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THE USE OF FINANCIAL DATA IN SUPPLY MANAGEMENT

1 December 1955

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Major General Andrew T. McNamara, USA, Director of Supply Operations, in the Office, Deputy Chief of Staff for Logistics, was born in East Providence, Rhode Island, 14 May 1905. He was graduated from the U. S. Military Academy and commissioned second lieutenant, 9 June 1928. His first assignment was with the 28th Infantry, Madison Barracks, N. Y. Then he did duty with the 35th Infantry, Schofield Barracks, Hawaii, and as Company Commander with the C. C. C., Alexandria, Louisiana. In September 1933 he entered the Infantry School and was graduated in June 1934; then entering the QM Subsistence School, he was graduated in June 1935. In 1937 he transferred to the Quartermaster Corps. Subsequently, some of his assignments included: 1942, assistant quartermaster, II Corps, England and quartermaster of the same Corps when it was transferred to the North African Theatre; 1943, First Army, European Theatre. Upon return to the United States in 1945, some of his duties were: 1945, Headquarters, First Army, Fort Bragg, N. C.; 1946, chief, Subsistence Branch, Office of the Quartermaster General, Washington, D. C.; 1948, graduated from the National War College and served as executive, Policy Branch, Plans and Operations Division of the Army General Staff; 1949, chief of the Policy Branch and assistant executive of the Plans Group; 1949, assistant executive secretary, Department of Defense; 1950, attended Harvard Business School for the Advanced Management Executive Course; 1951, executive to the Under Secretary of the Army. On 1 March 1953, he became Chief, Storage and Distribution Division in the Office, Deputy Chief of Staff for Logistics and on 1 April 1955 assumed his present assignment.

THE USE OF FINANCIAL DATA IN SUPPLY MANAGEMENT

1 December 1955

GENERAL HOLLIS: It is a privilege for me this morning to be able to introduce to you a distinguished officer who is also an old and valued friend.

As all of you know as well as I, the Armed Services are so much in the public eye these days that it is very reassuring for me to know that people of the caliber of our speaker are involved in the formulation of logistics policy today. You have seen General McNamara's biography. You know his achievements. The thing that I like to think about this system is that we have people, as I said before, who bring to their jobs the courage, the resiliency, the resourcefulness, and the hard common sense of our speaker today.

It is a great pleasure to introduce to you Major General Andrew T. McNamara.

GENERAL McNAMARA: Thank you, sir. Kind words from an old friend.

The subject assigned to me this morning is entitled "The Use of Financial Data in Supply Management." It is not a dull subject. I want to get that established right off. It is a stimulating subject. However, it is new to us in the Army, and therefore we can't summarize it in as nice a picture as you would like to have this early in the game. I think, however, before we talk generally about supply management and the relation of dollar value to it, I am going to have to put up some fences or boundaries around the ball park for our discussion here.

First, I want to say that our subject pertains only to inventories. This excludes property in use. Second, since we are discussing the uses of dollar data, we will be discussing the end product of financial inventory accounting and stock funding.

Now, these, of course, are merely titles given an accounting system. The purpose of this system is the management of inventory and the improvement of its management. As a byproduct, the improvement of supply managers is accomplished.

It has been stated many times that the Army's responsibility for supply management is the largest job of management ever to confront a single organization. Perhaps this is true. Certainly it is one of the largest. Comparisons can be made with civilian industry and other Federal departments and agencies to illustrate this point. However, this morning I do not intend to dwell on the magnitude, even though some of the figures are quite startling.

I merely want to point out that the total value of our Army inventory as of 30 June 1955 was 20-1/2 billion dollars. The major part of this inventory is located in the continental United States depots and comprises about 16 billion dollars. The sum of 4 billion is located overseas. Only about four-tenths of a billion dollars is located in the major continental United States posts, camps, and stations.

Now, while the latter figure is comparatively small, about one and a half billion dollars worth of supplies flow through the posts, camps, and stations during a year.

The very magnitude of our investment in supplies indicates a need for control. The problem, of course, is how? That brings us to the basic purpose for which financial inventory accounting is intended, namely, the control of inventory.

An Army policy of long standing is that inventory is managed by command. Financial accounting does not affect this policy. Each overseas commander, ZI Army commander, and chief of technical service is responsible for the management of his respective portion of the Army inventory. The chiefs of the technical services, of course, manage their segment located in the continental depot system.

To further illustrate the basic purpose for which financial accounting is designed, let me give you an oral diagram of inventory management as it applies to the last echelon of the distribution pipeline.

Now, we all know that management of inventory is not new to the Army. The Army has for years managed by means of item control. With this control by item, why is it necessary for us to put a dollar sign on our supplies?

Well, the focal point of item control at post, camp, and station level is the stock record card. The property officers there open a

stock record card for each item which they stock. Then they assign a clerk, based on a work measurement chart of some sort, to a given number of items.

That clerk establishes a control level, based for the most part upon issue experience. Replenishment, or input, is virtually automatic after establishing the control level. Supplies are requisitioned to satisfy that control level.

The control level is so important that we require Army commanders to make liaison visits at least twice each year to every station. In addition, we also require the distribution depot responsible for serving that station to make liaison visits for the purpose of reviewing the control levels.

This system of item control, supplemented with the liaison visits, begins to break down when you consider the large number of items in the supply system. At last count, the total item count was just under one million. Visualize a stock card for every item. Placed in a row, these stock cards would extend almost one mile.

You can recognize quickly the virtual impossibility of a timely review of every stock record card. An item-by-item review is a difficult task even for the property officer, who is the one individual assigned supply control as a full-time job. As we progress further up the chain of supervision from the property officer to the chief of technical service of the installation, to the installation G-4, to the installation commander, to the ZI Army technical service chief, to the Army G-4, to the Army commander, to the chief of the technical service, and to DCSLOG, we find each successive echelon has less and less knowledge of the adequacy of the inventory at the station. Management has long needed a means that can be used to influence the inventory position of the command. We think we have that means when we use financial inventory accounting and stock funding.

Now, a review of the development of financial inventory accounting will serve to further illustrate the basic purpose of the system. By definition, financial inventory accounting is a method of summarizing the inventory position by pricing inventory and recording inventory transactions.

Pricing of inventory is comparable to maintaining a record of the total balance on hand. We have always maintained records that reflect the balance on hand by item. In addition, we have also traditionally recorded inventory transactions by item. With dollar data, we can summarize the inventory transactions by groups of items, using dollars as the standard measure. So, you see, financial inventory accounting is integrated with item accounting. The same principles for supply control apply now as before the establishment of financial control.

The first step in establishing financial inventory accounting is to determine logical groupings of items; that is, to bring together all the flags and pennants into a single grouping, all heavy artillery into a single grouping, and all types of dry batteries into a single grouping. We refer to these groupings as categories. This reduces the magnitude of one million items to about 350 groups of items.

The next step is to establish a uniform standard pricing system and a standard price for each item. The dollar is used as a yardstick to measure quantities and activity within each category.

Then the next step is to design a logical method of presenting a summary of inventories and inventory activity. Two reports have been designed for this purpose. The first is called a "Statement of Inventory Transactions." It reflects the dollar value of the opening inventory, the increases and decreases during the reporting period; and the closing inventory. It is prepared in total by the technical service.

Examples of some transactions that are recorded this way would be salvage disposals, receipts from organizations, and returns to depots. The latter two reflect the degree to which supply echelons are exchanging supplies.

This form introduces a method of control for supplies in transit between depots, stations, and oversea commands. This, by the way, is the first attempt by which the value of the stock in transit is picked up on an accounting form.

Now, the second report is the "Supply Management Report." This report, as the name implies, is intended as an aid in managing supplies. It is that simple. It is prepared by category.

The last step in establishing financial inventory accounting was to develop a method of accumulating the financial information for the reports. As most of you know, the Army engaged six prominent firms of public accountants; and through them the mechanics of doing the accounting were developed and were installed worldwide by 1 July 1954.

Just a few words now about stock funds.

As I see it, stock funding is essentially a method of funding for the replenishment of inventories. Financial inventory accounting is a system of accounting for supplies, whereas the stock fund is a method of financing.

Both financial inventory accounting and stock funds use the same price and the same item groupings or categories as a point of departure. The Statement of Inventory Transactions and the Supply Management Report are also byproducts of the stock fund accounting system.

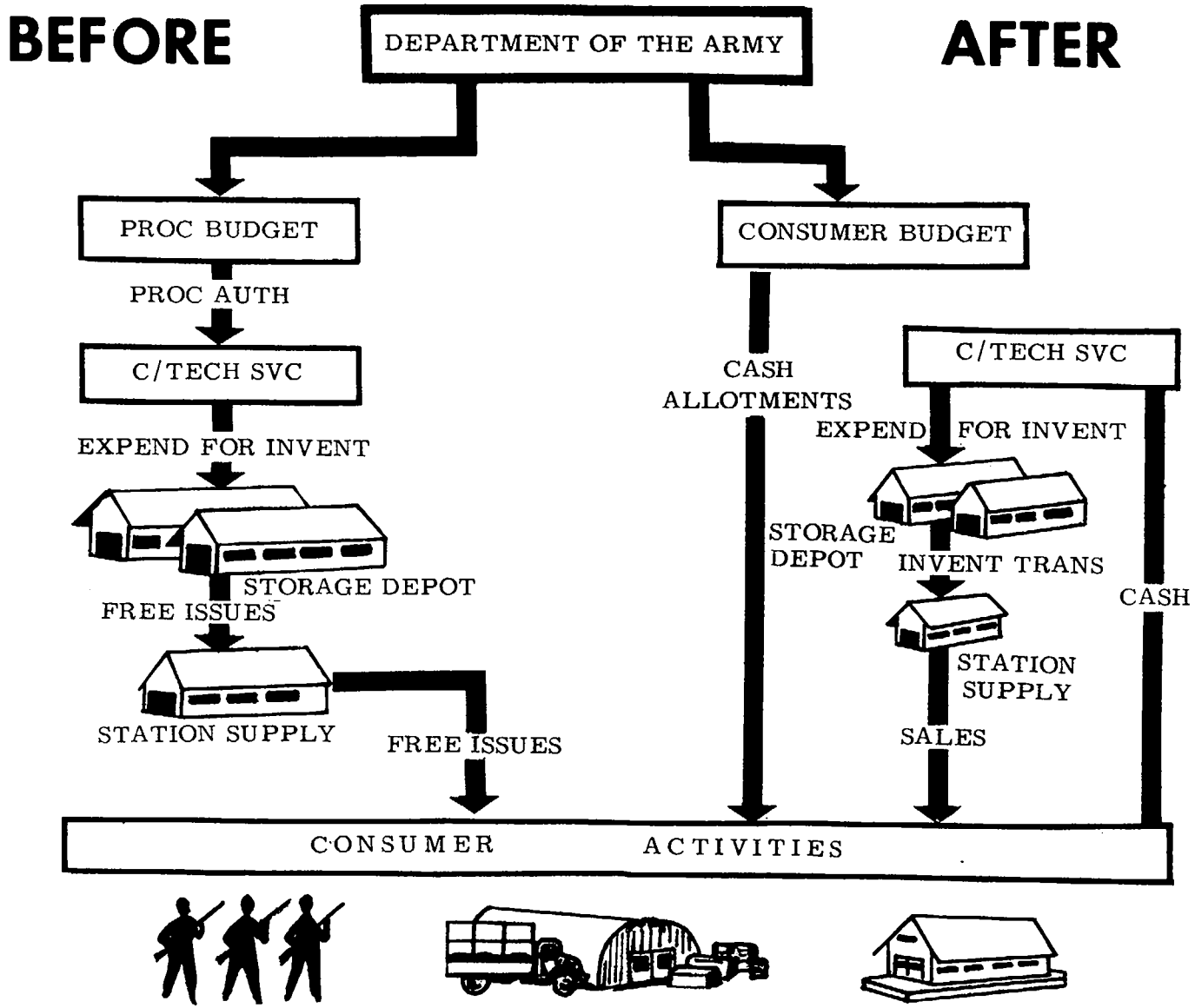
Now, to answer the question, "Why stock funds?" let us review for a minute our past funding procedures for procurement of supplies.

Chart 1, page 6.--In the past, procurement authority, based upon an approved procurement budget, has been given to the chiefs of the technical services. Appropriations were expended directly to replenish depot stocks. Depots effected a free issue to support bulk inventories at station level, and the station supply officer made a free issue to the consuming activity or user.

Under this system of financing, the Army did not know the value of the investment in inventories or the dollar value of material issued to the user. As a result, the Army was exposed to criticism. We were accused of spending money appropriated to satisfy our peacetime materiel requirements for a given period, for items we stored in our depots and station warehouses, without actually placing them in use during that period.

On the other hand, the Army was placed in the position of asking for dollars to sustain current requirements without being able to show the actual dollar consumption. And consumption is particularly significant in the case of common-use, recurring-issue-type items. For this reason, these are the types of items capitalized under stock funds.

CHART 1



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It is to the advantage of all concerned to establish a self-perpetuating fund for recurring-issue-type items. As a result, the stock fund concept came into being. A stock fund is merely a revolving fund established to provide working capital to procure, hold, and sell common-use items.

Under the stock fund concept, appropriated funds are allocated and allotted to the consumer. The consumer uses these funds to pay the stock fund manager only for supplies issued for use. The stock fund manager may use the funds to replenish the inventory.

You will probably recognize how this system of funding is a challenge to the stock fund manager. He must really do a job of merchandizing. If he invests his money in supplies that do not have an active demand, it follows that he will eventually run short of cash to buy the things his customers need. In commercial practice this is called "nailing dollar bills to the stock shelf."

The extension of stock funds to station level is a particularly controversial subject at the moment. We are just completing an evaluation of a test extension conducted in Third Army. Since the decision has not yet been announced, I would prefer not to discuss the point further.

We have roughly described the similarity between stock funds and financial inventory accounting. It gives rise naturally to the question: "Is there duplication?" The answer is: "No, there is not."

Stock funds consist of two accounting elements. That is, we account for stock and we account for funds. Financial inventory accounting is the "stock" part of stock funds. When a system of accounting for the dollars to replenish the stock is added to the financial inventory accounting, the result is a stock fund accounting system. Stock fund accounting will be done for stock fund items, and financial inventory accounting will be done for nonstock fund items.

Chart 2, page 8.--This second chart, prepared as of 30 June 1955, reflects the dollar value of our total inventory; second, that portion of the total inventory that is funded with working capital funds; and, third, the capital portion of the stock fund. This figure includes both inventories and cash.

CHART 2

PORTION OF THE TOTAL INVENTORY FUNDED
WORKING CAPITAL FUNDS — JUNE 1955
(MILLIONS OF DOLLARS)

	VALUE OF TOTAL INVENTORY	VALUE OF STK FUND INVENTORY	TOTAL CAPITAL OF STK FUND
TOTAL INVENTORY	20,547	5,542	6,683
CHEMICAL	419	54	61
ENGINEER	1,434	227	261
MEDICAL	276	185	242
ORDNANCE	13,700	2,680	2,777
QUARTERMASTER	2,764	1,899	2,727
SIGNAL	1,431	435	541
TRANSPORTATION	519	61	67

You will notice the total capital of the Quartermaster and Ordnance Divisions are approximately the same. On the other hand, there is a significant difference in the ratio of inventories to cash.

If you will note, Ordnance has 2 billion 680 million dollars worth of stock fund inventory, whereas they have only 2 billion 777 million dollars worth of capital of the stock fund. Thus they are heavy on inventory and light on cash. They have only approximately 97 million dollars worth of cash on hand. Quartermaster, on the other hand here, has 1 billion 899 million dollars in stock fund inventory, and almost another billion in capital of the stock fund--2 billion 727 million dollars. They are very light on inventory and heavy on cash.

From time to time it is necessary to make adjustments within the stock fund. Surplus cash is drawn off the top in one technical service and placed in reserve. The reserve fund is available for other divisions of the fund when required.

Thus far our experience has been that it is not necessary to replace everything we sell. In other words, we were overstocked when we capitalized the inventory, and we have been able to live off the shelf.

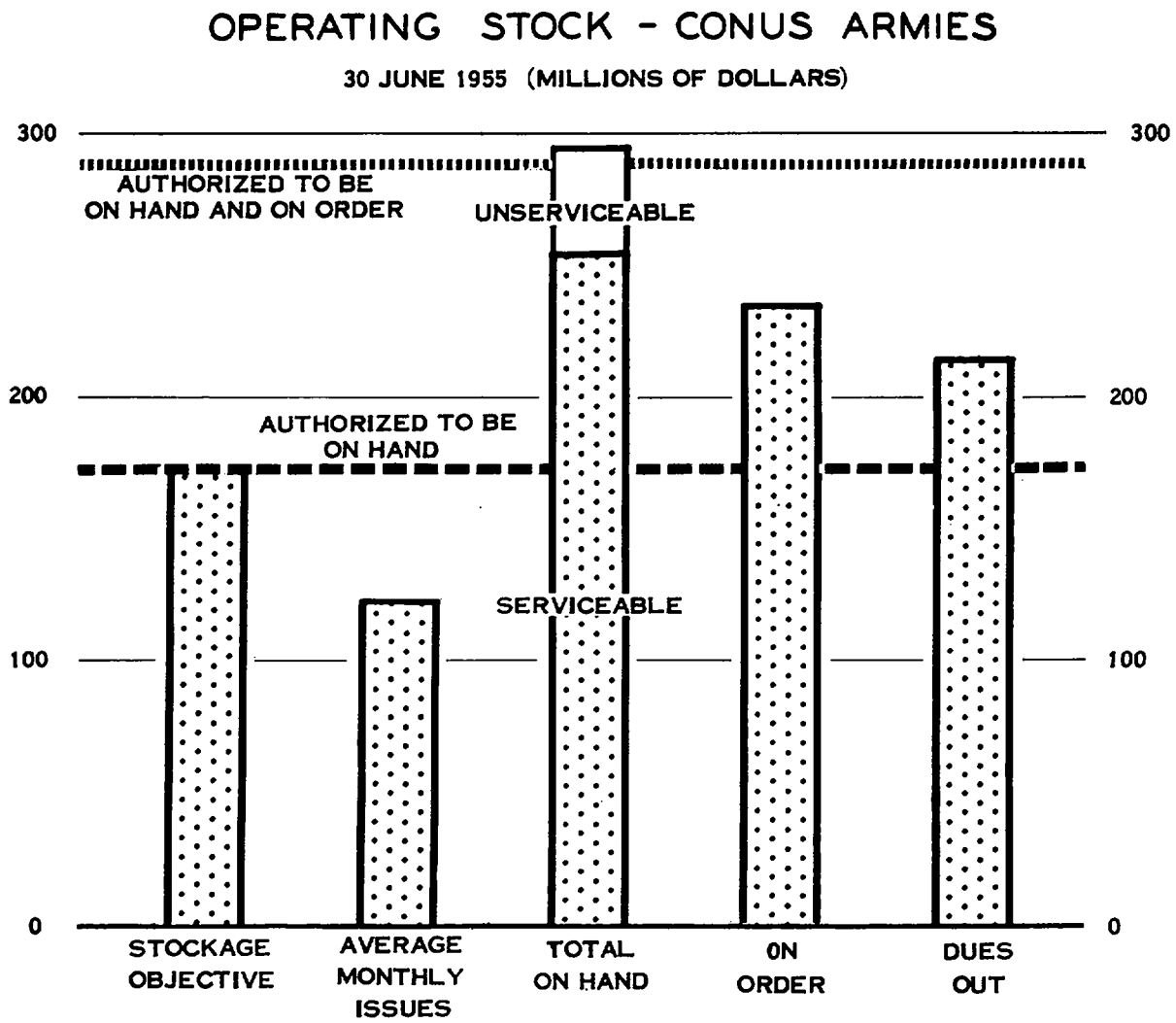
Chart 3, page 10.--This chart is a graphic portrayal of information taken from the peacetime operating stock section of the Supply Management Report submitted by ZI Army commanders for the period ending 30 June 1955.

On 30 June the ZI Army commanders forecasted the need for 175 million dollars worth of supplies for the next 45 days. This forecast is called a "stockage objective." The forecast can be verified by referring to past experience. In this case, since the forecast is for 45 days, the average 30-day issue should be about 116 million dollars. As you see, the issues are averaging about 125 million dollars. This is reasonable proof of a legitimate forecast.

The next logical step is to compare what is needed with what is on hand. We find about 255 million dollars worth of supplies on hand. In addition, there is about 40 million dollars worth of unserviceable stock on hand, all of which is repairable and is scheduled for repair.

Dollarwise, there is ample stock to meet the forecast. In fact, there appears to be too much stock.

CHART 3


OPERATING STOCK - CONUS ARMIES
30 JUNE 1955 (MILLIONS OF DOLLARS)
300
200
100
0
AUTHORIZED TO BE ON HAND AND ON ORDER
UNSERVICEABLE
AUTHORIZED TO BE ON HAND
SERVICEABLE
STOCKAGE OBJECTIVE
AVERAGE MONTHLY ISSUES
TOTAL ON HAND
ON ORDER
DUES OUT

There is one other element we have not yet discussed. This is called the "requisitioning objective" and represents the quantity authorized to be on hand and on order. The stockage objective includes a 30-day operating level and a 15-day safety level. The requisitioning objective also includes the order and shipping time necessary to maintain the 45-day stockage objective. The difference between the stockage objective and the requisitioning objective gives the supply officer room to maneuver. He is not criticized unless the total on hand and on order exceeds the requisitioning objective. Even then, unless an excess on hand represents more than 30 days supply, he is allowed to attrite it.

With that background, we can conclude the quantity on hand is 5 million dollars more than is desirable to be both "on hand" and "on order."

The next question is: "Do the supplies on hand represent what the customer is calling for?" To determine the answer, we examine the on-order and dues-out. These figures need some qualification. Because the dues-out exceed the stockage objective, at first glance virtually everything on hand is the wrong kind of supplies.

At station level, we stock items only when there are at least three demands in 180 days. For all other items, the supply officer submits requisitions to the depot only when he first has a demand placed upon him.

In addition, most of the high-value items are controlled and are handled in the same manner. As a result, there is always a high dollar value dues-out and on-order.

The difference between the two can be accepted as supplies on order to fill the gaps in the regularly-stocked items. In this case, this represents about 20 million dollars worth of supplies.

When this is added to what is on hand, it leads to the conclusion that the Armies are overstocked in an amount equivalent to 10 to 15 days of supply.

Now, I think this chart illustrates, as well as anything, that financial inventory accounting has not changed the principles of supply. We have always made item studies using these same elements. Financial inventory accounting simply presents these data in summary form.

This chart is a summarization of all technical service stocks in the continental United States stations which are under financial inventory accounting.

A similar summary can be made by Army area, by technical service within the Army area, by installation, or by category, at any echelon. For the first time it permits us to get a firm grasp of the inventory position.

The next series of charts that I will show you in a few moments shows a comparison of the total issues for the fiscal year 1955 with the closing inventory on 30 June 1955.

In addition to the peacetime operating stock and mobilization reserve, the inventory figures include items in long supply. We further identify our long-supply items as either economic reserve, contingency reserve, or excess.

The economic reserve contains items for which there is a foreseeable demand within a given period. For instance, you may be closing out theater stocks. Many supplies might be leaving the theater that can be used elsewhere. We call things like that economic reserves.

The cost of replacement is related to holding costs in establishing an economic reserve. In other words, if it costs one dollar to retain the item for two years, and it also costs one dollar to replace the item, we would retain up to a two-year supply, providing it is in long supply. Any remaining portion would be reported as excess.

The contingency reserve applies only to military-type items in long supply. Because they are purely military-type items, there is a limited or nonexistent market for disposal. Rather than give them away, they are held for use in the event of mobilization.

Chart 4, page 13.--Now, because of the limited time, I have presented all the assets in one lump figure. They will undoubtedly bring some questions to mind. That is really the point of showing them to you. My purpose is to show how financial data cause the logistician to question the supply operation.

CHART 4

COMPARISON OF SUPPLIES TO DEMAND

SIGNAL

(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	1,180	236	15
FY 55 ISSUES	367	86	67

APPROXIMATE ANNUAL RATE OF INVENTORY TURN-OVER.

- ZI DEPOTS — ONE TIME EVERY 3 YEARS
- OVERSEAS — ONE TIME EVERY 3 YEARS
- ZI STATIONS — 4 1/2 TIMES PER YEAR

A few other points in relation to the charts. The ZI depot peacetime operating stock is 9 months. For overseas theaters it is 6 months. For ZI stations it is 2-1/2 to 3 months. The turnover rate for peacetime operating stock has not been a problem. The reduction of the items in long supply is a problem.

Now, I am going to show you seven charts, and I want to talk briefly about each chart.

You will note on this particular chart, which is Signal, that they show an inventory as of June 1955, in the ZI depots of 1 billion 180 million dollars, and that during that same period, or in 1955, they issued 367 million dollars worth of inventory. So in effect the rate of turnover in the ZI depots is once every three years.

Now, in their overseas inventory they show 236 million dollars. They issued during that particular year 86 million dollars. So in effect they had a turnover dollarwise once every three years also.

In the ZI stations with 15 million dollars of inventory they had 67 million dollars being issued. They showed a rate of turnover of four and a half times a year. Very good dollarwise.

Chart 5, page 15.--The Engineers showed an inventory of 846 million dollars in the ZI depots, with 225 million dollars being issued; an inventory turnover once every four years. They had 558 million dollars overseas, with 112 million dollars issued, or an inventory turnover once every five years. In the ZI stations the ratio is 30 million dollars to 95 million dollars, or three times per year.

That is a remarkable improvement over what it was. But there is a lot of work ahead.

I would like you to recall the tremendous problem the Engineers have. Remember, they bought up anything that would move earth for the Korean War, and behind it was a mass of spare parts for the varied types of equipment. After that war was over, there remained the equipment, because the damned stuff simply doesn't wear out anywhere near where you can control it. I told General Baker many times, "I think they're putting back carbide headlights on some of these items." But it is not true. This proves that I am wrong. This shows they are right. They have a substantial supply improvement program.

COMPARISON OF SUPPLIES TO DEMAND

ENGINEERS

(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	846	558	30
FY 55 ISSUES	225	112	95

APPROXIMATE ANNUAL RATE OF INVENTORY TURN-OVER.

- ZI DEPOTS — ONE TIME EVERY 4 YEARS
- OVERSEAS — ONCE EVERY 5 YEARS
- ZI STATIONS — 3 TIMES PER YEAR

Chart 6, page 17.--In Transportation they have an inventory in the ZI depots of 441 million dollars. They issued 36 million dollars. The turnover is once every 12 years. Overseas it was 69 million dollars versus 29 million dollars, and in the ZI stations 9 million dollars versus 78 million dollars. Very good.

What does this show? An area of questioning? Yes, sir. They have a very heavy inventory floating at Charleston and Rio Vista and Beaver, I believe, on the West Coast. So dollarwise this gives you an erroneous picture of the turnover of the Transportation items.

But it makes you look. It makes the Chief of the Transportation Office get out and see, because he is very much interested in how much of that stuff that is floating it is worth while to retain. He has already done it this year. They came back with a very fine report on the things he is taking action on.

Chart 7, page 18.--This is Quartermaster. Two billion dollars versus one billion dollars. The turnover is once every 2 years. Overseas 587 million dollars versus 622 million dollars, once every year. ZI stations 84 million dollars versus 408 million dollars, 5 times a year. Looks fine. It should be fine. They handle commercial-type items. If they stock and store that stuff for years on end, it is bad business. This shows what it should show--a good turnover dollarwise.

Chart 8, page 19.--This one is Chemical. This is 388 million dollars versus 20 million dollars, or a turnover once every 19 years. I believe the last year it showed once in every 35 years. So improvement is being made just on the dollar sign.

But let's look at this a bit. As soon as the flag of interest was raised, storage analysts went right through the records, and what did they find? They found they were storing many types of old bombs, the mustard-type of stuff, Air Force bombs. There are lots of other reasons that would change this picture. It indicates, however, that there is a necessity to purify some of the stuff that they stock.

If perchance there exists a situation similar to last years experience, when Chemical had wing tanks in storage at the Memphis General Depot for airplanes that were obsoleted out of the system in 1946, there is some activity of excessing that should take place. At any

CHART 6

COMPARISON OF SUPPLIES TO DEMAND

TRANSPORTATION

(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	441	69	9
FY 55 ISSUES	36	29	78

APPROXIMATE ANNUAL RATE OF INVENTORY TURN-OVER:

- ZI DEPOTS — ONE TIME EVERY 12 YEARS
- OVERSEAS — ONE TIME EVERY 2 YEARS
- ZI STATIONS — 9 TIMES PER YEAR

CHART 7

COMPARISON OF SUPPLIES TO DEMAND

QUARTERMASTER

(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	2,093	587	84
FY 55 ISSUES	1,047	622	408

APPROXIMATE ANNUAL RATE OF INVENTORY TURN-OVER.

- ZI DEPOTS — ONE TIME EVERY TWO YEARS
- OVERSEAS — ONCE EACH YEAR
- ZI STATIONS — 5 TIMES PER YEAR

CHART 8

COMPARISON OF SUPPLIES TO DEMAND

CHEMICAL

(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	388	29	2
FY 55 ISSUES	20	11	6

APPROXIMATE ANNUAL RATE OF INVENTORY TURN—OVER.

- ZI DEPOTS — ONE TIME EVERY 19 YEARS
- OVERSEAS — ONE TIME EVERY 3 YEARS
- ZI STATIONS — 3 TIMES PER YEAR

rate, this would indicate the pursuit by Chemical, I believe, of some vigorous pushing to get out things that are not needed. If they are old-type stuff, out they go. If they are useful things, in they stay; and it is well they should be there. But, as I say, I think that perhaps I will be looking at that next report that is due next week with some interest.

Chart 9, page 21.--In Medical, 231 million dollars versus 36 million dollars. Once every 6 years of turnover. Overseas 42 million dollars versus 21 million dollars. Very good. ZI 2 million dollars versus 12 million dollars, 6 times a year.

Let's see. What does this mean? It means they have in their depots, tentage, dentist chairs, types of things that would sit there. And this isn't too bad. They are required, as you know, to keep things on hand for emergency issue, to run a train out in just a short period of time, each car marked as containing these things. They have them all broken down. That would be one reason why they would have a heavy inventory. It is not nearly as bad as one would think from the comments one hears from people that don't know very much about our inventory.

Overseas 42 million dollars versus 21 million dollars, once every 2 years. Very good. Two million dollars versus 12. Excellent. That is logical. That would be the type of stuff they have to keep on the shelf--cough syrup, aspirin tablets, and such. Good turnover.

Chart 10, page 22.--The next chart is Ordnance. Eleven billion dollars of inventory in the ZI, 1 billion 927 million dollars . Once every 5 years. Overseas, 2 billion 374 million dollars versus 878 million dollars. Once every 3 years of turnover. ZI stations, 242 million dollars versus 844 million dollars. Three and a half times per year of turnover. Not bad. This is all types of material that they handle--ammunition, tanks, all sorts of things, that sit for periods at a time. Looks pretty good.

When you isolate an area in Ordnance, you find yourself becoming an enthusiast in the pursuit of supply problems. It seems to me that there is a vast field in the various types of Ordnance; and this shows that they have a pretty fair turnover. Dollarwise, this looks pretty good.

CHART 9

COMPARISON OF SUPPLIES TO DEMAND

MEDICAL

(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	231	42	2
FY 55 ISSUES	36	21	12

APPROXIMATE ANNUAL RATE OF INVENTORY TURN-OVER

- ZI DEPOTS— ONE TIME EVERY 6 YEARS
- OVERSEAS — ONE TIME EVERY 2 YEARS
- ZI STATIONS — 6 TIMES PER YEAR

CHART 10

COMPARISON OF SUPPLIES TO DEMAND
ORDNANCE
(MILLIONS OF DOLLARS)

	ZI DEPOTS	O'SEAS	ZI STATIONS
INVENTORY AS OF JUNE 1955	11,085	2,374	242
FY 55 ISSUES	1,927	878	844

APPROXIMATE ANNUAL RATE OF INVENTORY TURN-OVER.

- ZI DEPOTS — ONE TIME EVERY 5 YEARS
- OVERSEAS — ONE TIME EVERY 3 YEARS
- ZI STATIONS — 3 1/2 TIMES PER YEAR

It goes without saying, the objective of all technical services for the next fiscal year will be to identify and dispose of the surplus and improve the rate of turnover, particularly in the ZI depot system and oversea commands.

You may be interested in how these data are assembled. The scheme for putting financial inventory data together is something like this:

1. Posts, camps, and stations prepare financial reports by technical service and submit them to Army commanders.

2. Army commanders consolidate the station reports and submit them to Deputy Chief of Staff for Logistics. The Department of the Army does not receive the individual station reports. That is a good point. For the first time we are keeping down at various levels reports that should be kept down, and not getting mountains of things up here to help us reach a solution that a summary should give us at our level.

3. Army commanders send a copy of the consolidated station report to the appropriate technical service chief. The technical service chief can then prepare a consolidated report of all stock of his particular service which is located in continental United States stations.

4. The technical service chiefs prepare a separate consolidated report of all supplies located in the continental United States depot system.

5. The oversea commanders submit consolidated reports, by technical service, to the Department of the Army.

The net result of all of this is that inventories can be identified, for purposes of management, by technical service within each command.

Now, stock fund reporting is accomplished on a branch office-home office arrangement. A branch is any installation holding inventories capitalized under a stock fund. Branches report to home offices. The home offices are the offices of the chiefs of the technical services and their supply control points.

In the past year we extended financial inventory accounting to 24 additional continental United States stations. We now have 85 percent of the station inventory under financial control. All of the continental United States and oversea depots were under financial inventory accounting a year ago. The stock fund has been extended to all oversea depots, except those on Okinawa and in Italy and Korea. The stock fund has also been extended to a limited number of continental United States stations on a test basis.

Our principal effort this past year, and our goal for the next year, is refinement of data reported in terms of dollars. For example, our initial reporting formats proved to be inadequate. In April we introduced a new format that is a major improvement. Uniform stock fund reporting requirements were published at mid-year. By next July we will have an improved category structure. And, of course, we are always striving for simplicity and accuracy.

We are frequently asked the question: "What will happen to financial management in case of war?" This, of course, is a difficult question, because the full financial management plan has not yet been implemented in peacetime. The wartime application is contingent upon an evaluation of the peacetime operation. War does not diminish the need for sound management.

Of course, financial data must do more than tell us how much the war cost. It must be proven as a necessary control of resources. The Deputy Chief of Staff for Logistics and the Comptroller of the Army have appointed a committee to prepare a post-M-Day financial management plan. You may be sure the work of this committee will be carefully reviewed prior to approval.

I have been asked to comment on the relative value of financial data at each echelon. Financial data have proven beneficial at all points of input. In other words, the man that controls the flow of supplies into a command or installation is the man that controls the inventory. The key points are depot supply control points and supply control officers at station level. Financial data provide someone besides the operator with knowledge of the inventory. At Department of the Army level, I can now ask the technical service chiefs questions that formerly only they could ask themselves.

For example, dollar data highlighted performance weaknesses in our item accounting system. The first few financial reports indicated a high rate of physical inventory gains and losses. This represents adjustments between the item stock control records and the quantities physically on hand. Since the item stock control record is the very heart of the supply system, this led to an investigation of internal depot operating procedures. Surveys indicated that in some instances the physical count varied substantially from the recorded balance. When the error favored the stock control card, we were depending on an asset that did not exist. When the error was in favor of the physical count, we were buying when we had unrecorded items on hand. As a result of the survey, we have placed added emphasis on item stock control.

The June 1955 reports indicated that 45 percent of the electrical appliance inventory was unserviceable. The Chief of Engineers conducted item studies to identify the items for which a requirement existed and scheduled them for repair during the first half of fiscal year 1956.

Of course, the management of peacetime operating stock is only part of the problem.

Financial data have raised a question which is of particular concern to the arms officer, namely: "Is the Army inventory a modern inventory?" Dollar data gained some staunch support from the tactical side of the Army when they began to reveal the obsolescent factor.

For example, we can now relate plan changes and adjustments to the changes in mobilization reserve stocks. In other words, when plans change, we can tell when the impulse strikes the reserve material program. The change in requirements can be detected; and, following that, the change in the build-up can be detected.

We are also attempting to work out a normal obsolescent factor.

In fiscal year 1954 the Army excessed 310 million dollars worth of unused ammunition. In fiscal year 1955 the amount was 552 million dollars worth of unused ammunition. These figures include Air Force bombs and some Navy ammunition, as well as Army excesses. Initial studies indicate we must excess a certain percentage of the ammunition each year in order to maintain a usable inventory. By "usable" I mean ammunition manufactured for the times.

This information invites further questioning. One immediately wonders what kind of ammunition it is we are excessing. Is it ammunition we should be using in training? Through what channel is it being disposed of? That is, is it earmarked for our allies, or is it being sold through normal surplus channels?

The June 1955 reports reflected a long supply of landing crafts. This raised a question as to serviceability. Are they old and deteriorated, and should they be excessed?

Since dollar data bring these questions to mind at Department of the Army level, a natural thought is: "How are dollar data used at depot level?"

Well, this is a problem of education and individual evaluation. Financial management has caused every Army officer associated with the program to search his soul. Individuals who have recognized the merit, and put financial data to work, have found gratifying results. Where the program is rejected, it has been found that it is merely an accounting exercise.

Members of DCS Logistics recently accompanied representatives from the Bureau of the Budget to a few of the Army supply control points. The purpose of this visit, as well as dozens of others made during the year, was to verify the use of financial data. Unfortunately, the findings of the group were not always encouraging. They found commodity managers computing requirements without information concerning obligational authority. In other words, the availability of funds was not considered in forecasting the quantities to be purchased.

They found one supply control point commander who spoke out against relating requirements to funds. This attitude simply cannot continue in today's Army. We buy supplies with the money that Congress appropriates. Let us face it: we just are not going to get as much as we feel we need. The commodity manager who computes requirements is in an ideal position to recommend where the cutbacks should come. He has intimate knowledge of the demand, available substitutions, and the other factors necessary to stretch the money we get.

Financial data really come into play on this type of inspection by enabling the inspector to be selective in the item studies he reviews.

A preinspection review of the financial reports will reveal the categories where problems exist. This is a substantial improvement over the random sampling of items accomplished in the past.

By selecting a category for review, the team was able to isolate specific items where unauthorized reserve procurement was initiated by the supply control point.

In summary, I want to say that the supply manager in the Army today is confronted with a supply management problem he has never been confronted with before, certainly in peacetime. He has huge masses of stock which he must control. As the result of the so-called cold war, it appears that a large military activity will be supported over a long period of time at a very high cost. So it is imperative that the supply managers in the Army take action to obtain maximum results for every dollar spent in the logistical area.

Financial inventory accounting and stock funds are designed to assist the supply manager, but they are not cure-alls. The Supply Management Report will isolate problems by installations, by technical services, and by category or grouping of items.

Now, at that point financial inventory accounting and stock funds have done the supply management job for which they were designed. Item balances must then be reviewed, item by item within the group. Problem areas exposed with dollar data are corrected by item analysis within the group.

When dollar data were first introduced, a number of people expressed the fear that top management would measure management progress through a reduction in the dollar value of inventories. None of the ratios used to measure effective management of inventory are expressed in this term.

The total value of an inventory, by itself, is of little or no significance from a supply management point of view. The questions are:

Is there enough stock on hand?

Is there too much stock on hand?

Will the quantities on order improve or distort the inventory balance?

Is the ratio of unserviceable to serviceable stock a normal ratio?

Is the stock being purified through disposal of excess?

The goal today is the same as it has always been--a balanced inventory that is adequate to meet the demand. Dollar data will help us achieve this goal.

Thank you for listening.

COLONEL LACKAS: General McNamara is ready for your questions.

GENERAL McNAMARA: Before I get started on the questions, I would like to make clear, due to some questions that were asked out in the lobby, that the figures that I have shown to you do include mobilization reserves; and therefore you find the inventory high.

Now, this would automatically cause you to look at it and wonder, because of that high dollar value of the inventory. But, nonetheless, even when you set aside the mobilization reserves, you find areas right in the same high line. I just used the contrast as an invitation for questions.

QUESTION: Could you tell us a little bit about how much it is costing to get this thing going, and how much it is going to cost on a continuing basis?

GENERAL McNAMARA: I don't know what the total cost will be. I know we spent over 5 million dollars getting it in. But I also know we have excessed since I have been connected with it some 2 billion 300 million dollars worth of equipment each year for the last 2 years.

Now, the question is: "Would the old system have produced this excessing?" I don't know. This system has helped us bring it to the fore, I am sure. The time element in excessing is so long that the chances are the old system would have had a substantial percentage of it. The timing of this with the total returns, purging the system, and so forth, gives some credence to the fact that the dollars spent were well spent. What it will cost each year I don't know. But I

know this: From my own end, as long as I am the supply manager, the supply manager is going to run the business and not the accountant.

QUESTION: If I recall correctly, in your talk you indicated that the inventory at posts, camps, and stations was approximately .4 billion dollars, which would be about 2 percent of the total inventory of 20 billion dollars. In view of this small fraction of the inventory at station level, I wonder whether or not the effort of putting in financial accounting at stations is really worth while. Would you care to comment on that?

GENERAL McNAMARA: Yes, indeed. This system has enabled us to tell that it was there. We didn't know what it was at the posts, camps, and stations level before. This is the first time we have had any idea what the dollar value at the post, camp, and station level is.

Now the question is, and properly so: "How long should we continue at these levels? Should we go further, or should we pull back?"

Our experience has been that we are able to readjust based on need. For instance, while we were putting financial inventory accounting at posts, camps, and stations, we suddenly located the fact that at ports of embarkation there were great quantities of goods and things. They themselves suggested the imposition of a dollar sign there. We had not intended to go there in the first place. So there we had an expansion.

Now, we may find that we want to withdraw. Certainly where the dollar cost of accounting is greater than the value received, we intend, since we have learned these business terms, to pull back. We can't just go because we have a place to go. We have to use judgment; and I expect fully not to misuse dollar accounting.

QUESTION: I notice you mentioned during your talk this business of high value. To me "high value" can mean one of three things. It can mean high unit cost, high asset value, or high program cost. In the Army what do you mean by that?

GENERAL McNAMARA: I don't know how technical your question is. I know that we slapped a dollar sign on our inventory, and it has a high value. A high value is merely the result of our standard pricing extension to the goods.

QUESTION: The implication I tried to get at there is that if you spend a lot of your dollars in trying to take care of such general issue items as GI cans and brooms, as opposed to some items that really are important--what is the line of demarkation between the two?

GENERAL McNAMARA: There isn't a clear line between butter and hardware. As you know, in our supply control studies in the Department of the Army there were some 622 items that are controlled due to their principal characteristic. They represent 65 percent of our dollar sign. We will continue to keep track of those by item, because it is a necessity to know how many 105's you have, how many tanks, and such things as that.

What we are reaching for is the field between those items on which we make individual supply control studies and the total number of items that we have in the system. So 65 percent of our dollar value will be wrapped up in approximately 622 items. The next 200,000 items would be perhaps 10 percent. And the balance of the thing, up to 1 million, would be a very small percentage. Of those, sure, we'll keep studying these items. Then we'll slice off into this field of common-use things and get results.

Now, insofar as the items in the system, we are still going to keep a dollar sign on these by item, whether they are small or heavy, because we want to know what their value is. There may be almost a gap between that type and the other. But we will know our items that we have to know for our positioning, whether they are in the National Guard or the Regular Army or wherever they are.

QUESTION: In this standard pricing that you use, I have two questions. First, do you use an average price, the highest price, or the last price paid for an article? Second, on the major types of items, such as landing craft, tanks, and that sort of thing, since you are using financial management terms, do you allow a depreciation allowance, such as businessmen do?

GENERAL McNAMARA: I think the answer is that I don't know. My guess would be that we still tack the acquisition value on the item. I do not believe that--although I am not knowledgeable on the details--there is depreciation permitted.

Does anybody want to talk on that point? Most of you are more expert on that than I am anyway.

STUDENT: I can answer that question. There is no depreciation allowed.

GENERAL McNAMARA: Thank you very much.

QUESTION: Can you describe to us the mechanics of developing a consumer funding at the station level? Does that require some sort of a stock control procedure at that place?

GENERAL McNAMARA: It is all fouled up, I can tell you, at the present. I wouldn't give you an adequate answer on that, I am sure. But let me describe what little I know, and then I think you will agree with me.

A sum of money is given to, we will say, a customer. He may be in this case a post, camp, or station. That customer is going to use that money to buy from his stock fund. Now, for some reason the customer has run out of money--we think, because he has some wrong things on hand, or because he has not anticipated the right things, or the dollar sign is not quite correct. But it is a fact that he has run out of money in many posts, camps, and stations right now. So he cannot buy from stock funds. Our inventory may not be decreased, because our customers can't buy, and who else is going to buy it? We can't get rid of our stock by sale. Therefore we are rigging up some sort of means of getting it out now by credit. That is another thing we have learned.

We are not sharp enough yet to put the proper amount of funds at our customer's level. We haven't really gotten the value out of this system yet, because we already know that he is out of money at many posts, camps, and stations.

It is also true that he has come back and said: "I have a 19-X refrigerator. Take it back, please, and give me full value." We, having learned some other ways of business, say: "Uh uh. Fifty percent."

QUESTION: Will you say something about the amount of money involved in those materials in the pipelines, which certainly could

bear some cutting down? In other words, you have identified that which you have in the depots here in the ZI and overseas, but not in the pipelines.

GENERAL McNAMARA: I don't have that broken down here, but the system does put the dollar sign on it. In other words, as of a given number of days, one outfit drops the dollar sign on its things and another outfit picks it up. So that we have the total dollar sign on these supplies moving from the depot to the customer. There is no gap.

Previously we had vast quantities of supplies on vessels, on trains, en route, that were never picked up. And so we usually had no knowledge of our inventory. We knew the on-hand right at the spot where these dollar signs were being placed. We knew that we had asked for certain things on order. So we are getting now the rounded picture of the on-hand and on-order and anything in transit.

Does that answer your question?

QUESTION: That isn't exactly what I had in mind. The Air Force, I know, have made a great effort to expedite delivery by rapid means, so that you don't have so much tied up in the pipeline. You have all this backed up behind you in the pipeline. Would you care to comment on that?

GENERAL McNAMARA: Don't let there remain an inference that there is a speedier and better system than we have. I don't want anybody in the room to think that we admit that such a thing exists. We do know, however, that the Air Force has made some strides toward that end. For instance, in Newfoundland--no depot up there at all. Shipping direct to them. That means they have dollar control right from the depot all the way up back and forth. I don't think their system gets their supplies to them any faster than ours. It doesn't get our supplies that we get from the Air Force any faster.

For instance, let me talk on this point of Army aircraft for a moment and spare parts, we will say, for them. Your system of maintenance is such, as I understand it, that you take your craft, whatever it may be, and get it back to a base point where it can be repaired; and, because of the type of craft that you have the miles between the craft and the base depot really are unimportant to you.

But you take these galloping things that we have. Miles create quite a big problem to us, because you are repairing our things, and they are coming back through your system. We may have twice or three times the number of craft in our pipeline, which is yours, because of the distance between your base and our command. It really hasn't helped us.

We are just as anxious to cut our pipeline down as you are. And this PROJECT MASS, which you probably have heard about, should assist us.

QUESTION: The charts that you had indicated 7 technical services, each with their inventory and stock fund. Then you would have 7 independently administered stock funds. If that is so, what are the chances of having a single stock fund for the Navy?

GENERAL McNAMARA: Actually that isn't true--that we have 7. We have 7 components of the Army Stock Fund. Remember, we can draw off the surplus butterfat in cash from the top and apply it to other divisions of the stock fund. Now, I don't know what yours is in the Navy.

QUESTION: Is the administration of that stock fund under a single organization? Or is there some organization in each of the technical services that has to worry about the stock fund?

GENERAL McNAMARA: Each technical service keeps track of what its own division of the stock fund is, and it reports back to the Department of the Army, and the Department of the Army draws the butterfat off the top.

Isn't that so?

COMMENT: Yes.

GENERAL McNAMARA: I have confirmation from my own office and two technical services. So that's a fact.

QUESTION: In view of the fact that you have an influx of businessmen that you mentioned in the Department of Defense who have learned to measure our efficiency by the inventory turnover, do you give consideration to removing from your total inventory those stocks which

do not move at all? For example, your mobilization reserves, your economic reserves, your strategic reserves. Take your issue rates and apply that against your peacetime operating stocks and you will probably come up with a high inventory turnover.

GENERAL McNAMARA: We can split it any way you want. For instance, you can take care of your mobilization reserves breakdown on the reports. I am just telling you that this stuff can be used to help you do certain things. I could have taken the category of posts, camps, and stations by item. I could have shown here, for instance, on one of these charts that instead of taking the overall figure, I could have taken one group, we will say one category, and explained how I might have reached for the telephone and called Colonel Caps, Hats, and Gloves and said: "What are you doing with this amount of stuff, an inventory like this?" with the dollar sign as it might show on this. But I deliberately threw in the total, so that there would be an emphasis on contrast, if you will. I can break it out by mobilization reserve.

QUESTION: Have you tried using that technique to appease Members of Congress or people in the Department of Defense?

GENERAL McNAMARA: No, sir. It is against our principle to appease.

QUESTION: Some of our problems in the command that I have been in recently were in keeping good men as managers. I have always maintained that any management system, whether it is financial management, dollar value, or anything else, is just about as good as the people you have in it. We have been having a devil of a time, probably like all the rest of the services, in keeping good supply managers.

Now, of course, the first thing you think about is that the property supply officer--we call him the accountable officer--if he loses anything he has to pay for it. He is responsible for everything. But in order to get stability into the system, so that we find that everybody is talking the same language and using the same figures--this guy comes to the station. He doesn't know the new language, but if we had stability there, he would. Have you in your service considered a bonded civil servant as the accountable officer on that station?

GENERAL McNAMARA: I could answer for myself. I never have. But I might say that I think the system has recognized something like that. We have bonded individuals who are at places of responsibility. I am thinking now of property disposal personnel. I think it would fit them.

Incidentally, while I am talking about the subject, let me say that we have met our payday. The question is: "Have you?" Our property disposal officers have all been promoted one grade within the last year, that is, the civilians. We have endeavored to recognize the problem that is your basic problem--"How do you keep the people so that we can do something?" We are trying to get some recognition of their efforts. We think a major accomplishment is to be noted in the field of property disposal, because we have done very well throughout the Army. That is a pretty good thing. For civilians, I am talking about.

QUESTION: But not the accountable officer. He has to be an officer.

GENERAL McNAMARA: Yes. That is a point. However, I think we have. I am thinking now of the Jeffersonville Depot. Who is here from Jeff? Any QM? Mr. Castner, at the Jeffersonville Depot, I believe, is the accountable officer. I may be wrong.

QUESTION: General, we do have Army Regulations which show you just how to go about bonding and establishing a civilian as an accountable officer.

GENERAL McNAMARA: Yes. I think he is there, but I am not positive on this point. I would like to talk some time--not this morning--on the subject of what I think about bonds.

QUESTION: My question is on the inventory of obsolete items. A survey made about two years ago showed that at the Columbus Depot and the Jeffersonville Depot there were on hand at that time a sizable quantity of horse artillery equipment. I wonder if that has ever been disposed of.

GENERAL McNAMARA: I can assure you that all of that equipment has not been disposed of, because we are still supporting a certain number of animals in some of our allied countries. While I admit the humor of the situation, I have faced this before certain people

who were elected, and I have been able to assure them that when you support 10,000 animals, as the Army supported in World War II, you just don't throw away the equipment.

Now, generally, however, the answer is that most of that equipment has been eliminated from the system. We are now down to the one thing that is left, and that is the stiff broom to push the remaining part of that surplus out.

QUESTION: In your charts I noticed that the ZI turnover ran 3 times a year and up, whereas in the overseas your turnover was approximately once every 3 years or less. Put the pipeline time into the figures and it still doesn't seem that the turnover rates against ZI are comparable. I wondered what element is in there that I don't see.

GENERAL McNAMARA: There isn't any element in there. Overseas we don't intend to rotate everything as fast as we do in the states. The reason we do it in the states is to have that modern thing going. You have the things that you are supposed to have over in the theater for your use. For instance, take tanks. You don't rotate those, do you? It is true they are not stock funds. So in this you may get an inference of the stock funds overseas total inventory--you have to be careful about that--on rotation. But they are under financial inventory accounting. But overseas the common-use items rotate just as fast as they do at home. It is a peculiar thing about them. There are other things that do not. I assume that the niceties of living overseas, maybe, are not on the same scale as they are back in the states. Therefore you use more of one type of item overseas than you do here. But I think it balances up pretty well.

As long as we get our spotlight on that equipment over there and keep it modern, that is all right, so that when someone says: "I am going to slap your face" you say: "Are you, boy?" and you are ready to do something with the stuff that you have there. That is what our thought is on this. Those that have to fight, have what they need to fight with. If it is overseas for them--they can be ready to go.

COLONEL LACKAS: General McNamara, again you have provided us with a most informative and interesting discussion. On behalf of the College, I want to express our appreciation to you for your presentation.

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