Campaign for a Healthy Alcohol Marketplace

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Special Issue: Alcohol Retailers and Offsite Warehouses
The issue of retailers owning an offsite warehouse has popped up recently in several states. This special edition of the newsletter is devoted to explaining why an offsite warehouse can decrease the price of alcohol, and tilt the "playing field" to the Big Box grocery retail chains. If the practice becomes widespread, it could erode the alcohol regulatory system; and, adversely affect tax collections and the tracking system which guards against tainted alcohol products.

It's the system that's important!
An offsite warehouse seems like an innocuous thing. But, it breaches the alcohol regulatory system which maintains the marketplace in three separate segments: retail, wholesale, and manufacturing. This system keeps alcohol under control and in balance particularly with regard to price, availability and promotion. It also has a tracking mechanism to collect taxes and prevent problems with tainted products. Picking apart the system one regulation at a time is detrimental to the system's integrity. If this piecemeal deregulation continues, the system will fail. The winners in this scenario will be a few large, global corporations. Small and local retailers will be at a disadvantage.

The system is designed to prevent large quantities of cheap alcohol from flooding the market.
Research is clear that lower prices increase consumption of alcohol for all categories of drinkers—moderate, heavy and hazardous. It is especially true for underage drinkers. The World Health Organization (WHO) has reviewed research in the US and other countries and concluded, "There is substantial evidence showing that an increase in alcohol prices reduces consumption and the level of alcohol-related problems." Over time, the price of alcohol in the US has declined and not just because taxes have failed to keep up with inflation. Mass merchandising techniques—which include using alcohol as a loss leader—have also contributed. That is why prevention efforts must include several measures to keep prices in balance. As WHO declares, prevention works best when "multiple policies are implemented in a systematic way." (See "What are the most effective and cost-effective interventions in alcohol control?" World Health Organization, Feb. 2004.)

Many states are under global industry pressure to eliminate or modify marketplace regulations that prevent price decreases. The separation of the marketplace into three tiers curtails some mass merchandising methods which rely on high volume sales to profit from very low prices. Lower prices can result when big retailers can negotiate large purchases at deep discounts directly from manufacturers. A warehouse is necessary to implement such mass merchandising methods since buying in quantity requires additional storage. It is critical that multiple regulations be used to maintain price balance—not too high to encourage bootlegging and not too low to push consumption.

How can having a warehouse result in lower prices?
It allows the retailer to buy alcohol in quantity at a discount and offer discounts to more customers. Consider this illustration:
▲ **Store A** is a small convenience store with floor space and a small backroom for storage.
▲ **Store B** is a small convenience store of the same size, but with an offsite warehouse nearby.

If wholesalers offer a particular product at a discount for a limited time, Store A can only buy 10-20 cases because they have limited storage. Store B can order several hundred cases and place them in their warehouse. Stores B can offer the product "on sale" for a longer time to more customers. In addition, by enticing customers to their store they will gain the destination value whereby customers buy other

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products while in the store. Store B does have additional costs for its warehouse. Therefore, they will have to aggressively promote the product and sell in enough volume to cover all costs. Store A has been undercut in price and may choose to lower its prices to compete. Once these practices become widespread, the overall price of alcohol is reduced.

The advantage of a warehouse system is even greater if a large supermarket chain is able to do its own distribution and storage. These chains often have warehouses and systems for other products, so the additional cost of storage can be spread among several products. All this equates to lower prices for alcohol to undercut competitors.

If a state prohibits volume discounts and requires wholesalers to offer the same price to all retailers, why should a warehouse be a problem?

It is still a major competitive advantage and can drive prices lower. Even when wholesalers must offer the same price to all, there are times when prices are lowered temporarily. These lower prices are offered to all. But, as the previous illustration shows, Store A can only take as much product as can be stored. Store B can take a lot more and can offer a discounted price to more customers for a longer period of time. A part of a state's regulatory power is to maintain a fair and orderly marketplace. In that regard, they must be alert to prevent abuses of one retailer over another.

Illinois' experience with a "secret warehouse" is a good example

In Illinois, a wine and spirits store specializing in high end products asked the alcohol regulatory agency for permission to have a warehouse. They were refused. So, they surreptitiously rented a building across the street from their store for storage purposes. It had no signs or any other identifying information. This enabled them to buy large quantities of product at a discount and undercut their competitors. After receiving complaints, the regulatory agency located the warehouse, interviewed all the employees and ordered the owner to shut down the warehouse. The end result was a settlement agreement with a $300,000 fine for the warehouse operation and other violations. After the closure of the warehouse, regulatory officials observed that new retailers opened in the area and other retailers in the area appeared to be better off financially. It appears that competition increased.

Convenience store chain in California wants to do distribution and storage like their other products

A chain of convenience stores has determined they should be allowed to use the same storage and distribution system for all its products including alcohol. This means receiving all products at a central warehouse which then fills orders for all stores and delivers on a routine schedule. The system would require that wholesalers drop the alcohol off at the warehouse for storage and distribution, but ownership would not transfer until the product is on the truck headed for the stores. This is a major advantage because the chain's money is not tied up in inventory until it is shipped to the stores. While at the warehouse, the distributor would actually lose control of the product to the warehouse operator. This is risky because beer has a shelf life (90-120 days) and once the date passes, the owner of the product loses out! Recently, the California alcohol beverage control agency raised significant legal concerns about this of this operation for alcohol licensees.

Oregon discount chain wants to be a both wholesaler and retailer

A discount grocer that specializes in selling discontinued and heavily discounted items has maintained a warehouse and distribution system for its products. The parent company owns the warehouse and the products. They are part owners of each store. Distributors drop alcohol products off at the warehouse and the warehouse uses its distribution system to ship products to the individual stores on consignment. Apparently, the parent company believed this was a legally permissible operation under Oregon law. Recently, the details of how the system operates have come to light and the situation is now the subject of an Administrative Hearing.

For more information about the Campaign, go to www.pamaction.com. Previous issues of the newsletter can be viewed on that site. Specific questions or comments can be directed to Pamela S. Erickson, Public Action Management, PLC at pam@pamaction.com.