House Appropriations Committee
March 19, 2015

Remarks submitted for the record on behalf of the
Pennsylvania Liquor Control Board ("PLCB")

Tim Holden, Chairman
Joseph "Skip" Brion, Member
Mike Negra, Member
John Metzger, Executive Director

Chairman Adolph, Chairman Markosek, Members of the House Appropriations Committee, good afternoon.

Thank you for the opportunity to address you today. We welcome this opportunity to discuss the current financial position of the agency, and to respectfully offer suggestions on ways to improve consumer convenience and to maximize the PLCB's monetary return to the commonwealth.

My fellow board members and I have the pleasure of appearing before you on behalf of an agency that transferred $552.5 million to the General Fund or to other commonwealth agencies in the last fiscal year, including $80 million in profits, $25 million to the Pennsylvania State Police's Bureau of Liquor Enforcement, $2.5 million to the Department of Drug & Alcohol Programs, and $445 million in state tax revenue. In addition to making these contributions, the PLCB also helped support other state and local entities by collecting and remitting $8.3 million in local sales taxes to Philadelphia and Allegheny counties, and returning $4.5 million in license fees to local municipalities. In total, PLCB contributions to state and local entities totaled approximately $566 million in FY 2013-14, representing a $16 million increase over the previous fiscal year.

This past fiscal year was another strong year for the PLCB. Through its operation of 603 brick-and-mortar stores and an eCommerce store, the agency generated $2.24 billion in gross sales (including sales and tax revenue), representing an increase of more than $68 million, or 3.2 percent, from the previous fiscal year. Sales growth was driven by an increase in wine sales, including a 5.6 percent increase in sales of the Chairman's Selection® product line. The Chairman's Selection program has been a tremendous success for the PLCB – in the last five years, Chairman's Selection wine sales have grown at a compound rate of 10.6 percent. Due to this remarkable success, in January, the board initiated a pilot program in 25 Philadelphia-area stores called the "Chairman's Advantage Program," in which we showcase select wines representing great bargains under ten dollars.

The agency has continued the expansion of the Fine Wine & Good Spirits store rebranding effort, bringing with it a warmer, more consumer-friendly atmosphere for our customers – your constituents. During the year, the PLCB rebranded or refurbished 26 Fine Wine & Good Spirit stores. In addition, the PLCB further enhanced staff training to improve product knowledge and give employees the ability to provide consumers with the exceptional customer service they should expect.

Expenses for the past fiscal year grew by $24.3 million, or 6.0 percent, but the increase was almost entirely from personnel benefit costs, which increased by $20.1 million, or 21.9 percent.

There has been some debate recently regarding the future profitability of the PLCB and whether, five years from now, we will be able to make an annual profit transfer. While we do not know exactly how the speculation began, we believe it may have been derived from information provided in an internal memo from our finance office last summer. To be clear, we routinely receive financial memos and projections outlining where we are, where we may be headed and what assumptions are being made. Every successful business continually evaluates sales and cost data, projecting profitability based on future assumptions and providing management with both optimistic and pessimistic forecasts. This particular internal analysis, which made its way outside our building (without necessary context), may have given rise to this recent speculation.

The analysis at issue represented a worst-case scenario regarding costs, sales and profitability based on certain assumptions. For example, the author assumed a very conservative rate of sales growth and, more importantly, assumed that recently experienced double-digit pension rate increases would continue. The actuarial section of the recent SERS annual report indicates our pension increases are expected to level off and decline, as a percentage of our payroll, after FY 2016-17, which will have a positive impact on our future net income. This was not anticipated by the author of that memo last summer.

Future projections regarding profit transfers are dependent on a number of variables, some of which we cannot directly control, such as increases in salaries and benefits. It should be noted that we do not make the final decision regarding the amount that is actually transferred from the State Stores Fund. In fact, last year, we informed you that we could have transferred an additional $20 million to the General Fund, but we were not called upon to do so. What we can tell you is that we are poised to continue making significant transfers to the General Fund for many years to come.

We understand that specifics may help allay concerns. Since FY 2000-01, our gross profit (sales less cost of sales) has grown at a compounded rate of 4.2%, and our rate of growth for sales is 5.3%. We should be able to grow at a similar pace for the foreseeable future assuming no changes to our current business model. While we cannot control personnel rate increases, we should note that we have successfully managed headcount by delaying the filling of certain positions, shifting personnel when necessary, effectively using part-time positions, etc. In our most recent long-term income projections, we estimated salary and wage growth of 3.0 percent, slightly above historical averages. We factored in the projected pension cost increases from the SERS annual report. We also factored in growth rates for health care costs (7.0%), other benefits such as Social Security (4.0%), and additional operational expenses (4.6%), all of which are in line with historical averages. Further, we factored 5.0 percent growth in our transfers to the Pennsylvania State Police, Bureau of Liquor Control Enforcement ($25M last year). In conducting a projection based on these assumptions, our net income grows every year from the current fiscal year: $121.9M, $126.2M, $130.6M, $135.0M and $139.4M by FY 2019-20. Based on this financial analysis, in 10 years, our net income would be $161.9M by FY 2024-25. Again, these are projections using the assumptions noted above, after deducting all of the above-referenced transfers, and assuming no legislative changes are made that would affect profitability.

With the start of a new legislative session, the agency finds itself once again operating in uncertainty in the context of the privatization debate. While that discussion continues between you – the members of the General Assembly – and the Governor's Office, we are committed to operating the PLCB in an efficient, profitable and socially responsible manner. Our team has worked hard to improve the shopping experience, build relationships with consumers and ensure that we are bringing the right products to shelves at competitive prices. The board members, joined by our dedicated team of employees, view this as our collective responsibility to the residents of Pennsylvania, and we will continue our efforts until the law requires otherwise.

The innovative and hardworking employees of the PLCB continue to look for ways to better serve our consumers and licensees. In fact, it should be noted that, because these hearings focus largely on the financial returns of the agency, we unfortunately do not discuss the PLCB's role in the regulation of the alcohol beverage industry within the commonwealth. But it should not be forgotten that the PLCB oversees the regulation of nearly 27,000 liquor licensees and permit holders statewide, including restaurants, clubs and beer distributors. This includes the processing and management of thousands of applications per year with limited resources. However, the PLCB's staff understands the vital role it plays in helping protect the welfare, health and peace of the residents of Pennsylvania.

The privatization debate has, over the last few years, centered around two polarizing concepts: "privatization" or "modernization." The term "modernization" has almost become synonymous with anything other than "privatization," yet the term can incorporate a variety of initiatives, including certain elements of "privatization," such as allowing the sale of beer and wine in grocery stores, depending on who is asked to define the term.

As you debate whether the state should incorporate these various initiatives into the Liquor Code, we ask that you do not postpone passing legislation specifically intended to benefit our customers – your constituents. We have made great strides in making the selection and purchase of wine and spirits a much more convenient and enjoyable process for the consumer, but we need your help to further that goal, and we would respectfully offer some suggestions.

We respectfully request your immediate consideration of the expansion of Sunday sales. Under the Liquor Code, only 25 percent of the PLCB's Fine Wine & Good Spirits stores are permitted to be open on Sundays, the second busiest retail day of the week, and only from noon until 5:00 P.M. As we advised the General Assembly last year, we are operating stores in excess of that 25 percent restriction. As we open new stores, our customers have been expressing the desire to have Sunday hours. We are therefore attempting to balance compliance with the restriction with the desire of our customers located throughout the state. Currently, 175 of the PLCB's 603 Fine Wine & Good Spirits stores (or 29%) operate on Sundays – putting us 24 stores over the limit. We ask that you take immediate action to eliminate this artificial constraint on consumer convenience for the benefit of all Pennsylvania consumers. Our store operations staff continues to identify locations that would greatly benefit from Sunday sales. We project that if we had the unfettered discretion to expand Sunday sales to all of those desirable locations, we could generate an additional $15 million in annual net revenue.

In addition, we would urge you to pass comprehensive legislation related to the direct shipment of wine to residents' homes by wine producers, as we continue to receive inquiries regarding this issue from your constituents. Direct shipment has evaded resolution since the U.S. Supreme Court issued its opinion 10 years ago in the case of *Granholm v. Heald*. There are a number of direct wine shipping bills that have been introduced, and we would be happy to discuss any concepts which need to be addressed in proposed legislation, including preventing sales to minors or safeguarding commonwealth tax revenue.

Further, due to feedback from your constituents, we are attempting to streamline the process in which customers order Special Liquor Order (SLO) items. We encourage you to consider an amendment that would allow such items to be ordered and paid for through the PLCB, but sent directly to the customer from the vendor, eliminating the current requirement that such items be delivered to and picked up from our stores.

We fully recognize the significance and importance of the current debate regarding privatization, modernization or a hybrid approach, but we believe that, while the debate proceeds, customer convenience and increased revenue can be attained through these and other measures to benefit the citizens of Pennsylvania.

The PLCB is an asset to the Commonwealth, one of the few revenue-generating agencies within state government. The board members and our team of employees are here as a resource to you and the Governor's Office to assist in understanding how the PLCB can be used to increase its revenue and, ultimately, increase its contribution to the General Fund. We encourage you to review and consider the various "profit enhancement concepts" we collected in the attached document, which provides a menu of different options for your consideration. The document includes the above-referenced convenience concepts, as well as revenue-generating concepts such as procurement of liquor (pricing relief), adding a license "surcharge" to cover increased administrative costs, increasing fines, allowing the PLCB to be a lottery retailer and to offer coupons to customers, and the creation of a casino license classification. This is by no means an exhaustive list; it is simply meant to illustrate the variety of ways in which this agency believes it can generate additional revenue for the commonwealth, benefiting all Pennsylvanians.

Ultimately, the PLCB's most valuable resource has been, and continues to be, the dedicated employees who endeavor to be recognized as "best-in-class." As the agency continues to grow and evolve, its mission remains the same – to serve as the commonwealth's responsible retailer of wine and spirits and regulator of the beverage alcohol industry, while striving to maximize returns to the people of Pennsylvania.

Thank you for this opportunity to address you and we welcome your questions.