of exchange activities by the military service, particularly since World War II with the establishment of the Exchange Service and the regional service centers. This chapter presents information which pertains to the management and organization of the domestic exchange system as it exists at the present time. It is important to consider such matters carefully because they provide the basis for understanding the scope and pervasiveness of present exchange operations.

The reorganization that took place in 1957, known as the "Command Concept," provides the basis for the exchange system as it operates today. Although there have been continual refinements since then pertaining to operating procedures and policies, the present basic structure has remained the same.

THE COMMAND CONCEPT

As indicated in the previous chapter, the centralization of exchange activities following World War II led to a considerable amount of confusion concerning who was actually running the exchange.
The problem was the result of a failure to clearly define line and staff functions and lines of authority, responsibility, and accountability. In an effort to clarify this situation, the "command concept" was devised and implemented in 1957 and has been in effect ever since. Essentially, this involved a redefining of lines of authority and responsibility to conform to those which are traditionally used in military organizations. With the exception of a few very special activities, the military services operate on a decentralized basis, delegating actual performance to the lowest practical level of command. The Armed Services encourage this concept of organization because it permits decisions to be made by commanders who have intimate knowledge of local conditions and who are charged with prime responsibility. It is said that this system is advantageous in that it encourages initiative and provides for organization flexibility.

Under the command concept, the decision was made to give individuals in the primary chain of command, namely major commanders and installation commanders, the final say so with regard to exchange operations. As in the case of other activities, however, these commanders are responsible to see that exchange operations conform to the basic regulations which have been established to

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2 Ibid., p. 135.
govern them. It is in this way that the Board of Directors, the Headquarters Exchange Service, and the four regional service centers continue to influence operations at the installation level.

In order to understand the relationships involved, it is necessary to consider line and staff organization as it exists in the military services. Unlike most business organizations, in the military it is not unusual for a staff unit to be directed by the line organization to issue directives and exercise supervision "as may be directed to insure carrying out the intention and policies of the commander." Pertaining to the exchange system, this means that the Army and the Air Force have recognized the Board of Directors, the Headquarters Exchange Service, and the service centers as the staff agencies which establish basic policies and procedures to govern exchange operations. These policies and procedures are not issued directly by the staff units but through command channels in the name of the Chiefs of Staff, U. S. Army and U. S. Air Force. This is clearly spelled out in a recent revision of the basic exchange regulation which states:

Directives embodying policies, plans, programs, and procedures will be transmitted through command channels. Army and Air Force Exchange Service manuals and bulletins heretofore published by the Chief, A & AFES, will have the force and effect of command directives until republished through command channels.\(^4\)

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\(^3\)Ibid., p. 171.

\(^4\)Army Regulation 60-10-6a, Air Force Regulation 147-7A-C1, May 7, 1959, p. 1.
R. C. Davis recognizes the distinction between staff in business organizations and those of the military and states that the greatest difference lies "in the relations of staff responsibility and authority to command functions."5 In the military "the distinction between staff planning functions and staff control functions is not clear-cut. The staff in military organization coordinates both thought and action."6 In actual practice this means that the Headquarters Exchange Service and the service centers exercise considerable functional authority over individual exchanges. This is done, however, in light of policies and procedures which have been approved by the Army and the Air Force.

An example will help clarify the existing relationships. Merchandise for domestic exchanges is purchased on an individual exchange basis. Purchase orders, however, are not sent directly to vendors but first to the service center for approval. The service center reviews these orders to insure that purchases are being made in accordance with prescribed regulations. If a purchase order is disapproved, the matter is then discussed with the individual exchange. If the reason for the disapproval was because of a violation of the regulations, the operating exchange has no choice but to comply. If, on the other hand, the disapproval had to do with an interpretation of merchandising practice, such as the poor selection of goods, the exchange could proceed in contravention of

6Ibid., p. 429.
the advice offered by the service center. This is because many aspects of buying responsibility rest finally at the installation level. For instance, an Air Force exchange recently submitted a purchase order for a large dollar amount of costume jewelry. Upon receipt of this purchase order, the service center advised the exchange to reduce the amount of the order because it felt that the order would cause the exchange to have an excessive investment in costume jewelry, considering the size of the operation. As it turned out, the exchange buyer disagreed with the service center and insisted on placing the order as originally submitted. Under the circumstances, the service center had to process the order as the exchange was within its rights to have the final say in the matter. If, on the other hand, the order had been placed for merchandise that was not authorized for sale, the service center could have rejected it outright because it was a violation of the regulation and the exchange would have no recourse in the matter.

MAJOR ORGANIZATIONS IN THE EXCHANGE SYSTEM

In an effort to provide a workable understanding of the organizational relationships as they now exist, the following discussion of the basic functions performed at each level of the exchange system is presented. Included is an analysis of organizational problems that are encountered with the present system and suggestions for possible improvements within the basic structure that has been established.
The Board of Directors, Army and Air Force Exchange Service

This is the over-all policy making group responsible for directing the exchange system. It functions in a manner very similar to a Board of Directors in a large corporation in that it is primarily concerned with general guidance pertaining to matters of a general policy nature. The Board is composed of general officers appointed by the Comptroller, Deputy Personnel Chief, and the Deputy Logistics Chief from each service. As indicated by the organization chart on page 45, the Board reports directly to the Chiefs of Staff of the Army and Air Force who in turn report to their respective civilian secretaries.

Headquarters Army and Air Force Exchange Service

The Headquarters Exchange Service administers from the top level the operations, activities, and resources of the world-wide exchange system in accordance with directives issued by the Departments of the Army and the Air Force. Located in New York City, it serves in many respects as the hub and center of all exchange activities both domestic and overseas. Usually, a Major General is the Exchange Service's commander, a position which is alternated between the two services. The deputy commander, as a rule, is a Brigadier General always selected from the opposite service. In other words, when there is an Army man in the top position, the deputy position is filled by the Air Force, and vice versa.
Figure 1

Organization structure showing lines of authority and responsibility in the domestic Army and Air Force exchange system.
Pertaining to overseas operations, Headquarters Army and Air Force Exchange Service is active in operational matters, principally because it serves as the central procurement office for all domestic products sold in exchanges abroad. In this country it functions more as a policy making and service organization designed to assist and advise the major commands and the installation commands on the operation of their exchanges. As explained above, however, some functional control over operations is maintained.

The following services are performed for domestic exchanges at the Headquarters level. First, the Headquarters establishes markup schedules and retail price lists for various categories of goods authorized for sale. This function is handled at this level in accordance with a policy of the exchange system to maintain approximately the same price for a product throughout the country. As previously indicated, before the exchange reorganization following World War II, each exchange established its own markup schedules and its own pricing policies. The military looked upon this unfavorably as it was confusing to exchange patrons who would frequently find considerable price variation for identical merchandise sold in two different exchanges.

A second service performed at this level is the negotiation of price agreements with prime sources for certain types of merchandise. These price agreements are in effect open-end options to buy a particular item at a certain price irrespective of the fact that exchanges buy individually and in small quantities. These price
agreements are frequently an advantage to the individual exchanges, enabling them to obtain certain goods cheaper than would be possible if they were buying altogether on an independent basis. At other times however, as will be explained in Chapter VII, they are a decided disadvantage.

Headquarters Army and Air Force Exchange Service also determines over-all personnel policies, including such matters as the establishment of wage plans and an executive development program. It conducts management training programs for both exchange officers and civilian exchange management personnel. It is responsible for prescribing and administering the various insurance programs needed in the system. It publishes a monthly merchandise calendar of goods which are considered to be important in any one month or season and provides scouting of merchandise sources which would be overlooked by the individual exchange. In this connection merchandise catalogues of certain classes of goods are published to assist the local buyer in selecting the proper merchandise for his operation.

Legal problems relative to exchange operations are also handled largely at the Headquarters level. The legal status of exchanges, a subject covered in detail in the chapter which follows, is a relatively complicated matter and one which is best handled with the assistance of a specialized staff group like that found in the Headquarters office. Other functions performed at this level have to do with the supervision of an over-all accounting system and the administration of a cash fund which is used for the repair,
renovation, and expansion of exchange facilities. This fund amounts to approximately 2% of the annual domestic exchange volume. One percent of it is retained by Headquarters Army and Air Force Exchange Service for major projects that are in excess of $25,000. These larger projects must have the approval of the Exchange Board of Directors. The other half of this fund is retained by the major commanders to take care of smaller exchange projects which are needed within the command, such as repairs, new store fixtures, air conditioning and the like.

Finally, Headquarters Army and Air Force Exchange Service is responsible for conducting an extensive education and public relations program designed to clarify the role and position of the exchange system in the economy. Public relations are particularly important because of the frequent criticisms that are leveled against exchanges by retail groups and others throughout the country. This Headquarters acts as the official agency handling the matter of criticism before Congress. An analysis of this controversy and the Congressional hearings that have resulted are considered in a later section of this study.

Regional Service Centers

The primary function of the regional service center is to maintain liaison between the major commands, individual exchanges and the Headquarters Exchange Service relative to policies, procedures, operating problems, and other matters of mutual interest. This is accomplished in two ways. First, in an effort to avoid unnecessary
duplication, the service centers perform certain operating functions for the individual exchange, particularly with regard to finance and accounting matters. Each regional service center is responsible for maintaining the accounting records of all exchanges within its region, making disbursements for purchases initiated by the local exchange and maintaining all payroll records. In addition, the service centers make annual audits and render monthly financial statements to the Headquarters, the major commands, and the local exchanges.

By intent and regulation, the second major purpose of the service center is to act as a specialized staff agency which gives technical advice to the local exchange on matters relating to merchandising, budgeting and finance, personnel, services, and other matters. The Baltimore Service Center, for example, claims to assist the local exchanges in the following ways:

1. Review, analysis and compilation of exchange capital expenditure, profit and loss, and merchandise budgets.

2. Development of a retail merchandising program.

3. Planning for new or improved retail, food, and service activities.

4. Improving and expanding concession, amusement, and vending machine operations.

5. Advise on procedures to control direct and general administrative expenses in the operation of installation exchanges.

6. Establishing training programs in areas required.

7. Providing legal advice and services as pertain to the operation of exchanges.

9. Advise on sources of supplies to include retail merchandise, food items, expense supplies, etc.

10. Advise on procedures to improve customer services.

11. Standardizing and maintaining exchange owned equipment.

12. Interpreting exchange regulations and A & AFES publications as pertain to exchanges within each command.\(^7\)

Although a limited amount of assistance along the above lines is given, such help is largely perfunctory at this time and much more room for improvement exists. The essence of the difficulty is that the service centers are not adequately staffed with the technical personnel that would be required to perform the above functions. Under present service center organization, there is but a single field representative who is responsible for advising a number of local exchanges in all of the above areas. Under this arrangement, the average exchange is likely to see a service center representative only several times each year, and then for only a short period—a few days or a week at a time. This is because of the large number of exchanges assigned to each man and the amount of time that it takes to travel from one exchange to another. It is clear that one individual could never become an expert in all areas of merchandising, let alone other operating problems. Some of the above tasks are highly technical, requiring years of experience.

and education in order to gain true proficiency. A good example is the problem of stock turnover and inventory investment. Many exchanges still do not have a workable unit stock control system and are unable to establish one on their own. Technically speaking, the service center should recognize this deficiency and assist the exchange in correcting this matter. Under the present system, however, many of the service center field representatives do not themselves have the experience to establish a stock control system, to say nothing of the time that it would take to install such a system. Similarly, the service center field representatives are supposed to help the exchange manager in the preparation of annual budgets. Many exchange managers point out, however, that this has become a mere formality in that the field representative makes only a superficial perusal of the budget because time does not permit a more detailed analysis. Additional examples will be cited in other sections of this study.

According to one executive in the exchange system, the role of the service center is to assist the operating exchange in a manner that promotes "the highest degree of efficiency."\(^8\) To do this, it must be recognized that specialized, expert staff assistance and advice are needed. No one person can possibly give advice in all aspects of an operation as diverse as an exchange. Further, it must be recognized that some of the problems facing the local

\(^8\)Ibid.
exchanges are very complex and that it will take considerable time and effort to arrive at realistic solutions. Together, the above factors call for an expanded technical staff at the service center level if real operating improvements are to be made.

Command Responsibilities in the Exchange System

Under the "command concept" instituted in 1957, operating responsibility for domestic exchanges rests with the major Army and Air Force commanders who in turn delegate it to their installation commanders. At the major command level, coordination of exchange matters is usually delegated to a staff exchange officer who reports through channels to the commander's staff. The major function of the staff exchange officer is to serve as a coordinator between the major commander, Headquarters Exchange Service, and the regional service centers relative to exchange operations within the command. The staff exchange officer is expected to be familiar with exchange problems and to formulate policy regarding those operations within the commander's jurisdiction. Such policies, however, must be consistent with the basic exchange regulations as these represent policy from a higher level.

The exact role and influence of the staff exchange officer varies somewhat from one command to another. In practice, the part that he plays depends in large measure on his experience and knowledge of marketing and, particularly, retail merchandising. Unfortunately, many individuals assigned this responsibility do not have a background which lends itself to effective supervision of exchange
operations. In describing the buying function as it relates to the exchanges within one command, one staff exchange officer wrote:

"This headquarters flatly refuses to permit our exchanges to return to the Neanderthal Age of jobber procurement merchandising." Another has written:

I personally for many years have violently objected to such methods (use of wholesalers) as they invariably result in salesmen, jobbers, rackers, etc., performing the duties of the merchandise manager with additional costs to the exchange.

As will be explained carefully in the analysis of buying which follows, such statements are not necessarily true and they indicate a confusion with regard to the basic fundamentals of marketing. The results have been unfortunate, principally because the major commands have not been in a position to formulate sound policy and to supervise effectively exchange operations within their respective jurisdictions. Combined with inadequate staff assistance from the service centers, this has left the operating exchanges largely on their own, operating many phases of their operations on a haphazard basis.

Exchange Operations at the Installation Level

In accord with the decentralized concept of organization traditional to the military services, the installation commander, in addition to his major responsibilities, is responsible for providing a variety of support activities for the military personnel assigned to the installation. One of the most important such activities is the post or base exchange. Responsibility for the day-to-day
operations of the exchange is delegated to an exchange manager who may be a military officer or a civilian. In recent times, because of military manpower cut-backs, more and more of these managers have been civilians.

The exchange manager, within limits defined by the regulations, is responsible for the major operational matters relating to the exchange. Determined at this level are such factors as hours of operation, hours salesmen should call, and matters pertaining to the establishment of concessions and branch outlets. Also determined at this level are the number of people to be employed, along with their hiring and dismissal. Within authorized limits, the exchange decides which merchandise lines it will carry, along with brands, quantities, and suppliers. Other aspects of merchandising, such as display, store layout, sales training, are also left largely to the discretion of the exchange manager. Many of these subjects will be analyzed in detail in later sections of the study.

The caliber of the exchange manager greatly influences the success or failure of the exchange activities under his supervision. This is because domestic exchange operations, in spite of the regulations and the influence of the Headquarters, the service centers and the major commands, are still fairly independent operations. Many important decisions continue to be made at the operating level. This being the case, it is felt that additional emphasis should be placed on the development of exchange managers and others who work at the installation level.
This could be accomplished through a more effective educational program. The need for such an educational program is evidenced by a study made by the Air Force School of Logistics in April, 1960, which showed that of 33 exchange managers replying to a questionnaire, only 10 had ever had a college course in general marketing.\textsuperscript{9} Four of these ten had taken a course in retailing. When asked for suggestions which would improve exchange operations, almost all of the thirty-three managers expressed the need and desire for courses of instruction in business administration, marketing, and retail merchandising.\textsuperscript{10} Headquarters Exchange Service presently conducts a three week course for exchange managers but a review of its contents indicates that it should be revised to place more emphasis on marketing and retailing. At present, the course is devoted almost altogether to other matters, which although significant are far less important than a knowledge of marketing. The need for additional knowledge of marketing on the part of exchange management personnel will become evident in the chapters of the study which follow. These chapters treat specifically operating practices which could be corrected readily if responsible personnel had a better grasp of the problems which confront them.

\textsuperscript{9}Albert V. Chapman, Edward D. Hawk, and Everit B. Lomax, "A Study of Management of Base Services in the USAF." A research report prepared by the School of Logistics, Air Force Institute of Technology, June, 1960 (mimeographed), p. 39.

\textsuperscript{10}Data collected directly from questionnaires received in connection with above study.
SUMMARY

This chapter has presented information about the current organizational relationships existing in the exchange system. It has been shown that the present system is based upon the reorganization made in 1957 when the "command concept" was instituted. It is "at best a compromise" whereby an attempt has been made to derive some of the benefits of a more centralized operation and still not violate the traditional command responsibilities. As with other organizations that rely heavily on a functionalized type of operation, certain difficulties are present. Line and staff functions overlap in such a way that it is sometimes difficult to determine where the actual authority and responsibility of each participating group begins and ends.

All things considered, however, it is felt that this type of organization has been to the advantage of the exchange system and that service is better today than in earlier periods during and after World War II. It must be recognized that the exchange system is only one of hundreds of activities found on a military installation. The organization of the exchange system must naturally be subordinate to that which serves the entire military best. At present, it is felt that this is achieved most satisfactorily through a decentralized type of operation. This precludes the possibility

of direct operation of exchanges by Headquarters Exchange Service and the service centers, even though this type of operation might prove to be more efficient. The command concept recognizes this situation and attempts to make the best of it.

There is always the possibility of making improvements in existing relationships, however. Certainly this is true with regard to the effectiveness of each group in the system—whether they be line or staff. Previously indicated were suggestions which it is felt would substantially improve the effectiveness of present exchange operations, and do so within the present organization framework.

Although, it appears to be only a remote possibility at the present time, for long range planning purposes, a study should be made to investigate the feasibility of circumventing traditional command channels and operating exchanges directly by Headquarters Army and Air Force Exchange Service and the Regional Service Centers. Pertinent to the matter of direct operation, it should be noted that there are organizations in the military which do operate apart from the normal command concept. The most notable of these are the Office of Special Investigations and the Auditor General's Office. These two organizations have been established outside of the normal decentralized system because of the special nature of their work. Perhaps the exchange system should also be considered as an activity which is sufficiently specialized to justify a special status. Certainly, the matter is important enough to warrant further investigation and study.
CHAPTER IV

LEGAL STATUS OF THE EXCHANGE SYSTEM

The exchange system, as an adjunct of the Armed Services, holds a unique position in the marketing structure. This is reflected in the special legal status of the system, which is explained in this chapter. Although Congress has never directly authorized the exchange by a specific statute, it enjoys a similar status resulting from (1) the authority given to the President to establish regulations governing the operations of the military, (2) congressional acts which have recognized and implicitly sanctioned the exchange, and (3) the findings of various courts which have supported the exchange as a legitimate military activity.

BASIC LEGAL PROVISIONS

Military Regulations

The most important type of legal authority governing the operations of the exchange system is that of official military regulations. Such regulations have all the force and effect of statutory law, as has been widely accepted in the United States for over 90 years.

By an act in 1870, Congress directed the Secretary of War to prepare a system of general regulations for the administration of the affairs of the Army, which, when approved by Congress, had the force of law until such regulations were altered or revoked by the
same authority.\textsuperscript{1} By an act in 1875, Congress modified that part of the original act which required that military regulations be reported to and approved by Congress. Instead, Congress authorized the President of the United States to make, publish, and enforce regulations for the government of the Army in accordance with existing laws.\textsuperscript{2}

As a result of these laws it can be seen that military regulations derive their force first from a congressional act and secondly from the power of the President as Commander in Chief of the Armed Forces. These regulations are binding upon all within the sphere of the President's legal and constitutional authority.\textsuperscript{3}

Recent legislation by Congress has upheld the same viewpoint. The Armed Forces Act of August 10, 1956, states that the "President may prescribe regulations to carry out his functions, powers and duties under this title."\textsuperscript{4} The title referred to is Title 10, General Military Law. With regard to the Army and the Air Force proper, Title 10 states that "the President of the United States is authorized to make and publish regulations for the government of

\textsuperscript{1}16 Stat. 319 (1870).
\textsuperscript{2}18 Stat. 337 (1875).
\textsuperscript{3}Kurtz v. Moffett, 115 US 487, 503 (1911).
the Army (and Air Force) which shall be enforced and obeyed until they are altered or revoked by the same authority.\textsuperscript{5} Again under this same law, the statement is made that "Army regulations...have the force of law.\textsuperscript{6}

Federal Statutes

As indicated above, military exchanges have not been established by a specific statute of the Congress of the United States. However, Congressional approval of the creation and operation of post exchanges is found in numerous acts which deal in some way with exchange operations. It can be concluded, therefore, that Congress has recognized the functioning of the post exchange and has implicitly sanctioned its existence.

At a hearing before the U. S. Senate Committee on Education and Labor, 75th Congress, the Director of Emergency Conservation Work recommended that Congress enact into law a Civilian Conservation Corps. One provision of this recommended bill called for the creation of post exchanges "just like the exchange the Army possesses" in order that such post exchanges would be "on the same basis as the post exchanges on the Army reservations.\textsuperscript{7}

\begin{footnotesize}
\textsuperscript{5}\textit{Ibid.}, pp. 1541 and 1949.


\textsuperscript{7}Senate Hearings Before the Committee on Education and Labor, S. 2102, 75th Congress, First Session (1937), pp. 48 - 49.
\end{footnotesize}
compliance with this request, Congress provided the statutory authority asked for by the Director and established post exchanges in the Civilian Conservation Corps. A study of the history and character of both types of exchanges reveals that there is no essential difference in their respective functions, even though the civilian type of exchange was created by statute and the military type was not. In fact, the words used in the act to establish the Conservation Corps exchanges were taken directly from General Order No. 46, which stated the purpose of the Army exchange "to provide articles of ordinary use and consumption not furnished by the government."  

Congressional recognition is also found in numerous appropriation acts. In 1903, by an act on March 2, Congress appropriated $500,000 for "continuing the construction, equipment, and maintenance of suitable buildings at military posts and stations for the conduct of the post exchange, school, library, reading, lunch, amusement rooms, and gymnasium, to be expended at the discretion and under the direction of the Secretary of War." Since 1903, Congress has repeatedly made substantial appropriations for these same purposes. Even today a modest amount of appropriated funds goes to the support of the exchange system.

850 Stat. 319, 322.
9Ibid.
1137 Fed. Sup. 972, 976 (1941).
In 1933 and 1934 Congress again recognized the governmental status of the post exchange by requiring that the balance of disbanded organizational funds, amounting to $298,068, which had been derived from post exchange activities, be handed over into the federal treasury.\textsuperscript{12}

In addition to the foregoing, implicit recognition and sanctioning is found in numerous statutes which have dealt in some way with the status of civilian exchange employees. For example, in the 1950 amendment to the Social Security Act, exchange employees were cited by name as being eligible for such benefits.\textsuperscript{13} In 1952, Congress passed a law specifically to clarify the position of exchange employees with regard to the Civil Service Commission. It was established that exchange employees, and those of other non-appropriated fund instrumentalities, would not fall under the provisions of the Federal Employees Compensation Act but that these employees would be provided similar benefits, through insurance programs and other means.\textsuperscript{14} The War Risks Hazard Act, passed in 1957, also makes reference to exchange employees. This act stipulates the provisions whereby civilian employees working with

\begin{flushright}
\textsuperscript{12}47 Stat. 1571, 1573 (1933), 48 Stat. 1224, 1229 (1934).
\textsuperscript{13}42 USC 410 (a) (6) (B) (IV).
\end{flushright}
the government would be compensated in case of injury, death, or detention. The statute specifically states that "any person employed as a civilian employee of a post exchange or ships service store would be entitled to benefits under the act."\textsuperscript{15}

Court Decisions

Over the years, the federal courts also have held the view that the exchange is a legitimate activity of the Armed Services. The first direct citation to uphold the legal status of the exchange was a Court of Claims case tried in 1899. Involved was a dispute over the right of the Internal Revenue Department to impose a license tax on post exchanges that were selling beer and wine. The Collector of Internal Revenue for the first district of Missouri, in which district the Jefferson Barracks post exchange was located, claimed that the exchange was required to pay the "retail liquor dealer" tax. The Comptroller of the Army declined to approve such a payment on the basis of the governmental status of exchanges and recommended that the matter be transferred to the Federal Claims Court for decision.

This court decided that the exchange was exempt and that it did not have to pay the tax on the grounds that "post exchanges so established (under General Order No. 46) were no longer the

\textsuperscript{15}42 USCA 1701 (a) (3).
mere social clubs the old canteens were, but that they were brought under the complete control of the Secretary of War by regulations as governmental agencies.\textsuperscript{16}

In arriving at this decision, the court recognized that exchanges were not established by a specific Federal statute but by military regulations. There can be little doubt about the weight attached to these regulations, however, as the court concluded:

True, such exchanges have not been authorized by direct legislation, but the President has the undoubted power to establish rules and regulations for the government of the Army, and whatever rules and orders are promulgated through the Secretary of War must be received as acts of the Executive, and as such be binding upon all within the sphere of his legal and constitutional authority. As was held by the Supreme Court in the case of United States v. Eliason (reported at 16 Peters 291) such regulations cannot be questioned or defied because they may be thought unwise or mistaken.\textsuperscript{17}

A similar case was brought before the U. S. District Court in 1941 when the South Carolina Tax Commission attempted to impose a license tax on the Fort Jackson post exchange for the privilege of selling beer, tobacco, and other products. The state maintained that the post exchange was not a bona fide component of the federal government and was subject, therefore, to state regulation and control.

\textsuperscript{16}Dugan v. United States, 34 Ct. Cl. 458, 465 (1899).

\textsuperscript{17}Ibid., p. 466.
The court ruled otherwise, however, and stated that such action could not be taken by the State of South Carolina as it would be a violation of the immunity from state taxation enjoyed by "federal instrumentalities" under the Constitution of the United States.

The Court concluded that:

The provisions of the state statute are not applicable to the activities of the Post Exchange...and that the order of the defendants to enforce the provisions of the state statute against such activities and their threat to enforce and their attempts to enforce the same constitute an interference with the activities of the United States, and are unconstitutional.18

In developing the case, the Court gave strong weight to the authority of the War Department to operate exchanges under official regulations and stated that "regulations promulgated by the Secretary of War for the government of the Army in accordance with existing laws have the force of law."19

The following year, in 1942, the Supreme Court of the United States ruled on a case which required that the relationship of the post exchange to the federal government be clearly established. The case was prompted by an attempt of the State of California to impose a license tax on gasoline stations operated by post exchanges. The Supreme Court of California ruled that such a tax was applicable to exchanges, citing as its reference a federal statute which stated that a Federal reservation could not be used as means of avoiding

18United States v. Query, 37 Fed. Sup. 972, 975 (1941).
19Ibid., p. 972.
state tax laws.\textsuperscript{20} The United States Supreme Court held, however, that this statute was applicable to individuals and private organizations but certainly not to the federal government itself.

The Court reversed the decision of the Supreme Court of California on the basis that it was repugnant to Federal Constitution in that the state did not have jurisdiction over exchange operations. It pointed out that exchanges are "integral parts of the War Department" that "share in fulfilling the duties entrusted to it, and partake of whatever immunities it (the War Department) may have under the Constitution and Federal statutes." In reviewing once again the entire status of the post exchange, the Supreme Court gave the opinion as follows:

That the establishment and control of Army post exchanges have been in accordance with War Department regulations, rather than specific statutory directions, does not alter their status as "arms of the government," since authorized war department regulations have the force of "law."\textsuperscript{21}

Opinions of the Executive Branch of the Government

It is noteworthy that the Executive Branch of the Government has also from time to time acknowledged the official status of the exchange system and has lent support to its operations. In the case which contested the right of South Carolina to impose a license tax on exchanges, the District Court stated that "the President of the United States, (and) the heads of the various departments


\textsuperscript{21}\textit{Ibid.}
of the United States, to whose opinions the courts always give great weight, ... have in many instances held that the post exchange and their predecessors were Federal instrumentalities."\textsuperscript{22}

The attitude of President Franklin D. Roosevelt toward the exchange is revealed in Executive Order No. 6589, February 6, 1934. In it the President stated that "this order shall apply to and include all vehicles owned and operated by the United States Government and by legally authorized instrumentalities thereof, such as post exchanges..."\textsuperscript{23}

THE EXCHANGE
AS A FEDERAL INSTRUMENTALITY

On the basis of the foregoing, it is now clear that the military exchange is considered to be a Federal government instrumentality even though it has not been created by a specific statute. The instrumentality status is important because with it goes a number of privileges and immunities which have widespread marketing implications.

The most important is that the exchange enjoys a significant competitive advantage in relation to regular retail stores which are subject to various state and federal laws and regulations. The exchange is not only immune to state control as described above, but the instrumentality status permits it to receive some direct

\textsuperscript{22}United States v. Query, op. cit., p. 976.

\textsuperscript{23}Ibid.
assistance from the Federal government. Such assistance includes (1) federal income tax exemptions, (2) use of government buildings, (3) the services of officer personnel assigned to the exchange management positions, and (4) other types of support.

Since exchanges are a part of the government, they are entitled to the legal services of the Department of Justice and the appropriate United States Attorney in situations involving the legal ramifications of exchange operations. Also, since exchanges are a part of the military they may obtain legal assistance from the Judge Advocate General's office and the local Staff Judge Advocate when necessary. Headquarters Army and Air Force Exchange Service has an established procedure whereby the individual exchange may avail itself of the services of these legal groups.

Another factor bearing upon the instrumentality status is the fact that exchanges are immune to suit, in line with the well established rule that a sovereign power cannot be sued in any court without its consent and permission. In a specific case relative to the applicability of state workmen's compensation laws to exchanges, the court concluded that "this immunity would clearly follow so essential a government agency as the post exchange,... and we are cited no Federal statute indicating any intention of Congress to waive such immunity."

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As a matter of policy, however, the Army and Air Force Exchange System does not rely on this immunity, particularly with regard to its ordinary business transactions. It is recognized that business transactions must be maintained on a high ethical level and the immunity should not be used to avoid obligations arising out of transactions entered into in good faith, or to escape the normal liabilities incident to commercial operations. Moreover, the exchange takes great care in drawing up legal contracts so as to avoid disputes which might involve court action.

CHAPTER V
THE PLACE OF THE EXCHANGE IN THE MARKETING STRUCTURE

The preceding chapters of this study have dealt with the growth and development, present organizational status, and legal implications of the Army and Air Force Exchange System. These subjects have been considered because they provide the basis for understanding the scope and pervasiveness of present exchange operations. The remainder of the study is concentrated primarily on the nature and significance of Army and Air Force exchanges with the intent of clarifying their role in our marketing structure. This chapter deals with essential elements which make possible the classification of exchanges into a basic category of retail establishments for purposes of analysis. The three chapters immediately following emphasize the manner in which exchanges perform marketing functions. Together, these chapters provide an insight into the character of the exchange system and an appreciation for certain operating problems resulting therefrom. Chapter IX deals with an economic evaluation of current controversies about the exchange system by discussing matters relating to criticisms of exchange operations, congressional investigations, and defense by the military establishment. Chapter X, the final chapter of the study, summarizes the entire analysis and states the major conclusions which have been reached.
Before undertaking the task outlined above, an understanding of the implications and scope of the term "post" or "base exchange" is essential. As mentioned briefly in Chapter I, the exchange is a broad term that embraces a number of retailing activities on an operating level. The expression refers to a complex of retail establishments at a particular military installation handling a limited line of goods and services. Occasionally an exception to the above occurs when a very small percentage of sales is made to military organizations located at the installation. For example, an officers' club might purchase decorating items from the PX in much the same manner as many businesses make occasional purchases from retail stores. Naturally, most purchases made by officers' clubs and similar military organizations go through normal wholesale channels.

Generally, the "post" exchange or the "PX" refers to an Army exchange, whereas the "base" exchange or "BX" refers to an Air Force operation. Many Air Force personnel use the term "PX" because they were in the Army before the Air Force became autonomous and they have simply persisted in the use of the older term.

The exchange system is in no way connected with any of the private organizations, such as "Fame" or "Fedco," that attempt to emulate in some ways its manner of operation. These stores are not operated under the auspices of the military services or any other government agency. In reality, they are discount houses that use
some type of special appeal. For example, Fame Stores claim to restrict their clientele by selling only to personnel associated with the government. It appears, however, that this requirement is interpreted very loosely so that almost anyone can shop there.¹

The Army and Air Force possess a common-law property right in the trade names PX, post exchange, Army exchange, BX, base exchange, Air Force exchange, or any combination of these terms. This right has arisen from constant usage over a long period of time.² Appropriate legal action is taken against businesses that attempt to create the impression that they are a part of the exchange system.

**OWNERSHIP CLASS**

For an understanding of the nature of the exchange system it is important to analyze its operations from an ownership viewpoint. Two distinct categories are involved. First, there are those activities that are directly owned and operated by the Army and Air Force as a hybrid type of chain operation. The largest portion of exchange business falls into this category. This is always true of what are designated as the "retail stores," which constitute the

¹To illustrate, Fame includes among its eligible patrons such broad categories as anyone receiving government pensions, social security, or anyone working for a company having a government contract. These are in addition to other very broad groups, such as any government employee; anyone in the military, including members of reserve forces; anyone connected with education, public utilities, non-profit industries, and the like.

²Army Regulation 60-10, Air Force Regulation 147-7, 27 February 1959, p. 3.
principal activity of the exchange system and sell the bulk of merchandise offered for sale.\textsuperscript{3} The variety and classes of goods handled in these retail stores is discussed in a later section of this chapter.

Business operations handled on a concession basis constitute the second type of ownership in the exchange system. These concessions are separate small businesses that are individually owned and operated. In 1958, there were 3,039 of them operating in the domestic exchange system.\textsuperscript{4} This type of operation is established when it is considered to be more advantageous to the military from a profit or service standpoint. The exchange policy governing concessions states that they will be authorized "where circumstances would preclude realizing comparable service and financial return through direct operation."\textsuperscript{5} The concessions are principally of a service nature such as barber and beauty shops,

\textsuperscript{3}Army Regulation 60-20, Air Force Regulation 147-14, 27 February 1959, pp. 28-29.


\textsuperscript{5}Army Regulation 60-20, Air Force Regulation 147-14, 27 February, 1959, pp. 28-29.
dry cleaning shops, and shoe repair shops. A complete list of the concessions which may be authorized at an installation is as follows:

- Grocery section or grocery items (rarely authorized)
- Gasoline filling station
- Automobile garage and service station
- Restaurant and cafeteria, including those in service clubs
- Soda fountain and snack bar, including those in service clubs
- Laundry and dry cleaning services
- Tailor shop
- Beauty parlor
- Barber shops
- Watch repair shop
- Radio repair shop
- Shoe repair shop
- Photographic studio
- Vending and amusement machines
- Optical service
- Guest house
- Personal services
- News stand
- Recreation and athletic facilities, other than bowling alleys

There are a number of factors which explain the advantage of conducting some of the above service activities on a concession basis. These circumstances closely parallel the reasons for widespread use of leased departments in department stores and departmentized specialty stores. First, there are instances in which a highly specialized knowledge is required for successful operation, a beautician's shop is a good example. Second, the exchange manager may lack the time and/or knowledge that would be necessary for adequate supervision and control of the specialized activity. A third and closely related factor is that the concession may not

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6 Ibid.
fit in with the present method of sale and hence could not be handled by regular employees. Problems resulting from these three factors are particularly important to exchange operations as both management and employees usually are far less specialized than their counterparts in department stores and specialty stores.

In addition, the concession allows an exchange to experiment with new services at a minimum of risk. In a small installation, for example, there might be uncertainty concerning the volume of business that could be derived from a laundry and dry cleaning operation. If it were decided to try out this service on a concession basis, the exchange could contract with someone already operating a laundry and dry cleaning plant who would agree to try out a pick up and delivery station on the installation. The actual cleaning and laundry would be done off the installation at the facility already established for this purpose. If the operation should not prove successful, the concessionaire would be out only the expenses incurred while experimenting with this service point. On the other hand, if the exchange operated the laundry and dry cleaning facility directly, and if it proved to be a failure, it would be necessary to dispose of expensive equipment and supplies, probably at a considerable loss to the exchange.

Finally, the concession can be used by an exchange that wishes to expand more rapidly than available capital requirements would permit. Some service operations such as beauty parlors
and barber shops, require a heavy investment in specialized equip­
ment which may preclude direct operation by the exchange. Conse­
quently, the only practical method of offering such a service
is through a concession arrangement.

In a concession type of operation, there are, of course,
certain disadvantages also. One drawback is that the exchange
automatically sets a limit upon the rate of profit which it may
secure from the concession operation, because the exchange is
compensated on the basis of a percent return on sales which may
be lower than would be obtained under direct operation. A second
and more important difficulty is that the concession arrangement,
in some respects, is more complex and involved than direct opera­
tion. There is always the possibility that conflicts over policies
and procedures will arise or that the concessionaire's aim for
immediate profits will lead to merchandising practices contrary
to the longer term interests and reputation of the exchange.

AUTHORIZED PATRONS

Only authorized patrons are allowed to buy in Army and Air
Force exchanges. These include individuals as well as certain mili­
tary organizations. Some patrons are allowed to buy on an un­
limited basis, whereas other individuals and groups are restricted
in their use of exchanges. The following are the principal groups of patrons and organizations that enjoy unlimited use of the exchange:

1. All uniformed personnel (and their dependents) on extended duty and members of reserve components while on active duty for training period.

2. Uniformed personnel (and their dependents) of the Armed Forces of foreign nations, when on duty with the United States Armed Force under competent orders issued by the Army, Navy, Air Force, or Marine Corps.

3. Official organizations or activities of the United States Armed Forces which are composed of active duty military personnel.

4. Government departments or agencies outside of the Department of Defense, when it is determined that the desired supplies and services cannot be conveniently obtained elsewhere.

5. All retired military personnel (and dependents).

6. Unremarried widows (and other dependents) of individuals who have died while on extended active duty, who have died while on active duty for training, and those who have died in a retired status.

7. Miscellaneous groups such as uniformed personnel of the Red Cross assigned for duty with the Armed Forces, contract surgeons, and foreign military personnel visiting United States installations.

Patrons entitled to limited use of the exchange fall into several categories. First, there are those who may buy all items except uniforms. Included in this group are (1) honorably discharged veterans who are hospitalized where exchange facilities are available, (2) totally disabled veterans who continue to receive some type of medical care through the Veterans Administration.

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7Ibid., pp. 29-34.
(3) exchange employees, and (4) under special circumstances, civilian employees residing within the limits of an installation. For example, civilian employees might be entitled to exchange privileges at a very isolated installation. Authorization is granted by the commanding officer at the installation, subject to the approval of the Secretary of the Army or Air Force, whichever is appropriate.

A second category of patrons entitled to use the exchange on a limited basis are those who may use the soda fountain, snack-bar, and exchange restaurant when it is determined by the commander that these facilities are not available from other sources. Civilian employees and visitors of the Government residing within the limits of, or working on, an installation would be included in this category. Other groups are sometimes allowed partial use of the exchange, such as civilian employees of the Department of Defense who are in a traveling status and residing in government quarters. Under special circumstances students who are a part of the Army and Air Force Officer Training Corps or members of the Civil Air Patrol are granted limited use of the exchange.

Due to the sensitive nature of exchange operations, which will be discussed fully in Chapter IX, careful control of sales is a matter of basic policy and strict measures are used to prevent unauthorized persons from purchasing merchandise or services. Each installation commander is directed to take whatever action is necessary in order to assure that all individuals making purchases are properly identified.
As a matter of interest, additional categories of individuals are considered authorized patrons in overseas exchanges. Consistent with international agreements made by the United States, the overseas commanders are allowed to designate who may make purchases in exchanges. Frequently included are civilian employees of the Department of Defense, Allied military and naval personnel stationed or traveling in the command, and personnel who are authorized privileges by the commander when he considers it to be beneficial to the mission of the command concerned. Non-appropriated fund and sundry organizations, as well as the dependents of all the personnel specified above, are also entitled to use overseas exchanges when so deemed by the commander.

VARIETY AND CLASSES OF GOODS HANDLED

In the domestic exchange system, the degree of freedom which is allowed in the selection of goods is limited by basic military regulation. This regulation takes the form of an authorized list of merchandise which may be purchased for resale. By contrast, overseas exchanges are not limited in their merchandise lines and, as a rule, handle many items which are not carried in this country. The larger exchanges overseas operate in some respects like department stores in this country.

There are two explanations for the differences that are found between domestic and overseas exchange operations. First, in overseas locations, the exchange is frequently the only source of American-type goods available to military personnel. Continued
availability of U. S. products to personnel assigned overseas is important because of the disparity which frequently exists between American living standards and living standards in foreign lands. Second, there are no pressure groups working on Congress to restrict the items of merchandise sold in overseas exchanges. The particulars which relate to the many congressional investigations of exchanges are taken up in Chapter IX. At this time, it is enough to say that the source of the present restriction is a series of congressional investigations of exchange practices which have occurred since World War II.

Appendix A enumerates the merchandise items and categories of items which the Army and Air Force regulation authorizes for sale in domestic exchanges. It will be observed that some of the items shown in this list are very specific whereas others apply only to categories or classes of goods. For instance, in the toiletries and drugs section, "dental floss" is listed as a separate item whereas in the clothing section, infants' clothing is grouped together as one category. Items in Section I of this authorized list are mandatory and must be handled by every exchange. Those listed in Section II, constituting the bulk of business for most exchanges, are optional in that the local buyer has some degree of choice in selecting the specific goods that will be handled. As a matter of practice, however, exchanges tend to handle most of the items and classes of items authorized for sale.
The authorized list shows that exchanges handle consumer products which fall into each of the three basic merchandise categories generally recognized in marketing literature. These are convenience goods, shopping goods, and specialty goods. Convenience goods are articles that consumers wish to purchase with a minimum of effort. Such purchases usually involve a small unit price. The consumer is familiar with the goods wanted, and his demand is clearly defined as soon as the want is recognized; also prompt satisfaction is desired. The demands of the consumer with respect to such merchandise lead him to expect ready accessibility. Tobacco, drugs, confectionery products, some hardware, and staple groceries are good examples of convenience goods. Section I of the authorized list shows that goods of this type are handled in every exchange.

Section II of the list indicates that exchanges also carry many items which properly fall into the shopping and specialty goods categories. When buying shopping goods, consumers generally wish to compare prices, qualities, and other merchandise characteristics at the time of the purchase. These goods usually have more lasting value than convenience goods, are of higher unit value, and are purchased less frequently. Unlike with the purchase of convenience goods, the consumer does not have a preconceived idea of exactly what will be purchased before the shopping expedition takes place. Examples of shopping goods handled in exchanges are small appliances, most items of clothing, and luggage.

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9 Ibid., p. 32.
Goods falling into the category of specialty goods are those which have some special or unique attraction other than price or convenience. Examples of such items carried in exchanges are uniforms and uniform accessories for which there is frequently no alternative source available.

THE GENERAL STORE CHARACTER OF DOMESTIC EXCHANGES

By examining carefully the authorized list and bearing in mind that exchanges handle convenience, shopping, and specialty goods it may be seen that exchanges fall within the basic classification of general merchandise stores. These stores are defined as:

Those that handle such an extensive variety of goods that they cannot be classified into some kind of business grouping designated by the name of a principal type of commodity sold. Stores within this broad group are of several distinct types, including general stores, department stores, dry goods stores, and variety stores.10

Within the general merchandise classification, exchanges tend to approximate the "general store" more than any other type of retail institution. According to the Census of Business, a general store is one which handles a wide variety but a limited assortment of goods in a number of merchandise categories, including groceries, hardware, dry goods, notions, staple lines of apparel, and some furnishings.

Historically, the general store flourished at a time when it was the only source of goods available in more sparsely populated areas. Under such circumstances more specialized types of

10 Ibid., p. 141.
establishments could not profitably survive. Even today, the general store continues to exist in out-of-the-way locations. The situation is similar with many Army and Air Force exchanges which serve as the only practical source of goods and service at a large number of isolated military installations. A study made in 1959 revealed that there were then 135 domestic Army and Air Force installations over 31 miles distant from the nearest civilian community.11 Many installations, of course, are much further than this, some as far as 135 miles away. These data give some indication of the importance of exchanges to military personnel.

The key to understanding the general store lies in the meaning of the words variety and assortment. Variety pertains to the classes of goods handled (such as drugs, hardware and dry goods) whereas assortment has to do with the selection available within a given class. The essential characteristic of the general store is the large variety but limited assortment of goods handled. On this basis the similarity between the general store and the exchange can be appreciated. The authorized list clearly shows that there is a parallel between the lines handled in exchanges and those mentioned above for the general store. The limited assortment invariably found in exchanges is explained in terms of their modest sales volume. For example, the Griffiss Air Force Base Exchange at

Rome, New York, served a total of 3500 military personnel and their families in 1959, with a sales volume of $850,000. In this type of operation, the opportunity for wide selection in many lines is obviously not possible considering the volume of business available.

It is important to note, however, that many exchange patrons, and even some installation commanders, expect their exchanges to handle a variety and assortment of goods comparable to what would be found in a metropolitan department store. This can be explained in part by the fact that many military personnel are not aware of the existence of the authorized list. A more basic explanation is that most individuals fail to understand the nature of the exchange as a marketing institution and the problems and limitations which are inherent in its general store operation. Whereas the department store is an outgrowth of strictly urban conditions, the exchange has developed and must operate under quite different circumstances.

The significance of the general store classification will be found in the chapters which follow. These chapters deal with specific marketing aspects of exchange operations and the problems resulting therefrom. It will be seen that the general store classification provides a practical and useful framework for analysis and solution to many of these problems.
CHAPTER VI

PRESENT EXCHANGE BUYING PRACTICES

This chapter and the two that follow analyze exchange operations from a functional standpoint. This approach, which stresses the manner in which exchanges perform essential marketing functions, contributes to a further understanding of the nature of the exchange system and provides the basis whereby improvements in present practices can be made. One of the most widely accepted definitions of a marketing function states that it is

a major economic activity which is inherent in the marketing process, pervades it, and which, through a continuous division of labor, tends to become specialized. In this sense a marketing function is not a technique, a tool, or a special activity that may be properly considered as but a part or phase of a function.¹

Using this definition as a foundation, those listed below are considered to be the basic marketing functions:

Buying Standardization and grading
Selling Marketing Finance
Transportation Risk-bearing
Storage Marketing information²

The following paragraphs show that all of the above functions must be performed by the exchange system just as they must be by all other merchandising organizations. Greatest emphasis in this

¹Beckman, op. cit., p. 35.
²Ibid.
study is placed on the buying and selling functions as the responsibilities for merchandising are centered here. The other marketing functions are discussed and analyzed within the basic context of buying and selling. This approach is taken because buying and selling activities (functions) are considered the "heart" of the retail business and because other functions performed are designed to supplement these activities and render them more effective.\footnote{Delbert J. Duncan and Charles F. Phillips, \textit{Retailing Principles and Methods}, Fourth Edition (Homewood: Richard D. Irwin, Inc., 1955), p. 169.}

Although separated in this study for purposes of evaluation, it must be recognized that buying and selling are quite interdependent. The action of buying obviously affects the success or failure of selling and vice versa, a relationship which explains the logic in such frequently made statements as "goods well bought are half sold."

This chapter explains the manner in which the buying function is currently performed in domestic exchanges. Specifically considered are buying policies and practices relative to (1) responsibility for buying and the level on which buying takes place, (2) selection of kinds of goods, (3) determination of quality and suitability, (4) determination of quantities to purchase, and (5) determination of types of suppliers. Following in Chapter VII is a critical analysis of present exchange buying with a view toward improving buying effectiveness wherever possible.
RESPONSIBILITY FOR BUYING

In practice, the responsibility for buying in domestic exchanges rests largely at the installation level. However, certain aspects of buying are strongly influenced by regulation and policies which have been established (with the approval of higher authority) by Headquarters Exchange Service and the regional service centers. The role that is played by these various groups in the performance of the buying function will be discussed fully in this chapter and the following one.

At the installation level, buying is the responsibility of an individual designated as the merchandise manager. This individual, under the direct supervision of the exchange general manager, is responsible for many decisions concerning each aspect of buying.

The fact that exchange buying remains largely at the installation level can be explained in a number of ways. In the first place, the history of the exchange system, as discussed in Chapter II, shows that it was one of the most thoroughly independent operations in the service and that up until the Second World War each exchange was a completely separate operation. Even though exchange operations have been centralized to some extent following World War II, the traditional influence still persists.

Second, many support buying on an individual basis on the ground that this practice makes it easier for the exchange buyer to understand and meet local needs and wants. Although sometimes true, it is probable that a more centralized buying system could
be adjusted to take care of such local needs. Furthermore, exchange patrons, more than most groups, lack true regional buying habits. This can be substantiated by such factors as frequent moves made by military personnel, similarity of environment from one base to another, the fact that military personnel tend to form their own social groups, and the fact that exchanges stress nationally advertised merchandise.

Differences in merchandise composition based on local conditions will naturally be found. An exchange operating in Florida without a doubt would feature a greater assortment of swimming suits than one in Colorado. Conversely, the Colorado exchange would emphasize wool sweaters and ski clothes, items that would not be found in Florida. The problem of minor differences between retail outlets is not unsurmountable in an organization that has an established system utilizing central procurement. Headquarters Army and Air Force Exchange Service, for example, buys for all overseas exchanges regardless of location. The outstanding success of such companies as J. C. Penny and Co. and Sears, Roebuck and Co. also support the fact that central buying can and does work under similar circumstances.

A third factor sometimes offered in explanation of an individual exchange procurement policy is the fear of criticism by the local wholesale groups that would be circumvented with a more centralized system. Apparently there was some trouble of this type in 1957 during a trial program of centralization in the Baltimore Service Center which experienced some complaints.
from wholesalers. In the final analysis, however, the possibility that these complaints might become a truly significant factor seems unlikely because most wholesalers would be reluctant publicly to take any position regarding exchange operations. The reason for this is the fear of reprisal by their best customers—the local retail stores with which the exchange is unpopular.

A fourth consideration is that a decentralized exchange procurement system attracts less attention than would a highly specialized group buying in the same manner as the variety and department store chains. Greater centralization and growth of the exchange system, in buying and other functions, is an aspect most severely criticized by retail groups. More centralized procurement, even if it proved to be no more efficient than the present policy, could easily intensify this criticism. Naturally, the exchange system avoids such conflict with retail groups whenever possible.

The most important factor which explains the emphasis on individual exchange procurement is that it is consistent with the basic concept of military organization which is highly decentralized. It was pointed out that in the exchange system, under the command concept, the installation commander has the authority and responsibility for each phase of the exchange operation. Although not necessarily the most

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5 See Chapter IX for a more complete analysis of this difficulty.
effective organization from the exchange viewpoint, it was explained
that the exchange system must naturally be structured to the over­
all organization of the Army and Air Force, which at present is
operated on a decentralized basis.

SELECTION OF KINDS OF GOODS

In any merchandising organization, the individual charged with
buying responsibility must determine first the kinds of goods that
he is going to buy. As discussed in the preceding chapter, exchange
buying is limited by basic military regulation in that only those
categories of items found on the "authorized list" may be purchased
for resale in domestic exchanges.

In spite of the authorized list, however, under the present
system of decentralized buying, exchange buyers exercise consider­
able judgment in selecting the kinds of goods to be handled. There
are two principal explanations for this. In the first place, needs
do vary from one installation to another. To illustrate, at Wright­
Patterson Air Force Base the majority of military personnel have to
rely on off-base housing, as government quarters are extremely
limited. There has been a tendency, therefore, for many military
personnel to purchase real estate in the Dayton area. This can be
contrasted to some installations, such as Barksdale Air Force Base
in Louisiana, where quarters are provided on the base for a large
percentage of military personnel. Considering for the moment this
factor alone, it is obvious that the contrast in the housing
situation will lead to some differences in the needs and wants of
exchange patrons. The sale of lawnmowers is a case in point. Whereas home ownership causes a considerable demand for this item at Wright-Patterson, there will be little demand at Barksdale where lawns and gardens are maintained by the government. Other differences in the items handled are found because of the dissimilar character of the two installations. Barksdale is a Strategic Air Command Base made up largely of company grade officers and enlisted men, the majority of whom have young families. Wright-Patterson, on the other hand, is the Headquarters for Air Materiel Command and has a far larger complement of senior career officers whose incomes and living patterns are somewhat different.

A partial explanation for the latitude which the buyer has in selecting the kinds of goods to be handled lies in the nature of the authorized list itself. An examination of Appendix A shows it to be a general rather than a specific guide because many of the so-called items are in reality categories of items. It is clear that any classification of "kitchen accessories," for example, leaves the actual selection of items up to the individual who is responsible for the buying.

QUALITY, SUITABILITY, AND BRANDS

The local exchange buyer has the primary responsibility for determining the suitability of a particular brand, size, quality, color, or design of a given article of merchandise. Some assistance is given, however, by Headquarters Army and Air Force Exchange Service in the form of catalogues and bulletins which describe a
manufacturer's line. In addition, the Headquarters sponsors three merchandise shows each year, two in clothing and one for toys, which are designed to aid the buyers in the selection of appropriate merchandise at good values. The local buyer almost always makes the final selection, however.

Examination of exchange buying practices reveals that heavy emphasis is placed on nationally advertised branded merchandise. This is encouraged by a specific exchange policy which stipulates that only "first quality merchandise in known acceptance will be purchased." A more fundamental reason, however, deals with the manner in which exchanges buy. Present buying practices, whereby one or two individuals are responsible for purchasing thousands of heterogeneous items, makes it almost mandatory for the buyer to rely on products with a well established reputation. Exchange buyers simply do not have the time or resources needed to investigate and examine many of the newer and lesser known brands.

A third reason is that exchange sales experience has shown that definite preferences exist for nationally branded merchandise. In most instances, military persons are probably best served by the national brands because they move from one locality to another at

6Army Regulation 60-20, Air Force Regulation 147-14, p. 50, 27 February 1959.

7John J. Ryan, Selling the Armed Forces Consumer Market (Washington: Army Times Publishing Co., 1957), p. 34. Mr. Ryan was associated with the Headquarters Army and Air Force Exchange Service for many years and has extensive knowledge of exchange operations.
frequent intervals. This makes it more difficult for them to develop sufficient experience to rely on "private brands" or on those of lesser known manufacturers.\textsuperscript{3}

The matter of branded goods has become even more important in recent years because exchanges gradually have been instituting self-selection and self-service merchandising techniques. Brands are particularly important to this type of merchandising because it is more essential that the customer have prior knowledge of a given product.

**QUANTITIES PURCHASES**

The local exchange buyer has primary authority for determining the quantities of a particular item which will be procured at any one time. However, in this area also the influence of Headquarters Exchange Service is felt, principally in two ways. The first concerns those items which are procured from a source having a price agreement with the exchange system. In these cases prices quoted are for particular quantities of a given product, with minimum quantities usually stated. This means that the exchange buyer must buy accordingly and act within the provisions of the price agreement. The second area in which the Headquarters exercises influence over quantities purchased is in connection with the dollar open-to-buy limits which are established on a departmental basis for each exchange. Obviously, such limits influence the quantities of any one item which may be purchased.

Generalizations concerning quantities purchased are difficult because considerable variance has been found among exchanges, even those that are of the same sales volume size. However, in every exchange there is a large number of items which must be bought in relatively small quantities. The explanation for this lies in the size of the average exchange, its general store character, and the fact that buying is done on an individual basis. It is particularly important to bear this in mind in considering sources of supply and channels of distribution, an aspect of buying which will be taken up in the paragraphs that follow.

**SOURCES OF SUPPLY**

Exchanges utilize several different types of suppliers. A significant number of items handled is purchased directly from manufacturers, many of whom have established price agreements with the exchange service. In addition to direct buying, purchases are made from various types of wholesale establishments. The more important types of wholesale establishments serving exchanges are (1) Manufacturers' Sales Branches, (2) Selling Agents, (3) Manufacturers' Agents, and (4) Wholesalers.

In the selection of suppliers, the influence of Headquarters Exchange Service and the service centers is more pronounced than in other aspects of buying. Although the local buyer has some latitude, his selection of channels is frequently dictated by regulation and policy, particularly with regard to price agreement items which are almost always purchased on a direct basis from manufacturers.
There is little doubt that price agreements which have been negotiated between Headquarters Exchange Service and the various vendors are useful under proper circumstances. However, contrary to the intent of present regulations, such price agreements do not always work to the advantage of the local exchange. This difficulty involves a detailed consideration of the various advantages and disadvantages of alternative types of suppliers and the role played in distribution by various types of wholesale middlemen. This entire matter is taken up in detail in the chapter immediately following.
CHAPTER VII
A CRITICAL ANALYSIS OF BUYING PERFORMANCE

In this chapter, current buying problems and difficulties that face exchanges under existing regulations, policies and procedures are outlined. The purpose of this analysis is critically to evaluate buying performance in terms of long established and well recognized marketing fundamentals with a view toward indicating possible areas for improvement. This approach has been taken in response to a request by Major General Harland C. Parks, former Chief, Army and Air Force Exchange Service, for an evaluation of the exchange system in light of general marketing practice.

It will be observed that a major portion of this entire study is devoted to an analysis of buying and the marketing functions related to it. This is not accidental. Strong emphasis has been placed on this area because it is considered to be the weakest element in the management of the exchange system at this time. A more realistic buying program, based on sound marketing practice, would solve many of the merchandising problems presently facing exchanges and would contribute immeasurably to a more effective system overall. This approach adheres to one of the basic objectives stated in Chapter I, for an analysis not only of the functions performed, but how well they are performed in the exchange system.
BASIC ASSUMPTIONS

Before proceeding, it is appropriate to state two basic assumptions upon which the following analysis is based, as follows:

1. Domestic exchanges will continue to purchase the bulk of merchandise on an individual exchange basis rather than utilizing a system of centralized procurement.

2. Domestic Army and Air Force exchanges will retain their general store character and hence will purchase most items in small quantities.

The analysis is based on these two assumptions, as this is considered to be the most realistic and worthwhile approach. For example, some would argue that the most successful and effective approach to exchange buying is through a system of centralized procurement. Even assuming for a moment that this may be the case, it is considered unrealistic since central buying is not possible without a drastic reorganization of the entire system—something which is not under consideration at this time in view of the command concept and possible political entanglements. This analysis concentrates on those aspects of buying which can be measurably improved within the framework of the law and the existing structure of the exchange system. Emphasis is placed, therefore, on modifications in existing regulations, policies, and procedures that will improve buying on an individual exchange basis.

THE EXCHANGE BUYING PROBLEM

In essence, the buying problem facing the domestic exchange system is that of trying to do too much with too little. What is needed is a more realistic, efficient, and economical approach to
buying. If this is to be found, it is imperative that exchange management understand fully the place of the exchange in the marketing structure (its general store character) and the inherent limitations which this position imposes on operations. Various aspects of buying are involved and these are presented below.

A Degree of Buying Specialization Needed

Considered together, the general store character of exchanges along with decentralized procurement gives an indication of the magnitude of the local buyer's job. Simply stated, the merchandise lines stocked in the average exchange are so diversified and complicated that it has become impossible for one or two individuals adequately to understand each item, each sales point, advantages and disadvantages, and to buy intelligently the 10,000 or more items carried in the inventory. Unfortunately, however, most exchanges are attempting to operate under precisely this type of system, whereby one or two persons attempt to make all of the buying decisions. The result, of necessity, is that many merchandise lines are bought on a haphazard basis with little real knowledge of what is most suitable for a particular situation.

In order to reduce the seriousness of this problem, some work is being done by various elements of the exchange system. Within recent years, Headquarters Army and Air Force Exchange Service has instituted three merchandise shows designed to provide local buyers with up-to-date information which will help them to do a better merchandising job. Although a step in the right direction, these shows have several limitations. In the first place, they cover
only two categories of goods—civilian clothing and toys. Second, being only one week in duration, it is difficult for the buyer carefully to evaluate the many different and unrelated categories which are shown. For example, women's and children's street clothes, sport clothes, and accessories are all shown during the same week. A third and related factor is that even a well-conducted merchandise show cannot serve as a substitute for needed buying specialization. Some lines simply are too complicated to be dealt with in the limited amount of time that the buyer now has available for the line. This is particularly true for seasonal and style goods which change from year to year.

As mentioned previously, Headquarters Exchange Service also assists buyers by publishing a number of catalogues which disclose the characteristics, prices, and sources for a number of lines of merchandise authorized for sale. Although an excellent aid to the buyer when properly utilized, these catalogues are also of limited use. Aside from the fact that they cover only certain types of goods, many items cannot effectively be bought without actual inspection. For example, every buyer interviewed in connection with this study stated that costume jewelry could not be properly purchased through the catalogue. Also, like the merchandise shows in New York, catalogues cannot be considered as substitutes for some degree of buying specialization. To illustrate, the 1960 exchange sporting goods catalogue included golf bags for the first time. A total of 54 bags from three different sources are offered. Each of the 54 golf bags listed is a separate item having characteristics
which distinguish it from the others. The important question that must be raised is: Can the buyer, who is responsible for this article in addition to thousands of other unrelated ones, intelligently select the proper styles, colors, fabrics, sizes, and price lines from a catalogue, particularly if he has only a few moments to devote to the line? In expressing his view of this subject, Mr. Charles Y. Lazarus, President of the F. and R. Lazarus Company in Columbus, Ohio, and former member of the Army Exchange Service during World War II, stated: "The best buyer in my organization (Lazarus Department Store) could not operate effectively in the exchange system without some degree of buying specialization."  

Obviously, the limited sales volume found in most exchanges precludes buying specialization to the extent found in department stores and departmentized specialty stores, but some division of buying responsibility is practical if only to the extent that key sales personnel share the buying load, as might be the case in very small exchanges. Many retail stores have found that their more experienced salespersons are capable and willing to assume buying responsibility. The National Retail Hardware Association, in an extensive study of hardware merchandising, points out that divided buying responsibility is one of the most noticeable management traits among the nation's leading hardware stores and that there is an increasing trend in this direction.  

1Personal interview with Mr. Charles Y. Lazarus in Columbus, Ohio, April 9, 1960.  
2"How Profits Are Made," Hardware Retailer, October, 1959, pp. 122-123.
Among the many exchanges visited in gathering data for this study, Pease Air Force Base, New Hampshire, stands out as a model in this respect. In the Pease exchange, buying responsibility has been clearly divided among five individuals who are specifically responsible for the procurement of certain types of goods. Purchases which are more routine in nature, such as tobacco, candy and drug sundries, are delegated to purchasing clerks who order on the basis of previously established maximum and minimum order quantities. Women’s and children’s clothing, accessories, and jewelry are purchased by the assistant merchandise manager who is fully responsible for these lines. In addition to overseeing the entire operation, the merchandise manager personally buys the more expensive shopping goods lines in the housewares and photography areas.

Although this program of divided buying responsibility has been in effect only a short time, the results in terms of sales and profits are already showing up. Certainly this is one exchange that deserves the close attention of exchange management personnel everywhere.

The advantages of a buying organization which has delegated responsibilities to individuals are many. Of particular significance, the individuals concerned are in a position to become familiar with the problems and characteristics of the merchandise with which they work. This leads to better prices, turnover, quality and more suitable merchandise in general. Of equal importance, delegation of buying responsibility frees the merchandise manager from buying details. Only then does he find or make time to analyze his entire operation—to discover perhaps that he is devoting 20 percent of his
stock to a line that produces 5 percent of sales, or vice versa. Free from the details of buying, the merchandise manager is then in a position to study the statistics necessary to make changes in inventory, turnover, store layout, promotion and other aspects of merchandising which will improve operating performance. If domestic exchanges are to improve buying effectiveness, it is essential for each merchandise manager to make better use of his time and his talents and those of the people who work under him.

**Interchange of Sales Data Among Exchanges**

The previous chapter explained that the individual exchange, within certain limits, is responsible for determining the suitability of merchandise handled. It was pointed out that exchange buyers, as a result of policy and buying expediency, rely heavily on nationally advertised merchandise.

This does not mean that they handle the same brands and models in all exchanges, however. In fact, the opposite seems to be the case, even within a single command. A survey of selected lines of merchandise handled in the nine exchanges operating within the Air Materiel Command indicates the lack of standardization by brands and models. Tables 1 and 2 list three lines of basic merchandise that were analyzed in this survey—men's white shirts, military type shoes, and small appliances. In the case of shirts and shoes, three exchanges were studied but for small appliances all nine Air Materiel Command exchanges were included. Examination of these tables shows the considerable extent to which the exchanges handle different brands and models in these merchandise lines. Specifically regarding the
appliance survey in Table 2, it is noteworthy that the exchanges with the smaller over-all sales volume frequently carry the most extensive assortment of goods.

Other illustrations of the merchandise difference found between exchanges are easily found. The exchange regulation (see Appendix A) authorizes the sale of garden tools and hand tools. Notice, however, that no mention is made of brands or qualities of tools to be sold. Consequently, one exchange was found to carry a simple, inexpensive line of hand tools whereas another handled only a line of very high priced tools, of a quality usually sold only to the trades. Once again, in the nine exchanges operated by the Air Materiel Command, a total of 152 items in the perfume and cologne line were handled, but only two of the items were common to all nine exchanges. Even in the case of tooth paste, only three items out of a total of 36 were found in all nine exchanges.

Although merchandise differences are to be expected with a system of decentralized buying, the extent of present differences with regard to brands and price lines suggests that exchange buyers would benefit from additional guidance and information in selecting the most appropriate items to handle. As explained in the preceding

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3 Study made by Headquarters Air Materiel Command Staff Exchange Officer, Captain Charles N. Maguinnis, together with the writer, April, 1960.

4 Ibid.
### TABLE 1

**Brands of Shirts and Shoes**  
**Handled By Three Air Materiel Command Exchanges**

<table>
<thead>
<tr>
<th>Category of Merchandise</th>
<th>Wright-Patterson</th>
<th>Tinker</th>
<th>Kelly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Men's White Shirts</td>
<td>Arrow &quot;Dart&quot;</td>
<td>York</td>
<td>Van Heusen</td>
</tr>
<tr>
<td></td>
<td>Button Cuff</td>
<td>Button Cuff</td>
<td>Button Cuff</td>
</tr>
<tr>
<td></td>
<td>Arrow &quot;Dale&quot;</td>
<td>Van Heusen</td>
<td>Arrow &quot;Par&quot;</td>
</tr>
<tr>
<td></td>
<td>French Cuff</td>
<td>French Cuff</td>
<td>French Cuff</td>
</tr>
<tr>
<td></td>
<td>Creighton</td>
<td>Van Heusen</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Button Cuff</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hathaway</td>
<td></td>
</tr>
<tr>
<td>Military Shoes</td>
<td>French Schreiner</td>
<td>French Schreiner</td>
<td>French Schreiner</td>
</tr>
<tr>
<td></td>
<td>2 Eyelet</td>
<td>5 Eyelet</td>
<td>2 Eyelet</td>
</tr>
<tr>
<td></td>
<td>French Schreiner</td>
<td>Bates</td>
<td>French Schreiner</td>
</tr>
<tr>
<td></td>
<td>5 Eyelet</td>
<td>2 Eyelet</td>
<td>5 Eyelet</td>
</tr>
<tr>
<td></td>
<td>French Schreiner</td>
<td>Bates</td>
<td>French Schreiner</td>
</tr>
<tr>
<td></td>
<td>5 Eyelet</td>
<td>Chukka Boot</td>
<td>Chukka Boot</td>
</tr>
<tr>
<td></td>
<td>Scotch Grain</td>
<td></td>
<td>Ward Hill</td>
</tr>
<tr>
<td></td>
<td>French Schreiner</td>
<td></td>
<td>Chukka Boot</td>
</tr>
<tr>
<td></td>
<td>Chukka Boot</td>
<td></td>
<td>Ward Hill</td>
</tr>
</tbody>
</table>

**SOURCE:** Study made by Headquarters Air Materiel Command Staff Exchange Officer, Captain Charles M. Maguinnis, 1958 (mimeographed).
TABLE 2

Number of Brands and/or Models of Small Appliances
Carried In the Nine Exchanges of the Air Materiel Command

<table>
<thead>
<tr>
<th>TYPE OF APPLIANCE</th>
<th>NUMBER OF BRANDS AND/OR MODELS HANDLED IN EACH AMC EXCHANGE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Wright- Patterson Tinker Griffiss Kelley Norton McClellan Brookley Robins Hill</td>
</tr>
<tr>
<td>Mixers</td>
<td>11 9 9 5 4 4 14 7 7</td>
</tr>
<tr>
<td>Toasters</td>
<td>5 3 4 3 4 3 4 2 4</td>
</tr>
<tr>
<td>Irons</td>
<td>6 7 6 4 5 5 5 1 5</td>
</tr>
<tr>
<td>Hot Plates</td>
<td>3 2 2 3 0 1 0 2 1</td>
</tr>
<tr>
<td>Electric Fans</td>
<td>14 4 8 3 2 2 4 0 5</td>
</tr>
<tr>
<td>Fry Pans &amp; Cookers</td>
<td>16 17 15 5 8 9 8 3 9</td>
</tr>
<tr>
<td>Coffeemakers</td>
<td>12 13 9 8 5 5 6 3 5</td>
</tr>
<tr>
<td>Heating Pads</td>
<td>4 2 2 2 2 2 1 1 1</td>
</tr>
<tr>
<td>Waffle &amp; Sandwich Grills</td>
<td>3 3 2 2 4 3 2 1 3</td>
</tr>
<tr>
<td>Blenders</td>
<td>3 4 1 0 1 1 3 1 2</td>
</tr>
<tr>
<td>Miscellaneous a</td>
<td>16 22 10 10 6 6 3 1 1</td>
</tr>
</tbody>
</table>

TOTAL NUMBER OF APPLIANCE ITEMS IN EACH EXCHANGE 93 101 84 46 40 41 50 22 43

TOTAL MERCHANDISE SALES, 1959 (THOUSANDS OF DOLLARS) 2,242 1,079 971 923 735 654 635 592 418

\*Items such as hairdryers, bottle warmers, sterilizers and vaporizers.

SOURCE: Study made by Headquarters Air Materiel Command Staff Exchange Officer, Captain Charles M. Maguinnis, 1958 (mimeographed).
section on buying responsibility, local buyers simply do not have the time carefully to select each item on its individual merits or in line with actual customer demand.

One solution that appears to be practical in this regard would be to establish a system whereby sales experience on brands and models could be disseminated among exchanges. Such a system would assist the local buyer in choosing merchandise which is known to have wide customer acceptance among exchange patrons and reduce the amount of guesswork which now takes place. Such a plan is currently being tested in Air Material Command. It deserves careful consideration and close watching.

Quantities and Sources of Supply

Essential to an effective buying program is the proper determination of quantities to purchase and the proper type of supplier for any given category of merchandise. In the domestic exchange system, considerable room for improvement exists as present regulations, policies, and procedures do not spell out clearly the requirements necessary for the correct accomplishment of these buying aspects.

It has been pointed out that exchanges utilize several types of suppliers, whereby some items are procured directly from manufacturers and others through various types of wholesale establishments. The need for these different suppliers can be appreciated in that one type is obviously not suited for all merchandise under all circumstances. The question, therefore, is not one of eliminating a given type of supplier but of finding out whether the most efficient one is being utilized for a given class of goods under particular conditions.
The data presented on the following pages will show that this is one of the weakest areas of exchange buying and that substantial improvements in merchandising are possible through a more scientific selection of sources of supply by type and by channels of distribution.

**Undue emphasis on direct buying.** The essence of the present difficulty stems primarily from a failure to appreciate fully:

1. The entire structure of distribution as it has developed in this country, particularly with regard to the role played by various wholesale establishments.

2. The essential and inherent nature of marketing functions.

3. The advantages to be derived from concentrating purchases with fewer sources.

Current exchange buying practices appear to place an undue emphasis on the direct manufacturer–exchange channel of distribution at the expense of alternative channels, which in many cases would provide exchanges with a more effective merchandising program.

At the Headquarters and service center levels, the emphasis placed on direct buying takes the form of buying policies and procedures which encourage, and in some instances force, the local exchange to buy on a direct basis. There is much evidence to show that this is the case. In a recent merchandise survey made of a Midwest exchange by the Baltimore Service Center, the following statement was noted:

Practically all merchandise is being procured from Price Agreement or Army and Air Force Catalogues wherever possible. Upon checking through two-hundred (200) purchase orders covering all departments in the open order file, there was not one instance when merchandise was procured from secondary sources.\(^5\)

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This statement typifies an attitude which seems to pervade the exchange system, namely, that prime source procurement utilizing price agreements and catalogues is almost always more desirable than buying goods locally through wholesale establishments. A further example of this attitude can be found in a memorandum from the same service center having to do with toy buying for the Fall 1960 selling season. In this memorandum exchange buyers were strongly urged to purchase at least 80 percent of their total toy requirements directly from manufacturers.

Concerning the numerous items which are under price agreement, exchanges are not only encouraged to buy direct but are compelled to do so by the basic buying regulation. This regulation has been established by Headquarters Exchange Service, is enforced by the service centers, and has the approval of the Departments of the Army and Air Force. The problem involves the rigidity of the regulation which states that "price agreement items will not be purchased from another source when the landed cost exceeds the price agreement source except under emergency conditions." As will be explained fully in a later part of the chapter, the difficulty with this policy is that landed cost is an unsatisfactory criterion with which to judge the suitability of a source of supply.

Policies and procedures emanating from the Headquarters and Service Centers are not the sole source of the problem. A large part of

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6 Army Regulation 60-20 and Air Force Regulation 147-14, 27 February 1959, p. 51.
the difficulty is found on the operating level. Exchange buyers buy many lines on a direct basis in addition to those items which they are required to buy in this way. This is based on the age-old belief that circumventing wholesale middlemen always results in lower costs. The fallacy of this viewpoint has long been recognized by marketing authorities.7

**Number of suppliers utilized by exchanges.** By its very nature, any buying practice which stresses prime source procurement for the domestic exchange system makes it necessary for each exchange to maintain contact with a very large number of vendors, since most exchanges handle many different lines of goods and most manufacturers produce only a few products. Exceptions are to be found, of course, as in the case of Procter and Gamble, a company which sells many items to exchanges. On the other hand, most firms are much smaller and produce and sell only a narrow line of products. The Murine Eye Drop Company, for example, produces but a single item.

Table 3 shows the total number of sources that were used by twenty exchanges during 1959. Although there is a wide range from one exchange to another, from 431 for Bergstrom to 972 at Wright-Patterson, it should be observed that many sources were found in every instance. In fact, 18 out of the 20 exchanges purchased from more than 500 sources each. Even the exchange having the fewest sources bought from 431. These data raise a number of important questions.

The first concerns the desirability and practicality of buying from such a large number of vendors, particularly when it is recalled that most items are purchased in small quantities by non-specialized buyers. Table 3 shows that it is not at all unusual for the average exchange to buy from between 600 and 800 suppliers during the course of a year's operation.

A second but related question involves the significant difference in the number of vendors used between one exchange and another. Barksdale Air Force Base, for example, bought from 576 different companies in 1959 whereas Wright-Patterson, an exchange with approximately the same sales volume, utilized 972 vendors or over one and two-thirds as many. The question that must be raised is whether the larger or smaller number of sources permits the exchange to do the best job of merchandising.

The analysis presented on the following pages will show that the average exchange buyer is currently utilizing a number of sources greatly in excess of what is necessary or desirable from the standpoint of sound marketing practice. The problem of "too many sources" is probably the single most important impediment standing in the way of a more effective and economical merchandising program for domestic exchanges.

An insight into the difficulties that are encountered by exchanges in dealing with such a large number of vendors can be obtained by examining the data presented in Table 4. This table breaks down on a departmental basis the number of sources used at two Air Force exchanges in 1959. In every department numerous sources are used, but
### TABLE 3

Number of Sources of Supply Utilized  
By Specified Exchanges in 1959

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Number of Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wright-Patterson</td>
<td>972</td>
</tr>
<tr>
<td>McConnell</td>
<td>890</td>
</tr>
<tr>
<td>Forbes</td>
<td>859</td>
</tr>
<tr>
<td>Bolling</td>
<td>801</td>
</tr>
<tr>
<td>Whiteman</td>
<td>798</td>
</tr>
<tr>
<td>Fort Devon</td>
<td>764&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Lockbourne</td>
<td>767</td>
</tr>
<tr>
<td>Altus</td>
<td>672</td>
</tr>
<tr>
<td>Kelly</td>
<td>633</td>
</tr>
<tr>
<td>Bunker Hill</td>
<td>614</td>
</tr>
<tr>
<td>Little Rock</td>
<td>613</td>
</tr>
<tr>
<td>Columbus</td>
<td>611</td>
</tr>
<tr>
<td>Chennault</td>
<td>606</td>
</tr>
<tr>
<td>Barksdale</td>
<td>596</td>
</tr>
<tr>
<td>Lincoln</td>
<td>589</td>
</tr>
<tr>
<td>Carswell</td>
<td>512</td>
</tr>
<tr>
<td>L. G. Hanscom</td>
<td>503&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>Clinton Sherman</td>
<td>501</td>
</tr>
<tr>
<td>Pease</td>
<td>450</td>
</tr>
<tr>
<td>Bergstrom</td>
<td>431</td>
</tr>
</tbody>
</table>

<sup>a</sup>For all exchanges except Fort Devons and L. G. Hanscom, the number of sources is slightly overstated because vendor information had to be collected on a departmental basis. This caused a slight duplication because some vendors sell items in more than one department. This is not considered to be a significant factor, however. Furthermore, the relationships shown between one exchange and another are not affected.

<sup>b</sup>Actual number of sources is higher than stated because records were maintained for regular suppliers only; seasonal sources and those used infrequently are not included.

<sup>c</sup>Actual number of sources; no duplication from one department to another.

SOURCE: Data collected from a detailed analysis of purchase orders maintained by each exchange.
TABLE 4
Number of Sources Used By Specified Departments at Wright-Patterson Air Force Base and Lockbourne Air Force Base in 1959a

<table>
<thead>
<tr>
<th>Department</th>
<th>Wright-Patterson</th>
<th>Lockbourne</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobacco</td>
<td>35</td>
<td>44</td>
</tr>
<tr>
<td>Candy</td>
<td>20</td>
<td>28</td>
</tr>
<tr>
<td>Drug Sundry</td>
<td>99</td>
<td>118</td>
</tr>
<tr>
<td>Military Apparel</td>
<td>41</td>
<td>32</td>
</tr>
<tr>
<td>Jewelry</td>
<td>62</td>
<td>70</td>
</tr>
<tr>
<td>Stationery</td>
<td>60</td>
<td>58</td>
</tr>
<tr>
<td>Civilian Clothing</td>
<td>254</td>
<td>165</td>
</tr>
<tr>
<td>Housewares, Other</td>
<td>375</td>
<td>238</td>
</tr>
<tr>
<td>Bottled Drinks</td>
<td>26</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>972</strong></td>
<td><strong>767</strong></td>
</tr>
</tbody>
</table>

a Data slightly overstated because vendor information had to be collected on a departmental basis. See explanation Table 3.

SOURCE: Data collected from a detailed analysis of purchase orders maintained by each exchange.
especially those handling drug sundries, civilian clothing and housewares. For example, at Lockbourne Air Force Base 238 vendors were utilized in Department Eight alone. A wide variety of merchandise is handled in this department, including housewares, hardware, paint, luggage, photographic equipment, garden supplies, toys, records and other miscellaneous categories of goods. This gives some idea of the enormous task which faces an exchange buyer as each individual source must be handled separately for purposes of buying and control. This involves the preparation of a multitude of separate orders, for which requirements must be individually determined, orders individually placed, scheduled, routed, and received.

In addition to the confusion and wasted effort which results from doing business with such a large number of vendors, this buying practice is uneconomical and, worst of all, ineffective. The detailed data which have been developed on the exchange at Wright-Patterson Air Force Base, serve to illustrate the futility of the present exchange approach to buying. Involved is a comprehensive study of the relationships that exist between sales volume and sources of supply in six of the nine selling departments in this exchange for 1959. These six departments were not selected at random but because the greatest opportunity for buying improvement exists in them.8 Table 5 portrays

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8Two of the three remaining departments, military clothing and other clothing, were not analyzed because the opportunity for a substantial change in the current channel choice (which now emphasizes direct buying) was not considered to be practical. There was little need to analyze the remaining department, bottled drinks, because the nature of the item causes it to be distributed almost entirely on a local basis.
the data collected for the drug department and Table 6 shows the data on the housewares, tobacco, candy, jewelry, and stationery departments. These data are presented because they show that the same buying pattern prevails throughout with regard to the utilization of sources.

The important point to consider is that in each case a small fraction of the sources utilized accounts for the bulk of dollar purchases and that the majority of sources account for an insignificant percent of dollar purchases. As shown in Table 5, for example, out of a total of 99 sources used in the drug department, over one-third (35 sources) are responsible for a mere 2.7 percent of drug purchases for the year. At the other extreme, fifteen of the 99 sources were responsible for almost 75 percent of dollar purchases. At Lockbourne Air Force Base, a similar relationship in the drug department was found to exist in that almost half of the vendors used (49 out of 118) accounted for only 4.4 percent of total drug purchases.

The situation in the housewares department, as portrayed in Table 6, is perhaps even more serious because of the complexity of the department and the very large number of sources involved. For this department, the table shows total purchases for the year and the number of vendors used in the department with the exception of toys. Toys were omitted from the analysis because of the seasonal nature of this business.

It can be seen that Wright-Patterson bought from a total of 241 vendors in this department during 1959. Of the 241 vendors used, 121, or half, accounted for a mere 2.9 percent of total purchases. The average size of orders placed with these vendors was $76.00.
TABLE 5

The Relationship Between Dollar Purchases and The Utilization of Sources in the Drug Department at Wright-Patterson for 1959

<table>
<thead>
<tr>
<th>Number of Sources</th>
<th>Purchases in Dollars(^a)</th>
<th>Percent of Total Purchases</th>
</tr>
</thead>
<tbody>
<tr>
<td>99 Total</td>
<td>$270,440</td>
<td>100.0%</td>
</tr>
<tr>
<td>15 Most Important</td>
<td>198,800</td>
<td>73.5%</td>
</tr>
<tr>
<td>34 Next Most Important</td>
<td>57,270</td>
<td>21.2%</td>
</tr>
<tr>
<td>15 Unimportant</td>
<td>7,040</td>
<td>2.6%</td>
</tr>
<tr>
<td>35 Least Important</td>
<td>7,330</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

\(^a\)Analysis considers only purchases for stock, all special orders are excluded because these are naturally small and would distract the data which is designed to show the buying pattern for regular purchases only.

SOURCE: Data collected from a detailed analysis of purchase orders maintained by the exchange.
This situation gradually worsens to the point where the least significant one-fourth of the sources (60) accounted for less than one percent of the purchases. The average order size in this case was only $47.00. The data presented in Table 6 on the four other departments studied at Wright-Patterson show that this buying pattern is pervasive and that a large number of sources account for a small percent of total purchases in each case. Also shown is the small average order size which results from such buying practices.

Basis for comparison of sources of supply. The primary fallacy in the present approach to exchange buying is that the decision concerning the selection of channel sources is based almost altogether on the landed cost of the item under consideration. There is little doubt that prime source procurement does tend to give the exchange goods at a landed cost which is frequently (but not always) lower than what is otherwise obtainable. This does not necessarily make the direct purchase the most desirable or economical, however. Landed cost, per se, is not a satisfactory criterion for channel choice. Many other factors must be considered, including the type of merchandise handled, size of the exchange, nearness to supply sources, policy with regard to quantity buying, and ability of the exchange to perform satisfactorily the many marketing functions incident to obtaining the goods for resale.

In the case of large sales-volume stores and multi-unit retailers using central buying, many direct contacts with manufacturers are common and practical. In such cases marketing functions ordinarily performed by wholesale establishments can be integrated within the
**TABLE 6**

Total Purchases, Number of Suppliers, Percent of Total Purchases and Average Order Size from Least Important 50 Percent and Least Important 25 Percent of all Suppliers, Specified Departments, Wright-Patterson Air Force Base, 1959

<table>
<thead>
<tr>
<th>Department</th>
<th>Total Purchases</th>
<th>Total Number of Suppliers</th>
<th>Percent of Total Purchases from Least Important 50% of Suppliers</th>
<th>Percent of Total Purchases from Least Important 25% of Suppliers</th>
<th>Average Size of Order from Least Important 50% of Suppliers</th>
<th>Average Size of Order from Least Important 25% of Suppliers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housewares</td>
<td>$592,070</td>
<td>241</td>
<td>2.9%</td>
<td>0.7%</td>
<td>$76</td>
<td>$47</td>
</tr>
<tr>
<td>Tobacco</td>
<td>453,961</td>
<td>35</td>
<td>0.7%</td>
<td>0.1%</td>
<td>40</td>
<td>22</td>
</tr>
<tr>
<td>Candy</td>
<td>56,481</td>
<td>20</td>
<td>7.6%</td>
<td>1.4%</td>
<td>82</td>
<td>50</td>
</tr>
<tr>
<td>Jewelry</td>
<td>91,902</td>
<td>62</td>
<td>24.1%</td>
<td>5.7%</td>
<td>109</td>
<td>82</td>
</tr>
<tr>
<td>Stationery</td>
<td>81,896</td>
<td>60</td>
<td>4.4%</td>
<td>1.0%</td>
<td>49</td>
<td>25</td>
</tr>
</tbody>
</table>

*Excludes seasonal toy purchases.

SOURCE: Data collected from a detailed analysis of purchase orders maintained by the exchange.
retailing organization. Notice, however, that these marketing functions are not eliminated but are performed by the retailing organizations themselves. As previously defined, a marketing function is a basic activity which must be performed in the marketing process. These functions can at times be shifted forward or backward in the channel of distribution (back toward the manufacturer or forward toward the retailer) but they cannot be eliminated. Good business practice dictates that these functions should be shifted only when they can be performed more efficiently at a different level in the distribution channel. The question facing the exchange system is whether or not it is practical for exchanges, operating as they do on a decentralized basis, to assume performance of marketing functions to the extent required by current buying policy.

At the outset, it must be understood that many direct purchases by exchanges are easily justified and constitute by far the most effective and economical method of procurement. For example, in the case of products purchased directly from the Colgate-Palmolive Company, even the smaller exchanges will purchase around $1,000 per month. In this case, the volume of purchases by the exchange makes direct contact with the manufacturer highly desirable and practical.

On the other hand, many purchases are now made by exchanges in quantities which are insufficient and at price savings which are too small to justify buying on a direct basis from manufacturers and the so-called price savings are more than offset by the additional costs involved. These small purchases should be consolidated and the orders placed with wholesale establishments which are in a much better
position to handle them. This can be appreciated by referring to Table 7, which shows three specific items that were purchased on a direct basis by Wright-Patterson in 1959. These items, which are merely representative of many, are Pacquins Handcream, Sight-Savers and Aspergum. For each of the items, the table shows total purchases for the year, the number of orders placed, and the average order size. Compared to this is the price that would have been paid by the exchange if these items were purchased from the local wholesaler and the percent difference in the price between the direct and the local source. It can be observed that the local price is higher in each instance, ranging from 2.4 percent higher for the hand cream to 15 percent higher for Aspergum. Present exchange policy causes these items to be bought direct because of the higher landed cost incident to purchasing them from a wholesaler. All things considered, however, the wholesaler is by far the more appropriate source for these items, even though the cost price is higher.

In selecting the type of supplier for a particular class of goods, it is essential for the exchange system to think less in terms of landed cost and more in terms of total marketing costs. When this is done, it will be found that buying direct is oftentimes more costly than buying through wholesale establishments. A low cost of goods sold becomes misleading if other expenses incident to the purchase are much higher. These expenses take a variety of forms, some of which are analyzed below for purposes of illustration.
TABLE 7

Landed Cost, Number of Orders, Average Order Size on Selected Items Purchased Direct Compared to Landed Cost of the Same Items Purchased Through a Wholesaler, Wright-Patterson Air Force Base, 1959

<table>
<thead>
<tr>
<th></th>
<th>Pacquins Hand Cream</th>
<th>Sight Savers</th>
<th>Aspergum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Landed Cost Purchased Direct</td>
<td>$661.00</td>
<td>$118.56</td>
<td>$54.48</td>
</tr>
<tr>
<td>Number of Orders</td>
<td>8</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Average Order Size</td>
<td>$83.00</td>
<td>$29.64</td>
<td>$13.62</td>
</tr>
<tr>
<td>Total Landed Cost Purchased from Wholesaler</td>
<td>$677.54</td>
<td>$124.40</td>
<td>$62.52</td>
</tr>
<tr>
<td>Percent Higher from Wholesaler</td>
<td>2.4%</td>
<td>4.9%</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

SOURCE: Data collected from actual purchase orders for the items compared to established prices charged for same quantities from local drug wholesaler.
Purchasing costs. One such expense that is totally overlooked in the exchange system at this time is the cost of placing a purchase order. Although it is difficult to state this cost precisely, when all aspects of the processing of a purchase order are considered, this cannot be regarded as an incidental matter. Involved is the buyer's time determining the individual order, the time that it takes the clerk to type the order, the cost of the order form, the cost of processing the order through the service center, maintaining accounts payable records, and the cost of receiving and checking the merchandise against the order when it is finally received at the exchange. It is beyond the scope of this study to determine these various costs on an exact basis. For purposes of analysis, however, it is possible to make several assumptions which illustrate the significance of this matter. While certain of these costs vary with the number of line extensions on a given order, a large portion remains relatively constant regardless of the number of items included on it. If the purchase order is for a single item, as is frequently the case with direct buying, the entire purchase order cost must be borne by the one item. On the other hand, if twenty items are purchased on the same order, that portion of the cost remaining constant per purchase order is distributed over the number of items involved. It is obvious, therefore, that costs incident to purchase orders will be less when purchases are consolidated with wholesalers than when an attempt is made to purchase items individually from manufacturers. The figures below, although not exact, give an indication of the importance of this cost when a small order for one or a few items is placed separately.
For purposes of illustration, it has been assumed that the portion of the cost of a purchase order that remains constant is $5.00, a figure which may well be conservative according to Brig/Gen Ray J. Laux, Chief, Army and Air Force Exchange Service, and authorities in the field of purchasing. It has been assumed also that if small orders were consolidated with wholesalers that at least ten line extensions would be obtained per order. This means that the portion of the purchase order cost that remains constant is reduced to fifty cents ($5.00 divided by 10) per line extension.

Table 8 shows the impact that this unavoidable cost has on the three small purchases cited previously—Pacquins Hand Cream, Sight-Savers, and Aspergum. When purchased direct it is necessary to add a $5.00 cost to each order; when purchased through a wholesaler only

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9Personal interview with Mr. Clifton E. Mack, former Commissioner of Federal Supply, United States Government, April 19, 1960 and Dr. Howard T. Lewis, Professor of Marketing, Harvard University Graduate School of Business, December 7, 1960.

For further reference see Howard T. Lewis, Procurement Principles and Cases (Homewood, Ill.: Richard D. Irwin, Inc., 1955), p. 782.

10This figure is felt also to be conservative. A comprehensive study, involving an analysis of a number of typical wholesalers' invoices for the year 1950 in five lines of trade (dry goods, drugs, groceries, hardware, and tobacco) revealed the fact that the average invoice for all these lines taken together totaled $107.14, involved over 24 items ($4.42 per item), and called for merchandise from about 17 manufacturers ($6.52 per manufacturer). For groceries the average order was $177, with 40 items and 26 manufacturing sources; for drugs it was $88, with 30 items and 20 manufacturing sources; for dry goods it was $117, with 20 items and 13 manufacturing sources; for hardware it was $94, with 18 items and 13 manufacturing sources; and for tobacco it was $59, with 14 items and 11 manufacturing sources. For further reference see: Milan R. Karas, The Contributions Made by Wholesalers to the Economy of Hamilton County, Ohio (unpublished doctoral dissertation, The Ohio State University, 1951), p. 125.
TABLE 8

The Impact of the Fixed Portion of Purchase Order Cost on the Landed Cost of Selected Items Purchased Direct and Through a Wholesaler, Assuming a $5.00 Cost Direct and $0.50 Cost Using a Wholesaler

<table>
<thead>
<tr>
<th></th>
<th>Pacquins Hand Cream</th>
<th>Sight Savers</th>
<th>Aspergum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Landed Cost Direct</td>
<td>$661.00</td>
<td>$118.56</td>
<td>$54.48</td>
</tr>
<tr>
<td>Number of Orders</td>
<td>8</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Landed Cost from Wholesaler</td>
<td>$667.54</td>
<td>$124.40</td>
<td>$62.52</td>
</tr>
<tr>
<td>Percent Higher from Wholesaler</td>
<td>2.4%</td>
<td>4.9%</td>
<td>15.0%</td>
</tr>
<tr>
<td>Landed Cost Direct plus $5.00 per purchase order</td>
<td>$701.00</td>
<td>$138.56</td>
<td>$74.48</td>
</tr>
<tr>
<td>Landed Cost from Wholesaler plus $0.50 per line extension</td>
<td>$671.54</td>
<td>$126.40</td>
<td>$64.52</td>
</tr>
<tr>
<td>Percent Lower from Wholesaler</td>
<td>2.9%</td>
<td>8.7%</td>
<td>13.3%</td>
</tr>
</tbody>
</table>

SOURCE: See Table 7.
$0.50 is added because these items are consolidated with others on the same order. In each of the three examples cited, observe that when this cost is added to the landed cost of the goods that it is more expensive to buy direct than through a wholesaler source. Since this analysis is based on assumptions regarding purchasing costs which have not been verified empirically, it is merely indicative of the probable effect of buying policies on such costs. Detailed study of the nature and extent of purchasing costs would, of course, be necessary in order to derive results that could be used in setting a more rational policy.

Stock turnover and inventory investment. The cost of purchase orders is but one factor which must be considered in addition to the landed cost of goods. Perhaps of even greater importance is the matter of stock turnover and inventory investment. In some department stores, for example, these matters are so important that department managers are charged a rate of interest on dollars invested in inventory. This focuses attention on turnover and the fact that money invested in inventory must earn a satisfactory return or be invested elsewhere. In this regard, many retailers have found that frequent purchases from wholesalers in small quantities sometimes permit reductions in inventory investment that justify the higher merchandise costs involved.

To be realistic the selection of the proper type of supply source can be made only when considered in relationship to turnover and inventory investment. The relationships that exist between these various factors are illustrated in Table 9 which shows, in a hypothetical
example, that the high gross margins that are sometimes obtained by buying direct are frequently more than offset by slower turnover and higher inventory investment.

For purposes of analysis, it has been assumed for Table 9 that on this particular item sold in exchanges, a turnover rate of four times a year could be obtained by buying through a wholesaler but that only two turns are possible when buying direct.\(^{11}\) A fixed selling price has also been supposed so that total sales are the same regardless of the source or the cost of the goods sold. This example further assumes that if the item is bought direct, the exchange could obtain a 20 percent gross margin on total sales but that if purchased from a wholesaler the margin would be only 15 percent. On the surface, it would appear that the direct purchase is by far the most profitable as the gross margin received is one-fourth greater in dollars and percent.

To discontinue the analysis at this point, as is done in the exchange system, is unrealistic because gross margin must be considered in terms of turnover and inventory investment. As shown in Table 9 with a turnover of 2 times a year, the inventory investment for this item averages $800 per year (on the basis of cost) while with a turnover of four times the average inventory is only $425 per year. What this means is that for the exchange to earn the additional $100 in

\(^{11}\)Considering the minimum shipping quantities required by many manufacturers, such a comparison is not unrealistic. For example, the Ludens Coughdrop Co., Reading, Pa., has a 250 pound minimum shipping quantity. This is a quantity of cough drops in excess of what many exchanges sell in an entire year.
gross margin, which seems quite admirable at first glance, it becomes necessary to increase its average inventory by $375 per year. When viewed in terms of gross margin return in dollars invested, this causes the exchange to earn less with the direct purchase because the added margin is not sufficient to offset the slower turnover and higher inventory investment. Whereas gross margin return is 50 percent on a direct basis, it is a more favorable 71 percent return through the wholesaler. For the exchange to earn a comparable return on inventory investment, the margin required with the direct purchase is frequently far in excess of what can be realistically obtained from the vendor. In the case of the hypothetical example cited, the margin required would be 26 percent, an amount considerably higher than the 20 percent now attained.

The importance of rapid stock turnover to the Rike-Kumler Co., a leading midwestern department store, was expressed by a vice-president of the company as follows:

We believe in good basic stocks with adequate assortments in style merchandise as well as staples in depth. But we do not believe that high stocks are any guarantee to proper stocks. Therefore, we believe in low stocks and in rapid turnover.... We believe in a working "never out" system that really functions—our low stock policy makes this essential to our operation. It is necessary to have the facts to work with, and we insist upon having good stock controls which are constantly being reviewed and improved.13

12 For a detailed analysis of this aspect of buying and the formulas used in computing the gross margin percent needed to offset lower turnover and higher inventory investment, refer to: "The New Look in Retailing," Hardware Retailer, October, 1958, pp. 124-127.

TABLE 9

The Importance of Turnover in Determining The Proper Channel of Distribution for a Particular Item, Showing the Relationship between Gross Margin and Return on Inventory Investment

<table>
<thead>
<tr>
<th></th>
<th>Item Purchased Direct</th>
<th>Item Purchased from Wholesaler</th>
<th>Gross Margin Needed for Equal Return on Inventory Investment when Purchasing Direct^a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$ 2,000</td>
<td>$ 2,000</td>
<td>$ 2,000</td>
</tr>
<tr>
<td>Assumed Gross Margin - Percent</td>
<td>20%</td>
<td>15%</td>
<td>26%</td>
</tr>
<tr>
<td>Assumed Gross Margin - Dollars</td>
<td>$ 400</td>
<td>$ 300</td>
<td>$ 520</td>
</tr>
<tr>
<td>Landed Cost of Goods</td>
<td>$ 1,600</td>
<td>$ 1,700</td>
<td>$ 1,480</td>
</tr>
<tr>
<td>Turnover Rate</td>
<td>2 times</td>
<td>4 times</td>
<td>2 times</td>
</tr>
<tr>
<td>Average Inventory Investment (at cost)</td>
<td>$ 800</td>
<td>$ 425</td>
<td>$ 740</td>
</tr>
<tr>
<td>Percent Gross Margin Return on Dollars Invested in Inventory</td>
<td>50%</td>
<td>71%</td>
<td>71%</td>
</tr>
</tbody>
</table>

^For formulas used in computing the gross margin percent needed to offset lower turnover and higher inventory investment, refer to source indicated below.

The above factors, the cost of purchase orders and the importance of turnover and inventory investment, suggest that comparisons of landed costs, per se, provide an inadequate basis for the selection of sources of supply for a retail establishment. Direct buying from manufacturers when volume does not justify such a practice violates sound marketing principles and disregards the structure of distribution as it has been developed in this country. What is needed on the part of exchange management personnel is recognition of the strategic role played by wholesale establishments in the distribution system and the advantages to be derived from concentrating purchases with them.

**Services of the regular wholesaler.** Concerning the regular wholesaler, the following are numbered among the important services that he is in a position to provide for exchanges. First, there is the matter of anticipating exchange needs. Exchange buyers, being responsible for the procurement of so many different lines of goods, cannot possibly keep track of what is happening in each merchandise line. The wholesaler, on the other hand, operating on a large scale, maintains very careful stock and sales records, and thus determines in advance quantities of various items that will be needed to satisfy his trade. In this connection, the wholesaler continually searches for new merchandise and drops old items out of the line before they become obsolete.

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14 For a more thorough analysis, see Beckman, *Wholesaling*, op. cit., pp. 109-150.
A second service performed for the exchange by wholesalers is that they assemble goods from hundreds of manufacturers. The size of the typical wholesale operation makes it feasible to use specialized buyers who concentrate their efforts on buying a limited number of lines of goods each. It is the absence of the wholesaler that is causing exchanges to buy from such a large number of sources at this time.

A third function performed by wholesalers for exchanges has to do with maintaining a substantial inventory of goods which is readily available to the exchange on short notice. In most cases goods can be delivered quickly after the order has been placed. To order direct from manufacturers commonly requires a far greater amount of time, frequently over a month to receive delivery. In this same connection, orders placed with wholesalers are delivered to exchanges at the expense of the wholesaler.

A final service performed by wholesalers for exchanges, and one that is becoming more important in progressive concerns, is that they provide information and advisory assistance. In addition to helping the exchange plan proper merchandise lines, other assistance is given in such matters as sales promotional advice, advice on store layout and arrangement, along with advice and assistance on display.

Although not generally understood, wholesalers have not only maintained their competitive position in modern times but have actually improved it during recent decades. This can be seen by examining the data in Table 10, which presents a comparison of sales volume of wholesalers and all retail stores for 1939 and 1954. This table
shows that not only has the physical volume of goods distributed by wholesalers more than doubled during this fifteen year period but the rate of increase was greater than what has been experienced by all retail stores. "This, indeed, is convincing evidence that the wholesaler has not only maintained his competitive position in modern times, but has actually improved it substantially." The above facts are presented because they clearly show that such statements referring to the "decline of the wholesaler," and more recently, the "comeback of the wholesaler" are erroneous in that the wholesaler as an institution has never declined in absolute or relative terms to have staged a comeback.

Even large firms rely on wholesalers for certain commodities under particular conditions. In gathering comparative data in connection with this study, it was found, for example, that in the drug departments of two very large and modern department stores, that in each case approximately 33 percent of total department purchases are made with local drug wholesalers. This is the case even though both stores have specialized drug buyers and great purchasing power. Similarly, the importance of the wholesaler is evidenced by their use by supermarket chains, normally regarded as integrated firms performing their own wholesaling functions. Even these chains sometimes make use of a special type of wholesaler, known as the rack jobber, for non-food lines such as drugs, clothing, and auto accessories.

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16 In one case, total store volume is approximately $50 million annually; in the other, almost $100 million annually.
<table>
<thead>
<tr>
<th></th>
<th>Sales Volume in 1954 Dollars (Billions)</th>
<th>Percent of Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesalers</td>
<td>$49.6</td>
<td>$101.1</td>
</tr>
<tr>
<td>All Retail Stores</td>
<td>88.5</td>
<td>170.0</td>
</tr>
</tbody>
</table>

**SOURCE:** Beckman, *Principles of Marketing, op. cit.*, p. 283
Manufacturers' sales branches. The manufacturers' sales branch is the second type of wholesale establishment which sells to exchanges. This particular type of wholesale establishment is perhaps the least understood, primarily because its ownership is often confused with its functioning. For example, many exchange buyers who were found to be opposed to buying from wholesalers were receptive to buying from manufacturers' sales branches because they felt that the latter was the same as buying "direct." In reality, of course, such thinking is incorrect because the very purpose of the sales branch is to perform marketing functions.

Generally, this type of distribution system is used only by larger firms which are able, by way of a long line of products or products with a high unit value, to generate sufficient volume to cover the costs inherent in performing marketing functions on an integrated basis. Westinghouse Corporation serves as an example of a manufacturer that operates its own sales branches. Westinghouse owns and operates 71 sales branches in the major metropolitan areas of the country which stock merchandise which is sold through its own sales force. Not all Westinghouse appliances are sold through these sales branches, however. In those areas where there is not sufficient volume to justify a direct operation, wholesale distributors are used. To illustrate, in the middle and southern sections of Kentucky, Westinghouse appliances are sold through wholesalers operating out of Lexington and Louisville. In contrast to this, the northern part of the state is serviced by the manufacturers' sales branch operating out of Cincinnati, Ohio.
Other types of wholesale middlemen. In addition to the regular wholesaler and the manufacturers' sales branch, selling agents and manufacturers' agents are also in a position to serve exchanges to a greater extent than what they are now being used. These middlemen, who do not as such take title to goods, serve exchanges in a more limited capacity than wholesalers. Whereas regular wholesalers perform to some extent all of the marketing functions, agents act principally as a specialized type of sales organization for vendors desiring to do business with exchanges. These institutions perform the selling function efficiently because they typically sell a number of related merchandise lines from different manufacturers. This allows the agent to spread his cost of doing business among all of the vendors that he represents, rather than only one. Obviously, this is advantageous to the manufacturer in that he is able to reach this specialized market more effectively than by using his own selling force.

Some manufacturers' agents specialize in selling only to military and government organizations. These sometimes are designated as "military representatives" in the exchange system. Some of these specialized manufacturers' agents do a thriving business with exchanges because they are intimately acquainted with exchange operations, the regulations which govern them, the location of exchanges, and the problems which face exchange buyers.

The success of manufacturers' agents and selling agents in the marketing system is explained by the efficiency with which they perform marketing functions, particularly the selling function. Take, for example, a manufacturers' agent who sells exclusively to exchanges,
the Medicated Products Company. The firm represents thirty different manufacturers, all of which desire to sell to exchanges but cannot economically do so on their own. By representing all of these manufacturers, this manufacturers' agent finds it profitable to call on every exchange in the country every four to six weeks to provide exchange buyers with information on new products, recent sales trends, special offerings, and other information which is essential for good merchandising.

When used properly, these middlemen are in a position to be of service to the manufacturer and the exchange in ways which cannot be economically duplicated by alternative channels of distribution. The agent may be looked upon as a type of middleman that does on a more limited scale and primarily on the selling function what the wholesaler (and sometimes the manufacturers' sales branch) does on a broader scale with more functions. There is a need for all three types of wholesale establishments under particular circumstances and conditions.

The inherent nature of marketing functions. Even if the exchange system changed over to one of central procurement, there is a serious question whether such a buying program would be more efficient than one which made proper use of wholesale middlemen. It is true that central buying would make direct contact with manufacturers practical, but this does not solve the problems associated with having the exchange system assume the other marketing functions that are presently being performed by wholesale establishments. Central procurement, if made to work at all, would involve shifting all of the marketing
functions forward to the exchange system, thereby having it assume full responsibility for transportation, storage, risk, additional financial needs, standardization, and information.

There is some doubt as to whether a completely integrated distribution system would be practical for domestic exchanges. Aside from the political implications, one must consider the operating difficulties that would be involved. Headquarters Army and Air Force Exchange Service, in effect, would have to establish a hybrid type of wholesaling organization to handle a number of distinctly unrelated merchandise lines. This would include merchandise in all of the jobbing lines (drugs, hardware, groceries, and dry goods) in addition to the many other lines handled in exchanges. This newly formed establishment would then serve a limited number of retail stores that are dispersed widely throughout the nation. The transportation and storage problems alone perhaps would be so serious as to make it impractical for the exchange to circumvent the wholesaler entirely. Ryan, in recognizing the role of wholesale establishments in exchange distribution, supports this view and concludes that too few individuals understand that the "geographical location of (exchange) stores...and the enormous problems of transportation of merchandise thousands of miles to inaccessible bases makes it a great deal unlike Macy's, Sears, Wards, Allied or Federated."17

17Ryan, op. cit., p. 54.
It is possible, therefore, that an integrated marketing system actually could compound present difficulties rather than alleviate them. Since the present situation is unsatisfactory, the key to more effective buying in domestic exchanges lies in an understanding of their general store character, a recognition of the marketing limitations which result therefrom, and an appreciation for the structure of distribution as it has developed in the country. It has been the failure to recognize these matters that has caused many of the undesirable present practices to develop and persist.
CHAPTER VIII
THE EXCHANGE FROM A SELLING VIEWPOINT

The exchange system, like other merchandising organizations, must give primary consideration to the way the selling function is performed. In retailing, "selling is an indispensable part of every transaction and is the basic reason for the operation."1 This chapter continues the analysis begun in Chapter V pertinent to the nature and functioning of the exchange system. Emphasis here relates to the manner in which exchanges perform the selling function although other marketing functions, such as transportation, storage, and marketing finance, are also considered in relation to selling.

Specifically, the following subjects are presented and analyzed in this chapter. First, there is an evaluation of the way exchanges are organized to perform this function. The chapter continues with an analysis of exchange pricing policies. This sensitive subject is particularly significant because it reveals the extent to which exchanges can operate on lower markups than retail stores operating on a private profit-motivated basis. Considered next are matters relating to the physical facilities and fixtures utilized by exchanges for merchandising operations, warehousing, service activities, and concessions. In the final section, merchandising policies relative to advertising, sales promotion, and customer services are presented and analyzed.

1Beckman, Principles of Marketing, op. cit., p. 129.
These areas are considered in this chapter because they indicate the manner in which the selling function is performed in domestic exchanges. An understanding of these activities provides further insight into the nature of the system and the extent to which exchanges meet the needs and wants of its military customers.

Before proceeding, it must be recognized that this chapter is not an evaluation of specific merchandising systems or techniques, such as inventory control, materials handling, or warehousing. Certainly, these are important considerations, as properly installed systems and procedures are vital to proper functioning of any business organization. This analysis is more general in scope and is intended to reveal the basic character of the exchange system and to analyze this system as a part of the total marketing structure. Studies that would consider specific systems and techniques should also be made with the view toward finding ways to improve these aspects of the exchange system.

ORGANIZATION FOR MERCHANDISING AND CONTROL

From a selling viewpoint, an effort has been made to organize exchange operations in a way which gives a degree of merchandise control. For purposes of accounting and control, a simple form of departmentization has been established for all exchange outlets selling merchandise, in which all goods sold are classified into nine separate selling departments. More extensive departmentization is sometimes found but no common pattern can be detected because this is left up
to the individual exchange. The major categories of goods handled in these nine departments are as follows:

1. Tobacco Products and Smoking Accessories
2. Candy
3. Drug Sundry Products and Cosmetics
4. Military Apparel and Accessories
5. Jewelry
6. Books, Periodicals, Greeting Cards, Stationery and Miscellaneous
7. Men's, Women's and Children's Clothing & Accessories
8. Sundry - Housewares, Traffic Appliances, Toys, Hardware, Garden Supplies, Photographic Equipment, and Other
9. Bottled Drinks (including 3.2% beer)\(^2\)

It can be seen that some attempt has been made to group related merchandise together. For example, note that all civilian clothing is found in Department 7 and that all drug sundries, cosmetics, hair grooms and related items are found in Department 3.

Although the modest size of most exchanges and the limited volume of business done in any one type of merchandise prohibits extensive departmentization, the changing character of exchange sales does suggest a need for further classification in Department 7, civilian clothing, and Department 8, classified as Sundry. Together these two departments accounted for approximately 36 percent of total

\(^2\)Appendix B shows in detail the items and categories of items which are authorized for sale in each department.
merchandise sales in 1959. Every indication is that they will continue to become proportionately more important each year because of the increasing number of family personnel in the services who naturally demand more goods of the type sold in these two departments. What is needed is some type of further classification for purposes of information and control, since exchange management is unable at present to analyze actual performance in these departments. For example, in Department 8, housewares, hardware, toys, luggage, photographic equipment and other major categories of merchandise are grouped together. Consequently, all of the important data needed for control purposes, including sales, cost of goods sold, markdowns, and turnover figures are maintained only for the department as a whole. If this department were broken down into several departments, sub-departments, or sections, there would be an opportunity to determine more precisely the performance of housewares as opposed to luggage or toys.

In addition to the need for further classification for accounting and control, more extensive departmentization of other activities should be carefully studied. The previous chapter indicated the practicality of using departments as the basis for further buying specialization. Concerning selling, a further degree of departmentization on the basis of layout and/or sales personnel would be practical, particularly for large exchanges. Within recent times some attention has been given to these matters, but there is still room for substantial improvement.

In considering the selling function, it is important to discover the methods that are used to determine the prices of goods and services authorized for sale. This is of particular relevance as the matter of exchange prices is a sensitive issue and a subject of considerable misunderstanding. The paragraphs which follow show how exchange prices are determined and explain the reasons why they are somewhat lower than those prevailing in private retail enterprises.

**Basis for Profit Goals**

It was pointed out in Chapter III that exchange operations are geared in part to produce money each year to supplement appropriated funds for the support of Army and Air Force morale, welfare, and recreation programs. The amount needed from the exchange system to support these programs each year is determined jointly by the Secretaries of the Army and the Air Force and, within recent times, has amounted to approximately $50,000,000 a year.\(^4\) This money, which is a dividend declared from exchange profits, is turned over to the Army and Air Force Central Welfare Fund, which in turn channels the money into unit welfare funds, primarily on the basis of a per-man, per-month allowance.

In addition to welfare and recreational activities, some exchange profits are plowed back into the system each year for remodeling inadequate facilities and making needed improvements. The exchange system bears directly the entire cost of all new fixtures, furnishings, interior improvements, and adaptation of buildings allocated by

\(^4\)Ibid., p. 10.
installation commanders for exchange use. Within recent times approximately $17,000,000 annually has been spent for such purposes.5

It is on the basis of this combined requirement, support of welfare activities and renovation of facilities, that the Board of Directors, Army and Air Force Exchange Service, establishes an overall profit goal for the exchange system. This profit goal is derived from merchandising operations, service activities, and income received from concessions. This profit goal together with sales and expense budgets constitute the criteria whereby Headquarters Army and Air Force Exchange Service can establish markup schedules for the various classes of activities.

Determination of Markups

Markups vary somewhat from year to year with changes in any of the important variables—welfare needs, facilities requirements, sales, or expenses. Each of the above items can affect what is considered to be the appropriate year-end profit goal. For example, if sales are running considerably higher than planned and expenses are held in line, total profits would be higher than the stated requirement. Under such circumstances, Headquarters Exchange Service might consider lowering the markups on selected items. This was done in Department 8 in February, 1959, when the markup schedule on a number of household items was reduced from 15 percent to 12 1/2 percent of retail.

The actual markup schedules used for exchange merchandise are graduated in that different schedules apply to different categories of goods. Products that generally fit into the necessity and convenience

goods category, such as toothpaste, razor blades and cigarettes, carry the lowest markup which is 7 1/2 percent of retail. Other products carry graduated markups which range from 7 1/2 percent up to 25 percent. The higher markups generally apply to goods which fall into the shopping and specialty goods categories, such as clothing and toys.

Price Advantage of the Exchange

On the basis of the preceding discussion, it is obvious that exchanges do not sell at cost, a popular misconception. Actually, exchange prices reflect the cost of merchandise, operating expenses incurred, and a margin of net profit. This brings up an often repeated question, how can exchanges operate with prices that are normally lower than those found in more typical retail establishments?

This is explained not by greater operating efficiency but by the absence of certain classes of operating expense and by a limited service policy. One important element leading to lower expenses is that exchanges pay no rent on land, buildings, or parking facilities as these are provided by the government at no cost to the exchange system. A second factor is that the exchange system does not pay the salaries of the military officer personnel who are assigned to exchange management positions. These salaries are paid out of appropriated funds. A third factor, which will be discussed in detail in a later section, is that exchanges have practically no advertising or sales promotion expenses. In contrast, department stores spend approximately 3 percent of total sales for advertising alone.6 Also to be considered is

the absence of credit and delivery expenses, as exchanges do not perform either of these functions. A final factor leading to lower selling prices has to do with the "instrumentality status" of the exchange system which entitles it to certain Federal Government privileges and immunities. As was pointed out in detail in Chapter IV, which dealt with the legal status of the system, exchanges do not pay Federal income taxes, state taxes, and other taxes and fees which add to the operating expenses of ordinary retail establishments nor are they obliged to observe state minimum price maintenance laws.\footnote{Federal excise taxes, however, are charged by exchanges on merchandise falling into the excise tax category.}

The above factors, taken together, explain why exchanges can operate successfully selling merchandise and services at prices which are typically lower than those found in most other retail establishments.

There is one area of exchange sales where there is no longer much of a disparity between prices charged in exchanges and those on the outside. This area has to do chiefly with several lines of relatively expensive "hard goods lines," such as traffic appliances, luggage and cameras. Within recent years these items commonly have been sold almost everywhere at substantial discounts off their traditional retail prices. This has caused some concern and frustration on the part of certain individuals in the exchange system who have seen the competitive edge lost in selected lines. It has been observed that many exchange managers and buyers have the same disdain and fear of the "discount house" as do many conservative and traditional retail merchants.
This study cannot discuss in detail the many aspects of "off-list" pricing, but the basic concept is presented for clarification purposes. Essentially, what is involved are changing relationships among prices, merchandise costs, store operating expenses, and the level of physical volume of sales. Prices have been lowered on certain categories of merchandise primarily because retailers handling these lines have been successful in (1) buying more effectively, (2) reducing overhead expenses, and/or (3) increasing volume. A change in any or all of the above factors can lead to lower prices.

The so-called "discount houses" have been successful within recent years in selling some lines for considerably less than was possible before the late 1940's. These retailers found that by lowering prices they could obtain a substantial increase in sales volume, and do so without having to offer many of the services traditionally provided by others. Price was found to be a very strong patronage motive for certain types of goods, particularly highly-standardized, well-known products of durable nature and high unit value. The curtailment of services naturally reduced overhead expenses and the increased volume led to lower merchandise costs through quantity buying, more favorable freight rates and other factors.8

There is little doubt that the widespread use of "off-list" pricing by other retail establishments has taken away a part of the price advantage enjoyed by the exchange, particularly in some hard goods lines. This, in addition to the practice of price-leader and

8 For a more detailed analysis of this aspect of pricing, see Beckman, "Principles of Marketing," op. cit., pp. 33 to 39.
loss-leader selling found in many private retail establishments, has led to the often repeated but illogical complaint that anything sold in the exchange can be purchased just as cheap elsewhere. Such a statement is inaccurate, however, as the over-all position of exchange prices remains favorable. In 1959, for example, the gross margin (after cash discounts) obtained on all merchandise sold in domestic exchanges was 16.5 percent of total sales. This figure is certainly well under that of most retailing establishments of a general merchandise character.

Price Variation Among Exchanges

For basic types of convenience goods, such as Gillette razor blades and Colgate tooth paste, the exchange system has established uniform selling prices world-wide. For most items, however, fixed selling prices have not been established and minor price fluctuations do exist. With a system of decentralized buying, this must be expected as exchanges do not handle necessarily the same brands or sizes, nor do they always buy in the same quantities or from the same types of suppliers.

Exchange pricing policies appear to be generally sound. For items for which no fixed selling price has been established, however, there is an aspect of pricing that is unworkable at the present time. This has to do with items that are usually purchased direct from manufacturers but, because of an out-of-stock condition, should be purchased

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for fill-in purposes through wholesalers, even though the cost may be higher in the latter instance. Under the existing policy, when the fill-in order is purchased at a higher price, the selling price must be adjusted upward temporarily so that a fixed percent markup on retail can be maintained. This is unrealistic and confusing to the customer who sees the price of an item vacillate up and down over a short period of time.

As a result of this policy, many exchanges, in order to avoid such confusion, have frequently remained out-of-stock rather than to buy from alternate suppliers at higher prices. A more flexible approach to this aspect of pricing is needed as each exchange should be allowed to maintain its regular prices even though the cost of a fill-in order may be higher.

Criticisms of Exchange Profits

Over the years much criticism has been heard over the matter of exchange profits which are used for welfare and recreational activities. Some argue that this is the responsibility of the Armed Services directly and that it is not fair to tax the serviceman for his own morale activities. These individuals claim that the idea of exchanges generating dividends for morale purposes originated in the early days when the Army was operated on a very tight budget. At that time servicemen had to improvise and provide many things for

themselves because of the limitation of funds. Military leaders in those earlier years hesitated to ask Congress for any but the bare essentials for existence. It is said that these conditions no longer apply to our modern fighting force.

It is further claimed in some quarters that the present system is inequitable because it serves only those individuals who are interested in the particular welfare activities which are sponsored. In 1949, a committee, called the Exchange Service Budget Advisory Committee, was appointed to examine, among other matters, the need for large exchange profits. This committee concluded as follows:

The soldier must pay a higher price for what he buys in order to be provided a dance, umpire fees, or other welfare that he may or may not enjoy. There is sufficient evidence to question whether some element of morale could not be inherent in a smaller markup percentage and in correspondingly lower prices. A concurrent reduction in some part of the fixed dividend schedule may be required but the soldier could see at the time of purchasing that his morale was being considered in a direct manner through lower prices. These lower prices will assist in restoring the competitive advantage of exchanges and counter balance the potential sales decline as a result of recent concessions to the Congressional Sub-Committee.

Although these objections are made no doubt in good faith, it must be recognized that the elimination of profits used for welfare purposes would not materially reduce exchange prices simply because profits are a very small percent of total sales. In 1959, for example, net profit from operations including merchandise, food, and

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11 Ibid.

services was only 5 percent of total sales. When it is considered that only three-fourths of profits are used for welfare purposes, it is clear that the elimination of this profit requirement would not result in very large savings to the military consumer.

Aside from this, it is necessary to view welfare activities sponsored by exchange profits in their historical perspective. Exchange profits have been used for this purpose for 65 years, even though during earlier periods such funds were often handled on a haphazard and unequitable basis. Traditions of such long standing are not easily changed without very strong cause.

**PHYSICAL FACILITIES**

Generalizations about exchange buildings and equipment are difficult because these facilities vary drastically from one installation to another. In few instances, exchange facilities are as modern as those found in civilian shopping centers. The exchange operation at Little Rock Air Force Base, for example, is housed in a new facility that was specifically designed for this purpose. There are several buildings, the largest being used for the exchange "retail store" operation and others for the variety of food and service activities which are also operated by the exchange directly or on a concession basis. Other activities are also located within this shopping center complex including the commissary store, base library, base theater, and clothing sales store.

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In contrast to this modern, shopping center type of retail operation, many exchanges occupy run down, non-standard buildings which are scattered all over the installation. Frequently, these buildings have been abandoned by other activities or have been turned over to the exchange because nothing else is available. It should be recalled that the exchange is considered to be in the nature of a military support activity not directly related to the primary defense mission of the Army or the Air Force. Naturally, every commander is obliged to give first consideration to the primary mission. This means that the facilities assigned to support operations must be made on a space available or low priority basis. It is for this reason that most buildings occupied by the exchange are inadequate in one or more ways for merchandising operations.

The following are numbered among the most common handicaps that face the exchange system in terms of physical facilities. First, there is the matter of appearance, inside and/or outside of the exchange. Since the majority of exchanges occupy facilities originally designed for some other purpose, it is not uncommon to find exchanges housed in converted barracks, mess halls, warehouses, airplane hangars, and other miscellaneous structures. Besides the fact that these buildings were not designed for retailing operations, many are quite run down and are in need of repairs for which funds are not available.

A second limitation concerns the size of exchange stores. In many instances there simply are not enough square feet of selling space available to do the right kind of merchandising job. Frequently, the same condition applies to the storage area which may be either
too small or be located too great a distance from the retail store. Pease Air Force Base, for example, has a warehouse capacity that is approximately one half of the size that is recommended by the Headquarters Exchange Service for an exchange in its sales volume class. Considering the general store character of exchanges, it is easy to see where a shortage of selling space or storage space could cause serious merchandising difficulties.

In an effort to alleviate the problem of limited selling space, a number of exchanges have begun placing selected lines of merchandise in one or more "annex" stores, located apart from the main store, in some other available facility. This system, although less desirable than having the entire retail operation under one roof where the customer can shop for his needs at one time, is reasonably successful when related lines are grouped together. For example, such lines as housewares, hardware, garden supplies, and paint are sufficiently complementary to form the equivalent of what may be considered to be an exchange hardware store. Lockbourne Air Force Base, in Columbus, Ohio, is an example of an exchange utilizing this idea. Most of the merchandise sold in Department 8, which includes all of the merchandise in the above categories plus some others, is sold in a separate facility apart from the main exchange store.

In some exchanges, however, the shortage of space is so acute that severe limitations have to be placed on the variety and assortment of merchandise that can be handled. The exchange at Warner Robins Air Force Base, Georgia is a case in point.
A third handicap facing many exchanges from a facilities standpoint is poor location. Some exchanges are located in isolated, difficult to reach places that are considerably removed from the heavier everyday traffic areas. This discourages people from frequenting the exchange and removes the image that the exchange is a "convenient" place to shop. Another location problem relates to the positioning of the food and service activities in relation to the main store. Ideally these operations should be in the same locality as the main exchange. In those installations where this has been feasible, such as Wright-Patterson, the exchange forms a cluster of stores which resemble a string-street shopping district. Although not as desirable as a regular shopping center type facility, this is at least better than having buildings scattered all over the base. When the commissary store, the clothing sales store (selling standard enlisted men's issue type clothing only), and the base laundry are located adjacent to the exchange, this arrangement becomes particularly desirable. Unfortunately, such an arrangement is seldom found.

A related facilities problem involves parking space, which is frequently inadequate or inaccessible to the retail exchange facilities for which it is intended to serve. This is quite understandable when it is considered that many exchange buildings were designed for another purpose. For example, if a warehouse is converted into an exchange, it is unlikely to have adequate parking space since little would have been required for its previous use.
The essence of the facilities problem is that little attention has ever been devoted to developing a master plan for all retail service activities. The majority of installation commanders, naturally, are mostly concerned with the primary mission or function of the post or base for which they are responsible. These individuals, as professional military leaders, usually lack knowledge and experience in dealing with the marketing establishments that are a part of their installations. Although there are probably a few commanders who are not sympathetic to the needs of support activities like the exchange and the commissary, it has been found that the majority become interested in helping with these problems when the requirements are clearly stated.

The Air Materiel Command used this approach with considerable success on its Air Materiel Area Commanders. When presented with the facts, it was found that these commanders met the challenge with enthusiastic response and initiated practical programs to renovate old buildings, increase floor space, move to better locations, and make other changes designed to increase the effectiveness of their exchanges and other retail activities. Wherever possible, commanders made an effort to locate exchanges and other service facilities together in a way that would resemble a community shopping center.


15 Ibid.
The simplicity, practicality and success of this program as initiated by the Air Materiel Command suggests that other Army and Air Force major commands would benefit from similar efforts. The initiative, however, must be taken from within the exchange system as the military commanders cannot be expected to solve problems which they are not aware exist.

FIXTURES AND LAYOUT

Within recent years, exchanges, like many other retailing organizations, have emphasized self-selection and self-service selling techniques. This has been a part of an over-all modernization program designed to improve the quality of exchange fixtures, layout, and service. Most of the merchandise handled is well suited to this type of selling since exchanges emphasize basic items which fall primarily into the convenience goods and relatively inexpensive shopping goods lines.

The importance of up-to-date fixtures in retailing is indicated by a study made recently by the National Retail Hardware Association. This study, which covered retail hardware stores throughout the country, showed that of the most profitable one-third of all hardware stores in the nation, 88.2% had installed new fixtures or remodeled or improved existing fixtures within the previous ten year period. Other studies also point out the dramatic effect that new fixtures can have on sales. In some cases retailers report that the installation

16 "How Profits are Made," Hardware Retailer, October, 1958, p. 120.
of modern, open display type fixtures have increased sales as much as 200 to 300 percent.\footnote{Paul L. Brown and William R. Davidson, \textit{Retailing Principles and Practices} (New York: Ronald Press Co., 1951), p. 481.}

Although considerable progress has been made within recent times, much remains to be done if fixtures and layout in exchanges are to be brought up to the level found in most other retail stores of similar size. The present problem is due partly to the lack of funds for this purpose. Although a portion of exchange profits has been allocated each year to this end, the funds have not been adequate.

Aside from the matter of funds, organizational difficulties have impeded fixture and layout improvements. These are highly technical fields which should be undertaken only by specialists. Unfortunately, at this time there are too few such specialists in the exchange system. There are several individuals doing this kind of work in the New York Headquarters, but they can hardly be expected to cover the exchanges world-wide with any thoroughness. Although technically responsible to assist exchanges with layout and fixture problems, the service centers can offer little real assistance because their personnel typically does not have the time or experience to handle these matters. The need for additional specialization on the service center level was discussed in detail in Chapter III.

Failure of the above agencies to provide needed assistance to the exchanges with regard to layout and fixtures has resulted in the haphazard planning of many modernization programs. Local exchange
managers have found themselves designing their own layouts and fixtures, even though it is usually admitted that they are not qualified to do the job properly. The results have been poor design, a lack of standardization, and most important, poor service and lost business. A recent message sent to Headquarters Exchange Service by the Air Materiel Command is indicative of the problems facing exchanges in this regard:

...We (Air Materiel Command) have had some unfortunate experience with plans and specifications drawn up by some Service Center representatives. This is a technical area that should be a technical service rendered by qualified personnel....For the most part present personnel are not qualified layout and equipment experts and, while acting in good faith, have blundered in many instances....

As discussed previously, the solution to this problem and similar ones lies in a more effective organization on the Headquarters and service center levels. The individual exchange must receive more specialized advice and assistance on the many technical phases of retail operation. Whether these functions should be handled from the service center level or the Headquarters level does not lend itself to sweeping generalizations. There is little doubt, however, that this matter deserves further attention than it is now receiving.

ADVERTISING AND RETAIL SALES PROMOTION

Exchanges, as a matter of policy, do not promote, advertise, or attempt to influence their limited buying public with active persuasion of any kind. Although there is sometimes a limited amount of point of

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purchase display inside an exchange, outside there is nothing of a promotional nature, not even to the extent of window displays or neon signs.

Several factors help to explain this selling philosophy. First, the exchange system is not by nature an aggressive retailing organization. It is primarily concerned with building goodwill and patronage strictly on the basis of the fundamental needs and wants of its customers. Although a good case can be made in marketing that consumers seldom buy items that they do not need or want, an aggressive sales policy would almost certainly bring complaints by retail interest groups that oppose exchanges. This is a sensitive area and one that would not be welcome as an added problem to be dealt with in congressional committees.

Second, it is felt that the exchanges' policies of providing goods at the lowest possible prices, and accessibility to its military customers, provide customers with patronage motives which are sufficiently strong to overcome the need for advertising and sales promotion. At isolated installations there can be no doubt of strong patronage motives as personnel assigned there has no alternative but to buy in exchanges. Even in other areas, servicemen and their families are accustomed to shopping in exchanges and look upon them as the logical source for certain types of merchandise.

In certain respects, however, it is doubtful that exchanges enjoy patronage motives to the extent that is sometimes believed. In addition to convenience and price, patronage is based on services rendered and the selection of goods available for sale. Although exchanges
handle a wide variety of goods, there is frequently little selection or assortment in any one merchandise category and few customer services are offered. These factors also are important in developing customer loyalty and patronage.

It is granted that the general character of the exchange system is conservative and should probably remain so. This would properly exclude from exchange merchandising such promotional devices as trading stamps, elaborate exhibits and contests, special sales, and a number of other aggressive promotional devices. However, more effective utilization of point of purchase promotion and display would be entirely in keeping with the character of exchanges. Proper display stimulates store traffic, arouses interest, helps sell featured merchandise, and in general reflects the character of the store and adds to its prestige by indicating that the entire operation is up to date and progressive. This is not to suggest elaborate displays requiring a high degree of technical and artistic talent as found in leading department stores. However, on a modest scale much could be done. Headquarters Exchange Service and the service centers could operate and provide some advice along these lines. Many wholesalers are of invaluable assistance in this area when properly utilized.

The hardware section of the Lockbourne Air Force Base Exchange, for instance, has been entirely reworked with the help of a major hardware supplier, who has even furnished and installed some of the fixtures which were required to do a better job.
CUSTOMER SERVICES

On the whole, customer services, such as credit, delivery, telephone orders, alterations, special orders, and repair services, are held to a minimum. As in the case of advertising and sales promotion, the lack of services is due partly to the nature of the exchange operation and partly because of restrictions which have been imposed from inside and outside of the system.

Delivery and Credit

Exchange sales are almost altogether on a cash and carry basis as credit is severely restricted and delivery service is non-existent. Since 1949, however, the lack of delivery service has not been a serious problem because exchanges no longer sell very heavy, bulky goods such as major appliances and furniture. Occasionally, there may be some slight difficulty, as with the sale of lawnmowers, baby carriages or bicycles, but items of this type constitute a small portion of total sales. For the most part, merchandise sold in the exchange can easily be accommodated in the average automobile and consumers today are accustomed to buying a majority of their needs on this basis.

The bulk of merchandise sold in exchanges is on strictly cash basis as credit transactions are severely restricted. Credit that is authorized in the exchanges takes the following forms only:

1. Uniforms and accessories can be purchased by officers and non-commissioned officers on deferred-payment basis, whereby $25 is paid at the time of the purchase with the balance being paid in $25 monthly installments. Graduates of the United States military
academies, aviation cadet flying schools, and officer candidate schools may also purchase uniforms on credit, up to the amount of their uniform allowance. This enables prospective officers to purchase their uniforms prior to commissioning and to pay for them when their uniform allowance is received which is usually several weeks later.

2. Official military organizations and non-appropriated-fund activities, such as officer clubs, are authorized to buy in exchanges on an open account basis as it is recognized that it would be impractical for these transactions to be effected on a cash basis.

3. Although not constituting credit directly extended by the exchange system, exchange service stations do sell on credit in that they honor credit cards issued by the oil company which is supplying the service station. In this situation however, it is the oil company that assumes all liability for such credit sales and the exchanges are not involved in collection.

An expanded credit system for exchanges was proposed in 1956 by General Curtis E. LeMay, who was at the time, Commander of the Strategic Air Command, and General Edwin Rawlings, then Commander of Air Materiel Command. General LeMay felt the extension of credit by exchanges was in line with the policy of the Strategic Air Command to provide its people with the best services possible thereby "augmenting career incentives."19 Similarly, General Rawlings held the opinion that

such a service was in line with "the Air Force policy of increasing the prestige of officers and non-commissioned officers" and pointed out that "our present economic system is in a large measure based on the use of credit."\textsuperscript{20}

Headquarters Army and Air Force Exchange Service acknowledged the requests of these two very responsible and highly respected senior commanders by making a thorough study of their proposals in order to determine the feasibility of offering credit to exchange patrons. Historically, it was found that a credit system was in effect prior to World War II and that it was widely used until 1942, not only in exchanges but also in commissaries, laundries, and quartermaster sales stores. Its use was considered by the War Department to have high morale value. It was discontinued by the Secretary of War in November, 1942, because of the tremendous buildup of our armed forces following Pearl Harbor and the deployment associated therewith made it impractical to administer such credit accounts.

Part of this credit study was a review of prior Congressional exchange hearings to determine if there was concern or interest by Congress or by retailers in the matter of credit extended by exchanges. Since nothing to this effect was found, it was established that the decision to extend credit was a matter of internal administration and clearly within the authority of the Board of Directors, Army and Air Force Exchange Service.

\textsuperscript{20}Ibid.
After weighing the factors involved, it was decided that trial credit systems would be experimentally installed for one year at Wright-Patterson Air Force Base, Ohio, and March Air Force Base, California. A thirty-day regular charge account system was devised for Wright-Patterson whereas March Air Force Base was to utilize a ninety-day deferred payment plan. Neither plan called for an interest or service charge of any kind. These two exchanges were to serve as pilot models from which additional information could be gathered concerning the practicality of adding this service to the entire system. The Exchange Service supported these tests because it was recognized that if the results were favorable it would make available a convenient service to customers in addition to possibly increasing sales volume and remunerative business. Both credit plans were to be made available to military personnel of all ranks, both officers and airmen.

It so happened that these trial credit plans were developed concurrently with the 1957 Congressional Subcommittee hearings on exchange activities. Upon hearing of the proposed credit plans, representatives of the retail industry complained bitterly to the Subcommittee. Although not on the original agenda, the Chairman of the Subcommittee, Congressman Philbin, agreed that it was a subject appropriate to the general hearings. Accordingly, the entire proposal was reviewed with each side presenting its views. The final decision of the Subcommittee was that credit should not be extended by exchanges, even on an experimental basis, and that the proposed plans should be dropped altogether. This decision was accepted as final and all plans for a credit system, other than what was already available for uniforms, were dropped.
Since the trial credit programs were never put into operation, it is difficult to estimate precisely what the effect would have been on exchange sales and expenses. Although not a serious handicap for most of the convenience goods sold, the inability of the exchange to offer credit in some of the shopping goods lines has no doubt curtailed sales. Many people simply are unable to budget to the extent necessary to purchase and pay for at one time such items as golf clubs, typewriters, luggage, cameras, lawnmowers, and other merchandise of relatively high unit value. A credit system, perhaps one like the ninety day plan suggested for March Air Force Base would certainly make it easier for military personnel to purchase these types of merchandise. Under the circumstances, however, it is doubtful whether this service will be offered in the near future.

Miscellaneous Services

Other services are also held to a minimum in the exchange system. Telephone inquiries are not accepted and prices are never quoted over the phone. This policy has been instituted in order to avoid direct price comparison between exchanges and off base retail establishments. Alterations are restricted to uniforms and then only for basic modifications such as pants length, waist, and coat sleeve length. Any tailoring, such as to alter a coat collar, is on an extra charge basis if it is available at all. Radio, watch, and shoe repair shops are the only repair services authorized and not all of these will be found at every exchange. Since these are most always operated on a concession basis, it is possible that similar services could be made available for small appliances, lawnmowers, bicycles and the like.
Special Orders

Before 1949, when the authorized list was devised, military personnel could buy almost anything through the exchange including high priced jewelry, furs, furniture, appliances and sometimes even automobiles. These items were seldom carried in stock, but were obtained for customers on an individual order basis as a special service. As will be discussed fully in the next chapter, this practice was objected to most strenuously by retail groups in the 1949 Congressional hearings. As a result of these hearings, an agreement was reached between the Department of Defense and the Subcommittee to restrict special orders only to items eligible for sale under the authorized list (see Appendix A).

The status of special orders in the domestic exchange system has not changed since the 1949 agreement. Today, they are accepted only for merchandise authorized for sale but which is not carried in stock. For example, a customer may desire to buy an item of luggage which is not stocked because of a lack of demand, or because the exchange handles another brand or model. Another illustration would be the case of a branch operation, which due to its size could not afford to carry any luggage in its inventory. Special orders have the effect, therefore, of partially overcoming the lack of merchandise assortment found in exchanges, particularly the smaller ones. The traditional nature of the special order system and its popularity among service personnel makes it reasonably certain that this will continue to be one service offered by exchanges.
At the present time, however, special orders are not usually encouraged as they involve considerable extra work for buying personnel and are almost always a money losing proposition for the exchange. This is largely due to the fact that these orders are handled in an identical manner and are subject to the same regulations as regular purchases for stock without regard for the costs involved in handling an order of insignificant value. This procedure actually compounds what is already a serious buying problem by encouraging even further small purchases from a large number of sources. The pitfalls and difficulties encountered under this buying policy were previously analyzed. One exchange, for example, recently processed a special order for a single tennis racket which sold for $6.90. This order was placed directly with the manufacturer, which because of the landed cost criterion, was the sole source that could be used for the item. There can be little doubt that the expense incurred in processing this order was far in excess of the 20 percent markup taken on merchandise of this type. The recommendations found in Chapter VII, relative to suggested improvements in exchange buying practices, are certainly even more pertinent to special orders because they have to do with the same difficulty—buying in uneconomical quantities from too many sources.

Another part of the special order problem is that many exchanges have failed to organize properly to handle this type of business. In many exchanges visited, these orders are handled in the business office on a hit or miss basis by anyone who finds the time to take care of the customer's request. Not only does this interrupt whatever other work is being done but it means that no one person actually becomes proficient
in the special order area. At the outset, this function should be assigned to a particular individual who would become responsible for handling it. In smaller exchanges, where there is not sufficient special order business to keep an employee busy full time, this function could be assigned along with other specific responsibilities.

Given a more effective buying system and better organization for handling special orders, it is possible that some special orders business could actually be put on a paying basis, especially in the larger exchanges. In larger exchanges, perhaps a special order booth could be set up in the retail store where available catalogues and other information could be obtained on merchandise not carried in stock. Such a plan would not only be more convenient for the customer but would avoid the confusion of having the customer enter the business office of the exchange, as is frequently the case at this time, which causes distractions and interruptions in the regular office work.

It is recognized that such a special booth may be found to be impractical, especially at smaller installations. Ordering in single quantities may be found to be prohibitively expensive regardless of the source of supply and may be more trouble than they are worth. Also, such a system could encourage special purchases at the expense of brands or models which are carried in the regular inventory. There is need for further investigation in this area. The exchange may be missing an opportunity to be of greater service to its customers and, at the same time, increase present sales and profit volume if these orders were properly handled.
CHAPTER IX
AN ECONOMIC EVALUATION
OF THE DOMESTIC EXCHANGE SYSTEM

This chapter carries further the analysis of the exchange system by presenting an economic evaluation of operations and an appraisal of those aspects of the system which are most controversial. As was pointed out in Chapter I, exchanges are frequently criticized and strenuously opposed in some quarters. This chapter presents a digest of the controversy in order better to interpret the present status of the exchange system and more fully to appreciate the reasons why exchanges function as they do. Treatment of this controversy is a necessary part of the study because the scope of exchange operations over the past decade has been determined largely by the arrangements and compromises that have been worked out in congressional committee between the exchange system and its opponents.

For the most part, the controversy has raged between the military establishment, which has naturally favored exchange operations, and various individuals, organization, and lobby groups which have felt that the military should not be in the business of operating retail stores. Among the principal critics of exchanges have been the Hoover Commission, individual retail merchants, retail trade associations, individual Congressmen, and, in some instances local chambers of commerce. Generally speaking, such criticism has centered around the role and functioning of the exchange system as a legitimate military activity. Opinions range from those who feel that exchanges should
be abolished to others who take a milder view and feel that exchanges should be cut back on their activities. For example, the Hoover Commission recommended to Congress that exchanges should be abolished at all but a few isolated installations where civilian facilities would not be conveniently available.\(^1\) The National Retail Merchants Association, on the other hand, is of the opinion that exchanges should be more on the order of canteens—selling only refreshments, tobacco, candy, notions, and a few miscellaneous items.\(^2\)

Organizationally, this chapter is divided into three major sections. The first section presents the background of the controversy since 1932. The second section deals with the major criticisms leveled against the exchange by those who oppose this type of operation and evaluates these criticisms in light of sound economic and marketing practice. In the final section, there is an objective analysis of the military viewpoint and the reasons why there is such strong support of exchange operations by the Armed Services.

**BACKGROUND OF THE CONTROVERSY**

The nature of the American economic system, which is essentially one of private enterprise, makes it almost inevitable that those business activities which are operated by the government will be subject to criticism. Undoubtedly, there has been some criticism of


post exchanges since their establishment around the turn of the century. The first formal public criticism of exchange operations was that made by the Shannon Committee in 1932. This committee was appointed by Congress in that year to make an investigation of government activities that were allegedly in competition with private enterprise. Concerning military exchanges, the committee recommended to Congress that they be abolished for the most part because of the challenge which they presented to the private economy. Nothing tangible came of this recommendation, however. One reason was that this committee failed to recommend an alternate system to take the place of the exchanges that would assume the marketing functions which were being performed by them. A second probable explanation was the relative insignificance of the Armed Forces in general during the 1930's. Exchanges were so small during this period that legislators must have assumed that the issue was not worth further deliberation. Finally, there was the change in administration in 1932 which, in addition to being very much occupied with the depression, was far more disposed toward tolerating government-sponsored business activities.

**World War II**

Of course, the situation relative to exchanges was altered radically during the early 1940's as a consequence of World War II and the exchange system grew in size along with our military strength. As might be expected, there were few serious objections to a large exchange system during this period as the entire nation was supporting the military in every way possible. This was true even though certain abuses of the exchange privilege did exist, particularly in connection
with purchases of hard-to-get merchandise for civilians who were not entitled to it. Attempts were made to ration such scarce merchandise, but abuses persisted because of the enormous task of controlling the rapidly expanded "citizen's army" under war time conditions.

The Postwar Period

With the end of hostilities in 1945, business and public opinion toward exchanges and other business activities operated by the government began to change. Added to this were the postwar efforts to centralize exchange operations. This called attention to the exchange system and made it appear to be a large-scale retailing institution, capable of being a formidable competitor to private business enterprise. This combination of events resulted in organized complaints by certain retail groups who wanted to see exchange operations curtailed or abolished altogether.

The first overt pressure on the War Department came in 1947 when it was announced that exchanges would be allowed to open concessions for the sale of men's clothing. Retail groups objected so strenuously to this move that The Honorable Kenneth C. Royall, who was then Under-Secretary of War, ordered plans for these concessions cancelled. Following this, complaints and criticisms of exchanges and other military resale activities grew louder and louder so that by April, 1949, the House Armed Services Committee appointed a special subcommittee, commonly referred to as the Philbin Committee, to investigate the entire area of resale activities within the Armed Services. This investigation included an inquiry into exchange operations, commissary stores, clothing sales stores, as well as miscellaneous activities of
a retail nature. For the most part, however, the investigation and testimony centered around domestic exchange operations as found in the Army, Air Force, Navy, and Marine Corps. Exchange activities came to the forefront because they handle goods which cross many merchandise lines and consequently affect many types of retail businesses.

Representing the retailer's viewpoint at these hearings were the American Retail Federation, six national trade associations, two local trade associations, two local chamber of commerce groups, and eight individual retailers. The individual retailers testified on the basis of personal injury which they felt that they had experienced as a result of exchange operations. With the exception of one businessman who represented a chain of several furniture stores, these were small independent business men. Without exception, these retailers operated stores in areas adjacent to large military installations. The local chambers of commerce likewise testified in behalf of member merchants who complained of injury by military exchanges. These were the Annapolis Chamber of Commerce, which objected to the exchange operated by the United States Naval Academy, and the Rantoul, Illinois Chamber of Commerce, which was opposed to exchange activities at Chanute Air Force Base.

The trade associations claimed that their testimony was representative of the view of their entire membership. For example, Mr. Rowland T. Jones, testifying on behalf of the American Retail

3Ibid., p. 3572.
Federation, stated that he represented the thinking of twenty national and thirty-four state retail associations which together comprised over 500,000 stores in all segments of retailing. In addition to the American Retail Federation, eight specific trade associations also testified against exchanges. These associations, which are listed below, indicate the segments of retail trade that felt particularly injured by exchange competition:

1. The National Retail Dry Goods Association (Now the National Retail Merchants' Association)
2. The National Association of Retail Clothiers and Furnishers
3. The National Retail Jewelers' Association
4. The National Association of Credit Jewelers
5. The National Wholesale Jewelers' Association
6. The National Association of Retail Druggists
7. The San Antonio Retail Merchants' Association
8. The Norfolk Food Dealers' Association

Briefly, the opposition to military exchanges by these individuals and groups centered around (1) unfair competition with private enterprise, (2) certain violations and abuses that were present in the system, particularly purchases by unauthorized civilians, and (3) the scope of exchange operations which, in the opinion of most retail groups, was far more extensive than was originally intended by the military or by Congress.

In defense of the exchange system, The Honorable John T. Koehler, Assistant Secretary of the Navy, presented the military viewpoint which staunchly supported extensive and diversified exchange operations as a necessary part of military life which, if curtailed, would cause serious morale problems. Since these same criticisms and defenses reappear in 1953, 1955, and 1957, they are analyzed separately in other sections of this chapter. This allows for a complete evaluation of the basic issues and eliminates repetition. This section is restricted to a presentation of the action which has been taken by the various subcommittees that met to discuss aspects of exchange operations.

**Modifications in Exchange System**

Without question, the 1949 subcommittee hearings have been the most significant to date. Major and substantial revisions were made in domestic exchange operations as a result of these hearings. The more important of these are as follows:

1. The list of merchandise items authorized for sale in domestic exchanges was substantially cut back, with most luxury goods, such as jewelry made of precious metals, being deleted altogether.

2. On a number of the items authorized for sale, such as women's sweaters, cost price limits were instituted. The purpose of these limits was to restrict exchange merchandise to items which would be classified as "basic" or "necessary."

3. Special order privileges, under which authorized patrons could buy a wide variety of expensive merchandise, such as major appliances and furniture, were abolished. Under the 1949 agreement, only items on the new authorized list could be special-ordered.
4. The Federal retail excise tax, which heretofore had not been collected on merchandise sold in exchanges, was imposed on appropriate items, thereby bringing the prices charged on these items closer to those charged elsewhere.

5. Exchanges were required to assume a larger portion of overhead expenses, such as those associated with heat, light, and interior maintenance, but exchange buildings continued to be available rent-free. This was also instituted to bring exchange prices closer to those charged by outside retailers.

6. The matter of who was considered to be an authorized patron was clearly defined and an improved system of identification was put into effect.

7. Exchange regulations, as they existed in each of the separate services, were standardized to a considerable degree. This was done with a view toward eliminating the wide differences found between exchanges operated by the Army and the Air Force and those operated by the Navy and the Marine Corps.

It should be observed that these changes, although considerable in scope, did not reduce exchanges to the status of "canteens," or small notion stores, as was desired by many of the retail groups. Although some activities were eliminated and others modified, the exchange remained in fact an important part of military life, operating in much the same manner as before but on a more restricted basis.

The subcommittee openly stated that neither the services nor their critics would be entirely satisfied with the decisions reached
as a result of the hearings. The subcommittee did say, however, that it was "confident that it had attained a reasonable and fair solution" to the controversy. Unfortunately, this was not the opinion of many, since the question of exchange operations has been brought to the attention of Congress on three succeeding occasions.

1953 Hearings

The first of these was in 1953 when the House Armed Services Committee once again received complaints from merchants and trade associations about certain exchange practices. The Armed Services Committee turned the matter over to the House Subcommittee on Defense Activities for investigation. Numerous letters were received from small retailers who claimed that their businesses were being severely damaged by military exchanges. These letters appeared to be part of an organized campaign to exert pressure on Congress to restrict exchange operations. The subcommittee felt that it was more than coincidental that it had received only a handful of complaints in the period that had lapsed since the 1949 hearings.

The principal organization testifying before the appointed subcommittee was the American Retail Federation, which was also one of the major opponents to exchange operations in 1949. The Federation's initial complaint was that large quantities of merchandise were being sold in exchanges to unauthorized patrons. In support of its claim,

a special report was presented to the subcommittee, based on the personal experiences of two unauthorized persons who were successful in purchasing some items in exchanges. These two agents were professional investigators who were hired by the Federation specifically for this purpose. Their report listed thirty-seven purchases, for a total value of $219.30, which they had been successful in making in fourteen exchanges between October and December, 1952.

The subcommittee, upon careful investigation, concluded that the findings of the report were of dubious value even though the American Retail Federation had presented them in good faith. The subcommittee pointed out that some of the techniques used by the agent-purchasers were highly questionable. For example, one of the two agents, although not in possession of an active duty service card, did show an official reserve card in making purchases. In other instances, it was found that the agents openly displayed articles which had been previously purchased in order to create the impression that proper identification had already been established. Other charges were found to be of dubious validity and some of the claims could not be substantiated at all.

After registering this complaint with the subcommittee, the American Retail Federation once again charged that the scope of exchange system, as it existed in 1953, was the cause of serious competition with private enterprise and that such operations should be drastically curtailed. After restating its claim, the Federation submitted to the subcommittee a list of items which it considered
appropriate for exchanges to handle.\textsuperscript{6} This list, if it had been forced on exchanges, would have had the effect of reducing exchanges to the status of canteens or very small stores selling primarily refreshments, candy, tobacco and notions.

The subcommittee flatly rejected this proposal and all other attempts which would have required a substantial deviation from the 1949 compromise agreement. This subcommittee concurred with the findings of the Philbin Committee on military retail activities and cited the concluding statement which was made in 1949:

\begin{quote}
The committee has long been convinced that the solution to these problems lies some place between the extreme desire of the respective interests, and we have sincerely and objectively attempted to find that solution.\textsuperscript{7}
\end{quote}

In 1953, the subcommittee concluded its findings with the following statement:

\begin{quote}
Most of the charges against the operation of exchanges are loose and reckless...The reason for the existence of the exchanges is necessity. They grew because of an evil much greater than any complaint against the present exchanges. We believe that under the 1949 agreement, which we have reviewed, the maximum of good management has been achieved. That agreement is being followed...We must face up to the needs of the servicemen and the complaints of retail merchants must be weighed in that scale.\textsuperscript{8}
\end{quote}

\textbf{Hoover Commission Recommendations}

The matter of the exchange service was again brought to the attention of Congress in 1955 with the publication of the Hoover Commission Reports. As generally accepted, the purpose of the Hoover Commission Recommendations was to address the shortcomings of the current exchange system and to improve the quality of service for servicemen.

\textsuperscript{6}\textit{Ibid.}, pp. 41 to 43.

\textsuperscript{7}\textit{Ibid.}, p. 10.

\textsuperscript{8}\textit{Ibid.}, p. 8.
Commission was to study Federal government activities with a view toward curtailing them wherever possible. This was particularly the case with those activities that were considered to be in competition with private business establishments.

Concerning exchange operations, which were among the activities studied by the Hoover Commission in 1953 and 1954, the Commission's recommendations are inconclusive and, to some extent, contradictory. Most of the analysis is taken up with a description of the major elements of the military exchange system. This is followed by conclusions which are generally critical of exchange operations, largely because it is an organization which competes with the private sector of the economy.

In studying the exchange system, the Hoover investigating team apparently recognized that it was dealing with a very complex and sensitive operation because it did recommend to Congress that a more thorough investigation be made. The purpose of the additional study would be to determine the extent to which exchange activities could be practically shifted to private business establishments. Paradoxically, the Hoover Commission then recommended to Congress, without the benefit of such a study, that exchange operations be drastically curtailed and in most cases eliminated. This investigation of exchange activities makes no mention of any of the Congressional hearings which had been held on this same subject. At the time of this

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9 Business Enterprises, op. cit., p. 25.
10 Ibid., p. 21.
writing, six years after the publication of the Hoover study, no ac-
tion has been taken by any branch of the government to implement the
Hoover recommendations regarding exchanges, either by way of addition-
al study or otherwise.

1957 Hearings

The most recent review of the exchange controversy took place in
1957 before another special subcommittee which was appointed to ex-
amine once again the exchange situation. This special subcommittee
was also chaired by Congressman Philbin, who acted as chairman in
1949. Unlike previous times, however, the 1957 hearings were initi-
ated by the action of the military rather than by critics of the
exchange system. The Department of Defense in 1956 appointed an
inter-service study group to examine the authorized list of merchan-
dise for purposes of determining whether or not some modifications
were needed. This group was composed of an Assistant Secretary from
each of the military service branches and was chaired by the Honorable
Robert H. Fogler, at the time Assistant Secretary of the Navy. After
taking into consideration the requests and views of the field com-
mmanders, a proposal was submitted in September, 1956, to the House
Armed Services Committee, requesting permission to add 23 items or
classes of items to the authorized list. Only 5 of these were com-
pletely new, the remaining recommendations involved modifications of
existing lines, such as increases in cost limitations or additions of
items to previously authorized classes, such as increasing the cate-
gory of children's clothing from 6 years to 12 years.
Before acting on these proposed changes submitted by the military services, the subcommittee decided to consult with representatives of the retail industry. While there was no requirement for such consultation, it was the view of the subcommittee that it would be fair to seek the views of those who might be affected by the decision. Also, it was felt that an improved climate of opinion might result from conferences between the military and retail representatives. As a result, a series of conferences was held between military representatives and those of the retail industry during February and March, 1957. By the time of the subcommittee's public hearings, agreement had been reached on 19 of the 23 recommendations. Three of the 4 had been unresolved and involved men's sport coats, tires and batteries, and baby furniture, which had not previously been authorized for sale. The fourth unresolved line was infants' and children's clothing which the exchange sought to stock up through age 12 rather than age 6.

On the basis of the foregoing, the subcommittee was of the opinion that only the unresolved items needed to be taken up at the time the public hearings opened. However, for reasons that are still not settled, various segments of the retail industry began to modify their positions after the public hearings began. The result was not only the consideration of the entire list of proposed changes but a complete review of the entire exchange controversy.

The effect was that this hearing followed the pattern that was established in 1949. Representatives of retail trade associations and individual retailers testified against the exchange system and the military services defended existing exchange operations. For
the most part, the criticisms and defenses offered were the same as submitted on previous occasions. The subcommittee received a large volume of correspondence from local businessmen who claimed to be injured and other letters were received from military personnel and their dependents who expressed fear over the curtailment of exchange services.

Concerning the general criticisms of exchanges by the retail industry, the subcommittee reiterated the position taken in 1949 and stated that military exchanges are necessary and an integral part of service life. With regard to the additional items requested by the military, the subcommittee recommended a compromise on those items on which no agreement had been reached. It rejected the exchange proposal to stock sport coats, tires, and some items of baby furniture, but accepted its proposal to stock batteries, infants' and children's clothing up to age 12, and other items of baby furniture. The criterion used by the subcommittee in making these decisions was the extent to which it felt that the items were of convenience or necessity.

Present Status of the Controversy

Although the work of the various Congressional subcommittees has created a certain degree of amnesty between the military and retail groups, it cannot be concluded that the central issues have been resolved. The 1957 hearings show that the position taken by various segments of retailing is not materially different from earlier periods and that there continues to be substantial opposition to exchanges as they are now operated. Rowland Jones, representing the views of the American Retail Federation, recommended at the most recent hearing
that a "thorough study of military stores be made, with ample opportunity for both sides to state their basic philosophy on the subject." Mr. Jones indicated that many elements of the exchange controversy needed further clarification and that such a study, attempting to define more carefully the basic issues, "might well provide permanent answers to many of the questions which now recur constantly." It is with this in mind that the following analysis, which attempts to evaluate objectively both sides of the controversy, has been made. Up to this time, much of the evidence presented by the retail groups has never been carefully examined. Likewise, many of the explanations offered by the military services in defense of the exchange system have not come to the forefront.

MAJOR CRITICISMS OF MILITARY EXCHANGES

Unfair Competition with Private Enterprise

At the center of all exchange criticism is the claim that exchanges constitute an unwarranted interference with the private enterprise system. It will be recalled that this was the principal factor leading to the suggestion by the Shannon Committee in 1932 that exchange operations be curtailed. In 1947, it was the matter of unfair competition that caused the Department of the Defense to cancel plans for exchange sponsored concessions that would offer for sale men's clothing. In 1955, this was the principal objection raised by the


12Ibid.
Hoover Commission against military exchanges. In addition, the Congressional hearings in 1949, 1953, and 1957 are replete with testimony by various retail groups to the same effect. Although a large part of this criticism lacks objectivity, the continuous reiteration of this point is an indication of the heatedness of the controversy and the importance of this issue to some retail groups.

Mr. Edward C. Sullivan, representing the National Retail Merchants' Association, summarized the position of his association by stating:

What the PX situation amounts to as we see it, is a service...that has been permitted and encouraged to become a colossus that seriously menaces the business and reputation of many merchants throughout the United States. It would be trite to say that this is merely another instance of Government business. The PX operation, as it exists, is much more than that, it is a Government sponsored subsidy pitted in opposition to individual initiative and a menace to wholesome and legitimate business endeavor.13

Mr. Rowland Jones, President of the American Retail Federation, testified that "the Armed Forces are actively competing with established private business and...retailers today face the competition of hundreds of military stores doing an annual business of several hundred million dollars. This is government competition with private enterprises."14 He went further to say that "military stores have expanded since 1945 until today they constitute big business in the most dramatic sense of the term, with stocks of merchandise comparable


14 Ibid., pp. 3576 to 3577.
to those of a modern department store." In 1957, Mr. Jones again testified to the same effect and pointed out that "as a basic principle retailers have recommended that the Federal Government should not engage in business activities which compete with private enterprise. These activities constitute unfair competition with the citizens of the United States." In 1957 before the appointed subcommittee, Mr. Louis Rothschild, Executive Director of the National Association of Retail Clothiers and Furnishers, stated that:

Armed Service Exchange Stores are one of the growing competitors of the classic men's wear stores. They are a big competitor....we urge the committee not to permit further competitive advantage for the Armed Services retail giant.

At the same hearing, Mr. Winston W. Marsh, Executive Secretary and General Manager of the Retail Tire Dealers and Retreaders Association, stated that his association would "unalterably oppose the addition of tires, batteries and retreading to the list of approved items for Armed Services Exchanges (because) the tire dealer simply cannot afford to compete with the Department of Defense." Also in 1957, Mr. Elton Kile, President of the National Association of Businessmen, Inc., testified that "a considerable number of (exchanges) have

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15Ibid.


17Ibid., p. 3391.

18Ibid., p. 3274.
developed into large retail operations with choice stocks of standard 
brand merchandise comparable to that found in a department store."¹⁹

The above statements are cited because they reflect the attitude 
that exists in the retail trade relative to exchange operations. A 
careful and detailed examination of the Congressional hearings shows 
that similar complaints were registered by practically every indi­
vidual testifying on behalf of some retail group. It can be concluded, 
therefore, that the matter of exchanges competition with private re­
tail establishments constitutes one of the central issues in the 
entire controversy.

**Extent of Competition with Private Business**

At the heart of the present problem is the failure to define and 
circumscribe the nature and extent to which exchanges do compete with 
private retail establishments. In fiscal year 1959, the latest year 
for which complete figures are available, Army and Air Force exchange 
sales world-wide totaled $850 million. It is this sales figure that 
has frequently been used as evidence that the exchange system con­
stitutes a "giant" government enterprise which competes unfairly with 
American retailers. It is further implied that if exchanges were 
eliminated that this business would be automatically diverted to 
other retail merchants. This aggregate figure does not, however, 
accurately reflect the extent of exchange competition with private 
retailers. This is because it includes several categories of sales 
which are beyond the reach of the private economy. In the first

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¹⁹Tbid., p. 3350.
place, this figure includes all overseas exchange sales, which in 1959
totalled $465 million, over fifty percent of the total. Included also
is $99 million in sales from food and service operations, such as the
271 cafeterias and the 375 snack bars and soda fountains which are
operated by domestic exchanges. Certainly, if activities of this type
are to be of any value, they must be located on the installation with­
in easy reach of those who patronize them.

Elimination of $465 million in overseas sales and the $99 million
in food and services leaves a balance of $286 million, which reflects
the total domestic sales volume in merchandise for 1959. Even this
figure does not realistically represent the retail sales which, if
military exchanges were eliminated or curtailed, would go to civilian
retail merchants. Included within this amount are the sales of certain
convenience goods and specialty goods which could not practically go to
outside retailers anyway. Certainly convenience goods must continue
to be handled in all exchanges. Even those groups in opposition to
the exchange system concede that the airman or soldier is entitled to
buy such items as tobacco, candy and toilet articles without going to
special effort to obtain them. Also, it is usually conceded that ex­
changes should continue to handle uniforms and accessories because of
their unique nature.

This leaves only the shopping goods as the business which could
logically be transferred to other retail establishments if exchanges
discontinued handling goods falling into this category. The percent
of total merchandise sales that could be properly classified as
shopping goods is shown in Table 11. This table classifies each
department on the basis of the type of goods which is predominantly sold in it. Although not an exact measure, an examination of Appendix B, which breaks down the classes of goods sold in each department, shows that each department handles predominantly one type—convenience, shopping, or specialty goods. The departments which handle primarily convenience goods are tobacco, candy, toiletries and drugs, stationery, and beverages. Specialty goods are handled in a separate department which sells only military uniforms and accessories. Shopping goods are sold in the jewelry, civilian clothing and sundry departments.

On this basis, it is estimated that sales in the shopping goods category amounted to approximately $117 million or 41 percent of total merchandise sales in domestic exchanges in 1959. Even this figure over-states the volume of business which could be expected by outside retailers if exchanges cut back the shopping goods which are currently being handled. This is because included within this $117 million are some shopping goods which are sold in exchanges in isolated locations. At the present time, the exchange system operates retail sales outlets at 662 military installations widely dispersed throughout the country. Of these, 174 are main exchanges located at major Army and Air Force posts or bases. In addition, there are 135 smaller activities, such as depots and arsenals. Finally, 353 of the 662 total retail outlets are located at radar, anti-aircraft artillery, and NIKE sites. Although no detailed figures are currently available, it is common knowledge that many of these installations, both large and small, are located some distance from civilian communities. One study shows 135 Army and Air Force installations are over 31 miles
TABLE 11


<table>
<thead>
<tr>
<th>CLASS OF GOODS</th>
<th>SALES (Thousands of Dollars)</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Convenience Goods</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>$64,000</td>
<td></td>
</tr>
<tr>
<td>Candy</td>
<td>$10,400</td>
<td></td>
</tr>
<tr>
<td>Drugs</td>
<td>$31,600</td>
<td></td>
</tr>
<tr>
<td>Stationery</td>
<td>$13,000</td>
<td></td>
</tr>
<tr>
<td>Beverages</td>
<td>$32,700 $151,700</td>
<td>53.0%</td>
</tr>
</tbody>
</table>

| Specialty Goods |                                |                  |
| Uniforms &      | $17,200                        | $17,200          | 6.0%             |
| Accessories     | ![Image](image.png)             |                  |

| Shopping Goods |                                |                  |
| Jewelry        | $13,100                        |                  |
| Clothing       | $38,500                        |                  |
| Sundry         | $65,100 $116,700               | 41.0%            |

Total - All Goods $286,000 100.0%

from the nearest civilian community. Many installations, of course, are much further than this, some over a hundred miles away.

To the extent that shopping goods are sold at these isolated exchanges, the $117 million must be adjusted to eliminate that portion which obviously could not be shared with retail merchants for the simple reason that many bases are either inaccessible or represent too small a sales potential to be worthwhile. Many of the smaller outlets are operated at a break-even or even on a net loss basis and are sustained only to provide an essential service.

On the basis of the above analysis, it becomes possible to place the matter of exchange competition with private business in its proper perspective. There is no doubt that exchanges do compete, but for practical purposes only to the extent that they sell shopping goods in areas where private retailers are selling the same or similar types of merchandise. Considering that there is approximately only $100,000,000 of total business involved, which would be divided among thousands of retailers throughout the country, it is doubtful that exchanges represent serious competition to private retailing. Some of the larger retail establishments in the country, for example, do a volume of business in excess of $100 million from a single store.

The above facts are presented because they show that much of the criticism of exchanges by retail interest groups is the result of misinformation or lack of information concerning the real nature

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of the domestic exchange system. This accounts for the often repeated statement that exchanges have become "large department store operations." The basic character of domestic exchanges from a marketing viewpoint has been outlined in the four preceding chapters.

It was pointed out that these retail establishments are of a general store nature, handling a wide variety of merchandise but in limited assortments. Also indicated was that exchanges operate on a non-specialized basis and that they do not stress advertising, sales promotion, or customer services. Although there is some classification of sales on a departmental basis, at the present time this is done for purposes of accounting and control more than for merchandising purposes.

Contrasted to this type of operation are department stores which emphasize almost entirely shopping goods offered for sale in wide assortments, bought and sold by specialized buyers on a departmental basis, and actively promoted through the use of advertising, display, and a variety of customer services.

The contrast can be readily appreciated by comparing the percent of sales volume done in tobacco, candy, and drugs for exchanges and by department stores. Whereas sales in the above named departments average 37 percent for all domestic exchanges, the average for medium size department stores is only 3.7 percent.\(^{21}\) In other words, sales of these convenience goods are ten times more important to exchanges

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than to department stores. Such differences clearly show that exchanges are not "department stores," since the nature of the two operations is quite dissimilar.

There are other aspects to the matter of government competition with the private economy. The testimony made by various retail interest groups reveals that a basic assumption is always made. This assumption is that such government competition is totally undesirable. Although this may be an admirable economic guide to public policy, many would argue that there are circumstances when such a policy is unsuitable. To illustrate, the Tennessee Valley Authority, which had its inception in the early days of the New Deal, continues to be critical of unfair competition with the private enterprise system. However, others argue just as forcefully that the TVA has accomplished much for the public good and point to irrigation, flood control, inexpensive electric power, water transportation, and wholesome recreation as the results of this government undertaking. Those that defend the TVA system claim that this undertaking would have been beyond the scope of private business enterprise and thus the government was the only force capable of carrying out such a large undertaking. As will be indicated in a later section, many military leaders point out reasons why the exchange system should also be considered as an undertaking which, due to the particular needs of operating the military, cannot be effectively turned over to civilian retailers.

Other Criticisms of Exchange Operations

In addition to the matter of unfair competition, other complaints have been registered against the exchange system. Many of these are
the result of misunderstanding. One such difficulty involves the nomenclature that has been given to military retail activities. The result has been that the words "Post Exchange" and "PX" have been used indiscriminately to include other resale activities. For example, in 1949 several of the country's leading newspapers reported a curtailment of commissary privileges (military food store operations) with the following headline: "House Group Agrees to Close PX." Commissary stores actually have nothing to do with the exchange operations other than the fact they are both retail type activities.

A second frequently heard criticism, resulting from misunderstanding, is that the exchange system is an "unwarranted burden" on the taxpayer. This criticism is the result of a failure to understand that the bulk of expenses incident to operations is covered by sales rather than from appropriated funds. For example, many have formed the impression that exchanges are staffed largely by servicemen who are assigned to them for regular duty assignments. As previously mentioned, with the exception of a small number of management personnel, all exchange employees are civilians or military personnel working for extra pay on off-duty hours.

A frequent criticism against exchanges is that military personnel abuses the privilege. Retail merchants are justifiably irritated when individuals inquire about a particular item, have the product demonstrated or its features explained, and then ask for the model number

so that they can buy the item through the exchange. There is also the problem of buying merchandise from the exchange for others who are not entitled to obtain goods from this source. Problems of this nature were far more serious in earlier periods than they are today. Within recent years the exchange system has instituted an aggressive program to eliminate such abuses and adheres strictly to a policy of making sales only to those who have proper identification. An indoctrination program using films, cartoons, daily bulletins and other media has been established to implement this policy and disciplinary action is taken against those that violate these rules.

DEFENSE OF THE EXCHANGE BY THE ARMED SERVICES

Role Played by Fringe Benefits

To understand the position taken by the Armed Services with regard to exchanges, it is necessary to understand the role of fringe benefits in general in the military life. For decades, one of the strongest appeals used to encourage individuals to make the military a career has been the variety of services offered to the soldier and his family, some of which are free and others at a cost typically less than what is available to civilians. Education (including university level), medical and hospital care, and recreational facilities are examples of fringe benefits which are virtually free. Illustrations of those available at reduced cost are service clubs, commissary stores, base laundries, and post exchanges.

The Armed Services point out that fringe benefits have become a regular and traditional part of service life. It is maintained that
to take them away (or drastically curtail them) would cause serious morale problems and endanger an already serious matter—the retention of skilled and experienced personnel in the military service.23

Opinions of Military Leaders

Admiral Arthur Radford, former Chairman of the Joint Chiefs of Staff, testified before the Senate Armed Services Committee in 1956 that:

The personnel problem is the real problem with which Congress has to wrestle, because unless we solve it, unless we get a better ratio of career personnel to total personnel, what we do about buying B-52's or anything else is not going to be important.24

In stressing the urgency of retaining qualified military personnel, Air Force Assistant Secretary David S. Smith stated:

We are confronted with a world situation which may require us to maintain effective deterrent strength for decades, or until the nations of the world work out a less perilous basis for peace. In this situation we can continue to depend upon Armed Forces manned by volunteers in and out of uniform or we can face the problem as a business would organize such an effort and provide for our service personnel the financial reward and necessary services which will encourage them to make the Armed Services a career.... In addition to pay a military man is entitled to adequate housing, medical care to his dependents, recreational facilities and stores which will provide for his and his family's personal needs...We cannot and should not expect patriotism and pride of service to make up for the lack of these factors which will affect a man's ability to provide reasonable comforts for his family and on a salary commensurate with his talents.25


It is noteworthy that Secretary Smith, in addition to mentioning low pay and housing, cited the requirement for maintaining the fringe benefits which have traditionally provided for the needs of the serviceman and his family.

Former Secretary of Defense Charles E. Wilson has testified specifically in behalf of the exchange. He stated that:

The Exchange is one of the things that the military services have had for a long time—the opportunity to buy things for a little less cost than they would have to pay in the downtown stores. If you want to take that away from them you had better be prepared to give them additional money.26

General Curtis E. LeMay, Vice Chief of Staff of the United States Air Force, has repeatedly mentioned the exchange as an important fringe benefit, one that is held in particularly high regard by military people.27 In 1956, at the Tenth Annual Convention of the Air Force Association, the manpower problem was the principal subject under consideration. This convention pointed out the importance of fringe benefits as "inducements to the military" and cited the base exchange specifically as an important factor in manpower retention.28

Importance of the Exchange to Servicemen

Perhaps of even greater significance than the views of military leaders is the value placed on the exchange by servicemen themselves.


28"They Get Better and Bigger Every Year," Air Force, September, 1956, pp. 39 to 41.
An extensive study by the Bureau of Social Science Research, American University, provides an insight here. This study was designed to show "how exchange benefits compare, in the eyes of servicemen, to other Armed Forces benefits (and how important they are) as a factor in men's desire to continue in the Army or Air Force as a career."\textsuperscript{29} A nationwide undertaking, the study was based on a carefully controlled sample of officers and enlisted men considered to be representative of the Army and Air Force generally.

The findings are significant and show that, in the eyes of the serviceman, the exchange is regarded as the most important of all fringe benefits, even ranking ahead of education and medical care.\textsuperscript{30} The continuance of the exchange service was ranked highest among benefits as a factor in deciding whether or not to remain in the service until retirement. Three-fourths of all enlisted personnel questioned and two-thirds of the officers indicated that the exchange was "very important" to them personally as to whether or not they would continue with service life.

Major General Harland Parks, former Chief, Army and Air Force Exchange Service, points to the military way of life in explaining the feelings of the serviceman toward the exchange. He points out that military personnel are not assigned to various installations as a matter of their own personal choice but that they go wherever and

\begin{flushleft}
\textsuperscript{30} Ibid., p. 11.
\end{flushleft}
whenever they are sent. Being subject to military discipline, they work at whatever hours their duties may require and often times cannot leave the military installation at times of their own choosing. Their movements and conduct are subject to restrictions not placed on the average civilian. These individuals must necessarily subordinate their personal desires and preferences to the needs of the service and their status as members of the Armed Forces affects not only themselves but their families as well.

The requirement to maintain a ready fighting force and to maintain high morale and control under circumstances different from civilian life has led to the establishment of military communities independent of those on the outside. Encumbent on such a system is the provision of the ordinary needs of the serviceman and his family. It is for this reason that military installations provide housing, shelter, hospitals, fire-police protection, and personal and family facilities such as religious, recreation and retail services.

The exchange is one of the most important of such facilities, providing for many of the essential personal and family needs of military personnel on the installation. The exchange is an important part of a neighborhood shopping district specifically designed for the serviceman and his family. Its purpose is to contribute toward a normal community life by providing a convenient source for basic goods and services.
CHAPTER X

SUMMARY AND CONCLUSIONS

This study has analyzed the Army and Air Force post exchange system, particularly as it operates within the United States. A marketing viewpoint has been stressed, but economic, military and managerial factors have necessarily been considered. The over-all purpose has been to clarify the nature and functioning of this little known and often misunderstood retailing activity and to determine, through original research, more accurately its role and importance in the economic system.

HISTORY AND DEVELOPMENT, ORGANIZATION AND LEGAL STATUS OF EXCHANGES

The first major section of the study dealt with the origin and development of the exchange system, the manner in which it is organized at the present time, and the legal status of exchanges. These subjects were necessarily considered because they provide the basis for understanding the scope and pervasiveness of the exchange system as it operates at the present time.

Historically, it was found that the exchange has been an adjunct of the military since 1895, when the War Department designated the post exchange as the official organization authorized to sell goods and services of a personal nature to soldiers and their families. Prior to this, such goods and services were not always available conveniently or at fair prices. The post traders operated for the
most part at the larger installations and they were not under the
direct control of the military. Their business practices were fre­
quently of an objectionable nature and oftentimes the soldier was
sold goods of inferior grade or charged exorbitant prices. The
cooperative canteens, which developed largely as a result of the in­
adequacies of the post trader system, were generally more effective
but certain weaknesses continued to prevail. The canteens were in­
formal organizations, also of an unofficial nature, and their activi­
ties and methods of operation varied greatly from one post to another.

Organizationally, it was shown that until the Second World War
exchanges operated completely independent of one another, but that
since 1941 there has been a gradual trend toward centralization. In
the post World War II period, this caused considerable confusion as
it was not clear where the authority and responsibility for exchange
operations rested. Technically, exchange operations were considered
to be the responsibility of the field commanders; in reality they were
being run largely by the Headquarters Exchange Service in New York
and the regional service centers, organizations that grew out of the
centralized system. Although these organizations were designed to act
in a staff capacity, they exercised considerable direct control over
operations in practice. The result was that for a time no one really
knew who was running the exchanges. In 1957, this undesirable situa­
tion was resolved with the implementation of the "command concept,"
which redefined the prerogatives of each group associated with the
exchange system and spelled out more clearly lines of authority and
responsibility. In essence, this was a compromise arrangement worked
out in an attempt to follow traditional military command channels and still retain many of the valuable services offered by the specialized staff organizations. Although the Headquarters Exchange Service and the service centers continue to exercise some functional control over exchanges, this is more clearly defined and circumscribed than before and the previous difficulties have been largely abated.

In analyzing the legal status of the exchange system, it was shown that the exchange, as an instrumentality of the Federal Government, occupies a unique position in the marketing structure. Although not established by a specific statute enacted by Congress, the exchange enjoys an equivalent legal status because it operates under official military regulations. In the United States, military regulations have the force and effect of law unless they are specifically altered or revoked by Congress, an action which has never been taken against the exchange system. In fact, since its inception 65 years ago, Congress has made numerous references to the exchange in appropriation acts, civilian employment acts, and in others. These have been interpreted by the Courts as official recognition of the exchange by Congress and an implicit sanctioning of its existence.

From a marketing point of view, the instrumentality status is significant inasmuch as the exchange is accorded privileges and immunities not available to private business establishments. Operating-wise, this is particularly advantageous because a portion of exchange operating expenses is borne by the government. Exchanges are not subject to state or municipal taxes and control and are not subject to the provisions of such federal laws as the Robinson-Patman Act or the McGuire Act.
The purpose of the second major section of the study was to
(1) examine the place of the exchange in the marketing structure and
(2) analyze the functioning of the system in the light of recognized
marketing principles with a view toward improving operating effec­
tiveness wherever possible. Marketing functions were stressed, par­
ticularly buying and selling, as the responsibilities for merchandising
are centered here. Other marketing functions were also taken up, but
within the basic context of buying and selling.

The term post or base exchange refers to a complex of retail es­

tablishments at a military installation that sell a limited line of
goods and services to authorized persons for personal consumption.
The services are certainly important, particularly the basic ones
such as barber and shoe repair shops, but the principal activity of
every exchange is the retail store which handles almost all of the
merchandise offered for sale.

Although limited by basic military regulation, the variety of
goods handled in these retail stores is quite substantial and crosses
many merchandise lines. A number of classes of convenience goods are
sold, such as tobacco, candy and drug items. On a limited basis, shop­
ing goods are also handled, including some lines of clothing and
jewelry in addition to others. The specialty goods handled consist
almost altogether of military items such as uniforms and accessories.
Although a wide variety of different kinds of goods is handled, the assortment found in any one line is usually very narrow. It is for this reason that the exchange resembles the general store more closely than any other type. The limited sales volume simply does not permit the selection as would be found in department stores or in departmentized specialty stores. Recognition of the general store character of the exchanges is important as this provides the basis whereby exchange operations can be analyzed from a functional standpoint and makes it possible to deal with certain of the operating problems now facing the system.

In the domestic exchange system, the buying function is performed on a decentralized basis as each exchange is responsible individually for planning its merchandise requirements and making the purchases that it needs. Certain aspects of buying, however, are strongly influenced by regulations and policies which have been established (with the approval of higher authority) by Headquarters Exchange Service and the regional service centers. For the most part, these guides are useful as they serve to eliminate wide differences in operations and encourage good practices. In some cases, however, the current regulations and policies are unrealistic and do not serve the best interests of the exchange.

The analysis on selling portrayed in an over-all way the manner in which this function is performed in the exchange system. For accounting and control purposes, it was shown that every exchange classifies sales on the basis of nine selling departments. Although not usually found and not required by regulation, some of the larger and
more progressive exchanges have begun to utilize more extensive classification systems. This has been prompted by the recognition that the present system has not been working effectively in some departments, which are now too large and carry too many unrelated lines of goods to be analyzed in a meaningful way. Further departmentization or classification of sales is felt to be desirable for every exchange.

Exchange pricing policies were also discussed within the general context of selling. It was shown that merchandise is not sold at cost, a popular misconception. Prices reflect the cost of goods, all operating expenses incurred, and a level of profit used for welfare purposes and capital expenditures. Prices for most items are lower, however, than usually found because exchanges pay no rent and receive other support from the military. Further, they are exempt from taxes, licenses and controls which confront the ordinary retailer and add to his cost of doing business.

Problems related to physical facilities, fixtures and layout were also examined. It was shown that most buildings occupied by exchanges were originally constructed for some other purpose and these are frequently not suited for merchandising purposes. Oftentimes the buildings are too small or suffer from some other drawback such as poor location, inadequate parking facilities, or the need for general repairs for which no funds are available. Even though the low priority of the exchange usually precludes the possibility of a modern, shopping center type of facility, many exchanges have been quite successful in improving facilities by enlisting the direct support of the installation commanders. Frequently, these commanders have
not been properly briefed on the needs of the exchange and cannot, therefore, be expected to make improvements for which they are not aware a need exists.

The trend toward self-service merchandising has led to a number of improvements in store fixtures and layout within recent years but further improvements are badly needed in many cases. Exchanges are supposed to receive technical assistance along these lines from the service centers, but it was found that there are really few people available who are qualified for this type of work.

Concluding the analysis on selling was a consideration of the policies which govern advertising, sales promotion and customer services. It was found that the exchange, by nature, is not an aggressive selling organization and that advertising and sales promotion are held to a minimum. Few customer services are offered and these are restricted by military regulation and political pressure. There is no delivery service of any kind and almost all sales are made strictly for cash as no credit is available except for uniforms and accessories.

The one customer service of any consequence is the special order privilege, whereby the customer who does not find what he is looking for in the regular stock may order the item on an individual basis. Prior to 1949, this service was used a great deal by military personnel as almost anything could be special ordered. Since that time, however, such orders have been severely restricted and are now available only for merchandise authorized for sale by the basic regulation. Special orders are almost always a money losing proposition. Specific recommendations were made which could serve to improve this situation.
The final section of the study dealt with an economic evaluation of exchange operations and an appraisal of those aspects of the system which are most controversial. These matters were taken up because the scope of present operations has been determined largely by the arrangements and compromises that have been worked out in congressional committee between the supporters of the exchange and those who are critical of it. Since 1949, exchange activities have been the subject of three congressional hearings as well as the subject of a special report to Congress by the Hoover Commission.

The most widely heard criticism has been made by retail interest groups (and the Hoover Commission) which claim that the exchange system, as it is currently operated, is in unfair competition with private business. These groups hold that the exchange has become a giant government enterprise, one that is taking away each year a substantial volume of business which would normally go to the private economy. In this connection, the exchange has been frequently referred to as a chain of department stores, with a scope of operations that makes it impossible for the smaller retailer to effectively compete. The study presented specific criteria with which to deal with this controversy and recommended a course of action which could clarify this issue more permanently.
GENERAL CONCLUSIONS AND RECOMMENDATIONS

Throughout the study, specific conclusions and recommendations have been presented as they have been applicable to particular phases of the analysis. The following are broad, general findings which are of primary importance and which are appropriate to the study as a whole.

1. Exchanges generally charge lower prices than competing private retailing institutions. This is explained not by greater operating efficiency but by the absence of certain classes of operating expense, especially rent, and by a limited service policy.

2. The history, development, and legal status of the post exchange is significant because it shows that the exchange has been an official, authorized activity of the military since 1895. Servicemen have come to regard the exchange as the normal and regular outlet for certain types of goods and services, which frequently are not available from any other source. Also, there is little doubt that exchange patrons appreciate the lower prices charged there. The high regard for which the exchange is held is attested by military leaders and servicemen themselves. It is generally recognized as one of the most important fringe benefits and is considered to be a definite factor in building morale. In short, the exchange system has become an integral part of military life and, for this reason is socially desirable and deserves public support.

3. On the whole, the reorganization toward a more centralized exchange system following the Second World War has been a decided
advantage in improving the quality of exchange operations. The Headquarters Exchange Service and the regional service centers have made possible a desirable degree of standardization, have encouraged many good operating practices, and have made available to the individual exchange a number of services which otherwise would not be obtainable.

Within the basic organization framework, however, there exists the opportunity for even further improvement at this time. A revised personnel program, which would make possible the acquisition and development of more qualified management personnel, would be particularly desirable. It was shown that many of the individuals who now occupy exchange management positions do not have the necessary background in retailing or even general marketing. The schools and clinics offered by the Headquarters Exchange Service in New York have made an effort to overcome this deficiency, but to date these have not placed sufficient emphasis on retailing and the other marketing aspects of the business. The exchange system, after all, is primarily a retailing institution and it has problems not unlike those found in other retail businesses. These problems must be given primary consideration if a higher level of operating performance is to be achieved. Hence, the educational effort should be thoroughly reviewed and modifications should be made in accordance with this essential requirement.

The personnel problem is not altogether a matter of training and experience, however. It was found that frequently there are too few individuals assigned to a given task. This is a problem at every level of the exchange organization but is particularly serious at the service centers where, according to present practice, the field representatives
are assumed to be staff experts on many different and unrelated ele-
ments of the business. Clearly, one individual cannot give effective
staff advice on all matters of an operation as diverse and complex as
an exchange. Additional staff personnel is urgently needed if the
advice and assistance given to the local exchange is to be of real
value.

4. Of primary significance to this entire study was the analysis
of the nature of the exchange system and the manner in which it per-
forms basic marketing functions. Here also it was revealed that
there is an opportunity to improve operating effectiveness, particu-
larly with regard to the way the buying function is performed.

Although the size of the typical operation does not permit exten-
sive buying specialization, the general store character of the exchange
requires that there be at least some division of buying responsibility
at the installation level. In very small exchanges, this may be no
more than assigning buying responsibility to chief sales clerks, as
is the trend in the hardware business. In most exchanges, however,
the addition of more specialized buying personnel is justified and
could be paid for from increased sales and profits which would result
from the more skillful selection of merchandise.

A second aspect of buying requiring further development has to do
with the wide differences now found among exchanges regarding brands,
sizes, price lines and other merchandise characteristics. With a
system of decentralized procurement, some differences are expected,
of course. However, the extent of present differences is perhaps
excessive as the lines of goods handled sometimes have little in
common from one exchange to another. The dissemination of sales data among exchanges, to be used for comparative purposes, would be helpful in overcoming this difficulty. It would take much of the guesswork out of planning merchandise requirements as exchange buyers would have an opportunity to see what is actually in demand by military personnel at other installations.

The greatest opportunity for improved buying effectiveness depends on the development of a more realistic approach to the selection of the correct type of supplier for a given class of goods. It was revealed that current exchange policies, procedures, and thinking have placed undue emphasis on direct buying and that various types of wholesale middlemen, who are frequently in a position to serve exchanges very advantageously, have not been properly utilized. Although direct contact with manufacturers is highly desirable under specific circumstances, these are not always present in the exchange system and the overemphasis on direct buying has caused exchanges to deal with a number of suppliers greatly in excess of what is practical or economical.

This difficulty stems from the fact that the landed cost of goods is the only criterion used to determine the source for merchandise at this time. The analysis revealed, however, that this is an unsatisfactory basis with which to choose types of suppliers as other costs also must be considered. Illustrative of these are the higher cost of purchase orders, increased warehousing costs, higher out-of-stock conditions, and greater inventory investment which frequently are associated with direct purchases. It was pointed out that marketing functions are inherent activities that must be performed in the
distribution process. Sound marketing practice recognizes that these functions, particularly in the distribution of consumer goods, are performed oftentimes most efficiently by wholesale middlemen which stand between the manufacturer and the retail establishment. It is axiomatic that these middlemen should be circumvented only when the volume of business and the other factors incident to the purchase are such as to make direct purchase economical and feasible.

5. The argument that the exchange system should be eliminated or drastically curtailed because it is incompatiable with our private competitive system cannot be substantiated in fact. Public policy has long recognized that, under particular circumstances, it is desirable for the government directly to undertake certain business enterprises. The special needs of the Armed Services require that the exchange be included in this category.

Besides, the matter of exchange competition has received attention far beyond its economic importance. The analysis showed that there is an element of exchange competition but that, for practical purposes, the impact of this competition on retailing is exceedingly small, almost inconsequential. Even those who are critical of present operations concede that convenience goods and specialty goods (uniforms and accessories) should continue to be handled by exchanges so as not to cause military personnel undue hardship. This leaves only the shopping goods in competition with private retailers, which in 1959 totalled $117 million for all domestic exchanges. This figure also overstates the dollar volume that would revert to the private economy as a portion of this business takes place at isolated locations.
where the exchange is the only retail outlet to begin with. Although no exact data are available, it is estimated that when sales from these isolated areas are subtracted from total shopping goods sales, the volume of business in possible conflict is only $100 million a year, an amount which can hardly be considered a significant competitive factor in our retailing system which currently accounts for an annual volume substantially in excess of $200 billion.
APPENDIX A

ITEMS AUTHORIZED FOR SALE IN DOMESTIC EXCHANGES

Section I. The following items are stocked in all domestic exchanges. Items marked with an asterisk must be stocked at installations where female military personnel are stationed but are optional at other installations.

Candy, bar, 6 brands
Chewing gum, 3 brands
Cookies or crackers
Ice Cream

Beer, bottled or draught, alcoholic content not in excess of 3.2 percent in weight
Soft drinks
Milk

Cigars, 2 brands
Cigarettes, 4 brands
Flints and wicks
Fluid, lighter
Matches
Pipes
Pipe cleaners
Tobacco, pipe, 2 brands

*Bag, douche
*Belt, sanitary
Brush, tooth
Brush, shaving
Comb, pocket
Cream, dental, 2 brands
Cream, shaving, brushless, 2 brands
Cream, shaving, lather, 2 brands
*Deodorant, perspiration
*Lipstick, except precious metals
*Napkins, sanitary
*Nets, hair
*Pins, hair and bobby
*Polish, nail
*Powder, face and compact

Powder, talcum
Powder, tooth, 2 brands
Prophylactics
*Puff, powder
Razors, safety and blades
Remover, nail polish
Rouge, including eye makeup
Shampoo
Soap, laundry or flakes
Solution, antiseptic
Tissues, cleansing

Cards, greeting, including postal
Envelopes
Ink
Paper, writing
Pencils, wood-cases, or mechanical $7.50 limit, and lead
Pens, fountain, $12.50 limit or holders and points
Periodicals

Brush, shoe
Cloth, metal polishing
Cloth, shoe
Laces, shoe
Locks
Mirrors
Nail files
Needles and threads
Polish, shoe
Scissors, small
Towels
Wash cloths
Section II. In addition to those listed above, the following items or categories of items may be stocked in domestic exchanges in accordance with prevailing needs.

Nuts, popcorn, and potato chips
Break and snack-type packaged food items
Ash tray, except precious metals
Box, cigarette, except precious metals
Case, cigarette, except precious metals
Cigar or cigarette holder, except precious metals
Humidors, except precious metals
Lighters, except precious metals
Moistener, tobacco
Paper, cigarette
Pipe filters
Pipe racks, except precious metals
Pouches, tobacco
Snuff
Tobacco, all types

Bottles, infants, including nipples
Brushes
Containers, soap, tooth brush, etc.
Cosmetic sets, $6 limit
Cotton, absorbent
Dental floss
Dentifrices
Dresser sets, $6 limit
Hair preparation
Jelly, petroleum
Perfume & toilet water, $5 limit per bottle
Pomade, lip
Powder, foot
Powder, tooth
Remedies, standard, first aid, in accordance with pertinent directives
Shaving accessories & supplies
Skin cream and lotions
Soap, laundry
Soap, toilet
Sunglasses, utility type
Tissue, toilet

Books and manuals
Books, scrap
Cards, playing
Games
Photograph albums, including mounting aids
Photograph frames, except precious metals
Stationery supplies
Training aid supplies
Typewriter, portable, $70 (#) limit

Bags, shoulder
Belts
Caps
Cap covers
Cuff links (military). No limit when prescribed by service regulations as item of uniform
Garters
Gloves
Insignia
Mufflers
Neckties
Shirts
Shoes
Socks

Outer garments in accordance with departmental regulations and with procedures prescribed by the Chief, A & AFES

Athletic apparel:
Footwear for active sports, $10 limit
Headgear, $2.50 limit
Jackets, hunting and windbreaker type, $12.50 limit
Pants for active sports, $10 limit
Shirts for active sports:
  Summer type, $5 limit
  Winter type, $7.50 limit
Shorts and trunks for active sports, $5 limit
Sports shirts, $10 limit
Supporters, athletic
Sweat shirts
Sweater, $5 limit
Swim trunks and suits, $10 limit
Belts, $2 limit
Collar stays
Dress shield
Handkerchiefs
Handbags, ladies', $10 limit
Helmets, sun
Infant clothing
Children's clothing for school wear to age 12 consisting of dresses, skirts and blouses, gloves, shoes, and boys sport coats
Intimate apparel, female:
  Bras, $5 limit, except maternity type
  Girdles and garter belts, $4.50 limit, except maternity type
  Gown, $8 limit
  Panties, $2 limit
  Slips, $6 limit
Maternity dresses
Mufflers
Neckties
Overshoes and rubbers
Pajamas, $5 limit
Raincoats, $10 limit
Rain hats, $2.50 limit
Robes, $10 limit
Sandals, bath
Shirts, white, civilian, collar attached, $2.50 (#) limit
Slippers
Socks
Stockings
Suspenders
Umbrellas, $6 limit
Underwear
Work clothes
Bracelets, $5 limit
Charms, $1.50 limit
Clips or pins, tie or collar, $3.50 limit
Compacts, $5 limit
Cuff links, $5 limit
Identification chains, $2.50 limit
Earrings, $5 limit
Lockets, $5 limit
Necklaces, $5 limit
Pins, $5 limit
Rings, $3.50 limit
Watches, $35 limit
Watch straps & attachments (#) limit
Accessories, kitchen, such as pots, pans, bowls, pitchers, can openers, spatulas, egg beaters, food choppers, cutlery, and paper products
Baby furniture as follows:
  Car seats, $5 (#) limit
  Safety gates, $6 (#) limit
  High chairs, mattresses, and play pens, $15 (#) limit
  Strollers, baby bath, & cribs, $20 (#) limit
  Baby buggies and chests of drawers (juvenile) $25 (#) limit
Bags, garment and laundry
Bathroom fixtures and accessories such as mats, towel bars, glass holders, tooth brush holders, fixture covers, $5 limit
Blankets, sheets, and pillow cases
Cleaning and maintenance equipment and supplies, $5 limit, except carpet sweepers, ironing boards, kitchen stools, clothes dryers, $10 (#) limit
Clocks, except precious metals $15 limit
Dinnerware (excluding chinaware), Plastic:
  4 piece place setting, $3.50 (#) limit
  5 piece place setting, $4.50 (#) limit
6 piece place setting, $5.50
(#) limit
Extra pieces, $3 (#) limit
Earthenware:
4 piece place setting, $2.50
(#) limit
5 piece place setting, $3.50
(#) limit
6 piece place setting, $4.50
(#) limit
Extra pieces, $2 (#) limit
Electrical Appliances, $15 limit
except mixers, fans, vacuum
cleaners, coffee makers $30
limit
Electrical supplies such as
bulbs, plugs, outlets and wire
Flatware, including chest,
$35 (#) limit per set of
34 pieces
Glasses, drinking, $0.25 limit
Hangers, clothes
Lamps, table, desk, or bed
$10 limit
Linens, table, $7.50 per set
Phonograph records and needles
Radios, table and portable types,
$35 limit, except transistors,
$50 (#) limit
Record players, table and
portable, $50 (#) limit
Sewing accessories
Washing machines, small portable
type, $30 limit
Window curtains and shades, except
venetian blinds

Bicycles, $35 limit
Fishing equipment, $20 limit
Golf club sets
Guns (as limited in note 2)
All other items of sports and
recreational equipment and
supplies and manual arts and
garden tools, photographic
film and supplies, $25 limits,
except power tools, photographic
accessories, lawn mowers,
$50 (#) limit. All other
items, $25 limit

Gasoline and oil
Supplies and accessories, $10
(#) limit

Batteries
Where price limits are indicated, these are cost price limits, not retail price limits.

The symbol (#) following the cost invoice price limitation reflect price levels as of July 1, 1957. This cost price can be adjusted by the A & AFES, in relation to the Department of Labor Wholesale Price Index (1947-1949=100) whenever a five percent change in the all-commodity (other than farm products and processed foods) index has been existent for a period of six months. Federal excise taxes levied against manufacturers where applicable, are considered to be part of the cost price limitation.

APPENDIX B

A DEPARTMENTAL BREAKDOWN OF CLASSES OF GOODS
SOLD IN DOMESTIC ARMY AND AIR FORCE EXCHANGES

Department 1

Tobacco Products
Cigarette Regular
Cigarette King
Cigarette Filter
Cigars
Pipe Tobacco
Other Tobacco

Smoking Accessories
Pocket Lighter
Table Lighter
Lighter Fluid
Flints & Wicks
Pipes
Miscellaneous

Department 2

Candy
Bars
Box, Can, Jar, Pkg.
Bulk
Other Candy

Gum, Mints, Drops
Chewing Gum
Mints
Other

Cake, Cookies, Crackers

Snack Package Food
Ice Cream

Nuts
Packaged
Bulk

Groceries (limited)

Miscellaneous

Department 3

Dental Items
Cream
Powder
Brushes
Brush Containers
Antiseptic Solutions

Shaving Items
Cream Lather
Cream Brushless
Cream Pushbutton
Brush
Razor Non Electric
Razor Blades
Lotion

Hair Grooms
Shampoos
Dressing & Tonics
Combs
Brushes
Hair Wave Kits
Spray & Wave Lotion

Bath Toiletries
Soap Face & Hand
Soap Containers
Department 3 (Contd.)

Cosmetics
- Lipsticks
- Perfume & Cologne
- Powder Face & Dust
- Make-up
- Creams & Lotions
- Deodorant
- Dresser Sets

Mail Accessories
- Polish
- Remover
- Implements

Drug Sundries
- Remedies
- First Aid Items
- Vitamins

Miscellaneous
- Baby Toiletries
- Sunglasses

Sanitary Items
- Sanitary Napkins
- Prophylactics
- Cleansing Tissue
- Toilet Tissue

Department 4

Army Uniforms
- Green Elastique
- Blue Elastique
- Summer Uniform
- Trench Coat
- Raincoat

Air Force Uniform
- Blue Gabardine
- Summer Uniforms
- Summer S & T Sets
- Summer Shade 505
- Topcoat
- Raincoat

Fatigue Clothing
- Army All
- Air Force All

Shoes Army & AF
- Low Quarter
- Boots

Socks Army & AF
- Cotton
- Wool
- Synthetic

Insignia
- Army All
- Air Force All

Neckties
- Army All
- Air Force All

Other Furnishings
- Army
- Air Force

Uniform Caps
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<tr>
<th>Department 5</th>
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<tbody>
<tr>
<td><strong>Watches</strong></td>
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<td>Men's</td>
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<tr>
<td>Women's</td>
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<tr>
<td>Children's</td>
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<tr>
<td><strong>Watch Bands</strong></td>
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<tr>
<td>Men's</td>
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<tr>
<td>Women's</td>
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<tr>
<td><strong>Jewelry</strong></td>
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<tr>
<td>Men's</td>
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<tr>
<td>Women's &amp; Children's</td>
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<tr>
<td><strong>Rings</strong></td>
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<tr>
<td>Engagement &amp; Wedding</td>
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<tr>
<td>Men's</td>
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<tbody>
<tr>
<td><strong>Books &amp; Periodicals</strong></td>
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<tr>
<td>Air Force Books</td>
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<tr>
<td>Army Books</td>
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<tr>
<td>Magazines</td>
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<tr>
<td>Other</td>
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<tr>
<td><strong>Cards &amp; Gift Wrap</strong></td>
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<tr>
<td>Everyday Cards</td>
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<td>Seasonal Cards</td>
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<tr>
<td>Gift Wrap</td>
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<tr>
<td><strong>Playing Cards</strong></td>
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<td><strong>Outerwear, Men's Civilian</strong></td>
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<td>Slacks</td>
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<td>Jackets</td>
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<tr>
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<td>Suits*</td>
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<tr>
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<td>Raincoats</td>
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<td>Furnishings, Men's</td>
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<tr>
<td>Shirts Dress</td>
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<td>Shirts Sport</td>
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<td>Sweaters</td>
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<td>Shorts &amp; Briefs</td>
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<tr>
<td>Undershirts</td>
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<td>Pajamas</td>
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<td>Handkerchiefs</td>
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<td>Outerwear, Women's</td>
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<td>Jackets</td>
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<td>Dresses*</td>
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<td>Suits*</td>
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<tr>
<td>Coats &amp; Toppers*</td>
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<tr>
<td>Maternity Wear</td>
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<tr>
<td>Accessories, Women's</td>
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<td>Shirts &amp; Blouses</td>
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<td>Sweaters</td>
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<td>Gloves</td>
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<td>Department 8</td>
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<td>Furlough Bags</td>
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<td>Luggage Hard</td>
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<td>Luggage Soft</td>
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<td><strong>Radios, Phonographs</strong></td>
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<td>Portable Radio</td>
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<td>Record Players</td>
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<td>Radio Phonograph Comb</td>
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<td>Television*</td>
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<tr>
<td>Tape Recorders</td>
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<td>Phonograph Records</td>
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<td>Accessory Items</td>
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<td><strong>Photographic Items</strong></td>
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<tr>
<td>Still Cameras</td>
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<td>Film</td>
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<td>Flash Bulbs &amp; Gun</td>
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<td>Exposure Meters</td>
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<td>Photo Accessories</td>
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<tr>
<td><strong>Auto Supplies &amp; Accessories</strong></td>
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<tr>
<td>Batteries</td>
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<tr>
<td>Tires*</td>
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<tr>
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<tr>
<td>Accessories</td>
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<td><strong>Toys &amp; Christmas Decor</strong></td>
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<td>Dolls &amp; Accessories</td>
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<td>Trains &amp; Accessories</td>
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<tr>
<td>Games</td>
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<tr>
<td>Wheel Goods</td>
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<tr>
<td>Educational &amp; Construction</td>
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<td>Decorations</td>
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<td>Lights</td>
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<tr>
<td><strong>House Furnishings</strong></td>
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<td>Baby &amp; Youth Furniture</td>
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<tr>
<td>Lamps</td>
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<tr>
<td>Dinnerware</td>
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<td>Clean &amp; Maintenance</td>
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<tr>
<td>Kitchen Accessories</td>
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<tr>
<td>Pots &amp; Pans</td>
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<td>Rugs &amp; Carpet</td>
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<td>Coffee Makers</td>
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<td>Steam Irons</td>
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<td>Dry Irons</td>
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<td>Travel Irons</td>
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<td>Fry Pans</td>
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<tr>
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<tr>
<td>Vacuum Cleaners</td>
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<tr>
<td>Washing Machines*</td>
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<td>Clothes Dryers*</td>
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<td>Refrigerators*</td>
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<td>Ranges*</td>
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<td><strong>Sport &amp; Recreation Equipment</strong></td>
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<tr>
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<td>Hobby Items</td>
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<tr>
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<td>Shoe Findings</td>
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<td>Gift Items</td>
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<td>Padlocks</td>
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<td>Pocket Knives</td>
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<td>Paints and Brushes</td>
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</table>
Department 9

Beer

Soft Drinks

Milk

*These items are authorized only at extremely isolated locations and then only with approval at the Department of Defense level.

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I, Alton Frederick Doody, Jr., was born on October 18, 1934, in New Orleans, Louisiana, where I received my primary education. My secondary schooling was begun at Baton Rouge, Louisiana, in the University High School of the Louisiana State University and was completed at Oakwood High School in Dayton, Ohio, where I graduated in 1952. After one year of college at Miami University, Oxford, Ohio, I transferred to Ohio Wesleyan University in Delaware, Ohio, receiving a Bachelor of Arts degree in 1956. My undergraduate major was economics but I pursued a general liberal arts curriculum with considerable emphasis on history and English literature. I received the degree Master of Business Administration in August, 1957, from the Ohio State University where I remained until January, 1959, in order to work toward the Ph. D. degree. During this period I taught several courses in the Department of Business Organization. In January, 1959, I entered the United States Air Force for a three year active service tour and was assigned to the School of Logistics, Institute of Technology, Wright-Patterson Air Force Base, Ohio. My position there has been Assistant to the Dean, School of Logistics, and it is while in this capacity that I completed the requirements for the Doctor of Philosophy degree.