Washington State
Liquor Control Board

Washington State Liquor Control Board Business Plan 2007-2009

Trends and financial measures impacting supply chain operations

Submitted to Office of Financial Management
June 1, 2006

Washington State Liquor Control Board

Business Plan 2007-09 Biennium

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Agency Vision, Mission, Goals and Values

Vision
Ensure the responsible sale and consumption of alcohol and tobacco in Washington.

Mission
Promote public safety and prevent the misuse of alcohol and tobacco through controlled retail and wholesale distribution, licensing, regulation, enforcement and education.

Goals

- Ensure the highest possible level of public safety by continually improving business, regulatory, enforcement and education processes.
- Maximize financial return to the state by running an efficient business operation with strategically located state and contract stores.
- Recruit, develop, retain and value a highly competent and diverse workforce capable of responding quickly and effectively to challenges in our business and regulatory environment.
- Encourage the innovative use of technology and information tools to ensure efficiency, expand communication and foster continuous improvement.

Values
Respect for people
Professionalism and integrity
Honest and open communication
Internal and external accountability
Public trust and stakeholder involvement

Acknowledgements

Store employees, managers, district managers, headquarters employees and others in the agency who provide data, analysis and additional perspective, develop the WSLCB's Business Plan collectively. Members of the Board also provide input for the plan, as do key stakeholders (Washington Restaurant Association, Distillers Representatives Association of Washington), Retail task-team representatives and contract store representatives.

Introduction

Washington's Control System

In 1933, the 21st Amendment to the U.S. Constitution ended prohibition and provided states the authority to regulate the importation, manufacture, distribution and sale of liquor. Subsequently, the Washington State Legislature passed the Steele Act, creating the Liquor Control Board. Under the Steele Act, tight control of liquor distribution was established through state ownership of liquor stores. Today, the Board continues to carry out its mission of preventing the misuse of alcohol through a controlled distribution system that provides an emphasis on public safety and revenue generation.

Since its inception, the Liquor Control Board has returned more than $4 billion in revenue to the state. In FY 2005, the LCB distributed more than $263 million to state and local governments from profits, taxes, and license fees imposed on the sale of spirits, wine, and beer. In FY 2006, that amount is expected to exceed $302 million.

Why States Adopted Control Systems

There are 18 states with control systems. Two counties in Maryland also have control jurisdictions. States adopted these systems because they were concerned about mitigating the health, social and economic problems associated with over-consumption. Control states chose different models. Some exercise a monopoly over spirits at the wholesale level only. Others, like Washington, operate wholesale and retail systems.

Benefits of control systems include lower per-capita consumption levels; fewer alcohol-related deaths; fewer lost work days; fewer health care issues; and safer roadways. Control systems work because there are fewer outlets from which to purchase alcohol; limited store hours; no employee incentive to sell; higher prices; coordinated enforcement and licensing processes; and bans on advertising.

Board Organization

A three-member board appointed by the Governor and confirmed by the Senate provides strategic and policy oversight for the agency. The Board holds regular public meetings to enact rules, approve policy, develop strategy and hear citizen and stakeholder concerns. Board members serve staggered six-year terms. An Administrative Director, hired by the Board, manages the agency's operations.

Board Members

Merritt D. Long	Roger Hoen	Vera Ing
Chairman	Board Member	Board Member

Administrative Director

Pat Kohler

Milestones

1995	Contract store managers no longer considered state employees.
1996	Wine program introduced.
1997	Agency Web Site launched. Credit/debit card program implemented.
1998	Enhanced technology & communications within agency launched.
1999	Washington State University's customer survey completed.
2000	Administrative Director position created.
2000	Governor's Retail Task Force studied and reported on the issue of privatization.
2001	Wholesale-only outlet opened in Seattle.
2002	New Distribution Center opens. Board changes direction to focus on policy-making and assigns responsibility for daily operations to the Administrative Director. Board reduces time and pay to 60 percent. Business Advisory Council formed.
2003	Merchandising Business System (MBS) project authorized by Legislature. Five new stores authorized by Legislature.
2004	The WSLCB works in conjunction with the Distillers Representatives Association of Washington (DRAW) to create a shelf management program for state stores.
2005	New point-of-sale system, installed in the 161 state stores. Forty-five additional deck lanes added to Distribution Center. Four new state stores and a contractor-operated "hybrid" store open. Public Knowledge independent review completed. Legislature approves Sunday sales at 20 state stores in a two-year pilot program. Legislature approves 28 FTEs and $2.7 million to increase store staffing. A study is authorized to determine the appropriate level of store staffing and store development needed to support future growth.
2006	Legislature passes two new direct shipping laws. Task Force named to study Three-Tier System. Wide Area Network (WAN) installed. Strategic Research Associates completes Customer Satisfaction Survey.
2007	A 62,000-square-foot expansion of the Distribution Center begins.

Business Operations

The WSLCB exercises a monopoly over spirit sales in Washington, operating a $650 million retail and wholesale business. Packaged spirits are sold in 161 state and 154 contract stores. Key state stores also supply spirits to the state's more than 4,000 businesses licensed to sell liquor by the drink. State stores also sell wine, cider, malt beverages and lottery tickets, but may not sell other products by state law. Beer and wine can be purchased in grocery stores, supermarkets, beer and wine shops and other licensed retail venues.

In FY 2005, the agency generated more than $705 million in income from all sources in FY 2005. About $650 million of this resulted from gross sales in state and contract stores. The remainder came from beer and wine producer taxes, licensing fees, penalties and other sources. After all expenses were met, the agency returned about $263 million to the state, cities and counties. More information on the financial aspects of the business can be found in the Financial Plan section of this document.

Rising Profits/Tax Collections

About 72 percent of the $263 million returned to the state was generated by sales in state and contract stores. Many programs and other units of government, including cities and counties, health services, education and prevention and research programs benefit from this stable revenue stream. Consistent with sales growth, there also has been growth in the amount of taxes collected and profits generated and distributed to the state general fund, local governments and health care funds.

Tax and Revenue Distribution FY 1995-2005

Local Gov.	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Cities	$25.7	25.5	26.2	30.3	31.0	29.6	33.0	34.0	35.7	40.7	42.1
Counties	6.4	6.4	6.6	7.2	7.4	7.1	8.2	8.5	9.0	10.3	10.5
Border Areas	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3
Rapid Transit	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3
State Government											
General Fund	$96.8	95.9	98.5	100.7	101.7	107.9	113.9	117.1	121.6	137.8	144.7
Drug Enforce	9.9	9.7	9.6	10.1	11.8	10.4	10.2	10.7	11.0	11.3	18.4
Health Care	11.6	20.3	20.7	29.2	37.6	35.8	35.3	37.6	38.7	40.6	38.3
Youth Tobacco								0.1	0.1	0.1	0.1
WSP Toxicology								0.2	0.2	0.2	0.2
DSHS	5.2	5.4	5.4	5.2	5.3	5.3	5.6	5.8	6.1	6.0	6.4
SPI	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Universities	0.8	0.8	0.9	0.8	0.9	0.7	0.6	0.8	0.8	0.7	0.8
Sub-Total	**$124.5**	**132.3**	**135.2**	**146.1**	**157.4**	**160.3**	**165.8**	**172.5**	**178.7**	**196.9**	**209.2**
Other											
Wine Comm.	0.3	0.3	0.3	0.3	0.3	0.5	0.5	0.5	0.4	0.6	0.7
Total	**$157.1**	**164.7**	**168.5**	**184.2**	**196.5**	**197.9**	**207.9**	**215.9**	**224.4**	**249**	**263.1**

Why Revenue Is Increasing

The financial success of the system can be attributed, in part, to the following factors.

- A monopoly on spirit sales
- Increases in state population driving increased sales
- Experienced employees.
- A bailment inventory system that defers payment for product until it is shipped to stores
- The amount of taxes collected on sales
- Good relationships with stakeholders and suppliers
- Centralized distribution system
- The margins and large-scale of the operations

Supply Chain Team

Three divisions are responsible for business operations: the Purchasing Division, the Distribution Center and the Retail Services Division. In addition, the agency's Licensing Division closely regulates the manufacture, importation, distribution and sale of beer and wine through a 'three-tier system,' which separates producers from retailers by requiring a separate distributor tier. The supply chain team members work collaboratively to coordinate the importation, distribution and sale of spirits, beer and wine in Washington state and contract stores.

Retail Services Division

More than 800 full- and part-time employees work in the Retail Services Division, about 780 of them as store clerks, assistant managers or managers. More than 2,000 spirit, beer and wine products are offered for sale through state and contract liquor stores. Store location, in-store merchandising, store leasing, contract stores, Business Performance Management and all other aspects of the retail business are managed by this division.

Purchasing Division

Product selection, supplier management and in-store merchandising are the key activities within the Purchasing Division. This team is responsible for ensuring that a diverse portfolio of products is made available to meet the changing interests of our customers. These products must generate appropriate levels of revenue and profitability for the state. Category strategies are used to strike the balance between selection and financial return. Progressive supply management techniques are used to drive accountability, efficiency, and value across the supply chain.

Distribution Center

The Distribution Center was expanded in the late 1990s to its current size. It began operating with an automated material handling system in April 2002. Cited by Modern Materials Handling Magazine for its use of technology to distribute more than four million cases of liquor each year, the 159,000-square-foot facility had reached near-capacity shipping levels in 2004 following rapid growth in spirits sales that began occurring in the mid- to late-1990s. In 2005, the Legislature authorized funds for a 62,000 ft. expansion of the warehouse to be completed in 2008.

Challenges to Growth

- Supply chain staffing and infrastructure is not keeping pace with the demands of growth. Increased staffing is needed in our stores to adequately serve our customers. Improved business technology is needed to provide more analytical capacity.
- State law forbids the agency to advertise or engage in product promotion through discounting.
- The state's two-year appropriation cycle slows the ability to respond quickly to a wide range of business challenges – to open new stores and relocate existing stores, for example. The uncertainty of the appropriations process significantly diminishes the agency's ability to plan and perform strategically.
- The Distribution, Purchasing, and Retail Divisions must realign themselves to work more effectively as a seamless supply chain organization that is focused on serving the public responsibly and efficiently.

Achieving Increased Efficiencies

Consistent with the agency's strategic goals, the supply chain divisions continue to look for ways to increase efficiencies and revenue while maintaining high-quality customer service. In preparing this plan, teams of agency employees were asked to look for opportunities to improve business operations in the following areas:

- Create revenue enhancement opportunities and best practices in retail operations by identifying sales growth opportunities, expense savings opportunities or some combination of both.
- Improve distribution and purchasing, with particular emphasis on how to favorably affect the Cost of Goods Sold.
- Improve customer service and store presentation, with emphasis on in-store merchandising, design strategies and employee training programs.
- Improve management tools and technology, with employees identifying management systems, reporting, quality control or corrective action tools for system improvements.

In response to these questions, employee teams have identified key investments and work strategies needed to advance organizational goals. The Strategic Objectives section of this document provides greater detail on individual divisional strategies, which are included in the agency's Strategic Plan accompanying this report.

Market Analysis

Summary

This chapter discusses *marketplace trends* and their effect on WSLCB retail and wholesale operations.

Important conclusions regarding this information:

- Gross sales increases are being driven by growth in the drinking-age population, increased spirits taxes and consumer preference for higher-priced brands.
- Consumption trends have been stable since the mid-1990s.
- Our customers want better product choices and increasing numbers of up-scale products.

National Consumption/Sales Trends

In the last two years, consumers have continued to favor new products, new tastes and new packages. Flavored spirits are especially popular, a trend expected to continue this decade. Flavored spirit brands have increased 36 percent in the last two years, especially in the vodka and rum categories, and growth in flavored brandies and tequilas is expected.

Beer, wine and spirit dollar sales grew in 2005 as did case sales of these products. However, case sales grew at a somewhat slower rate (2.7 percent) than they did in 2004 (4.1 percent). Sales of light, imported, and craft beers, table wines and virtually all spirit segments were strong. Distilled spirits and wine took market share away from beer, the only category that experienced decline. Vodka, rum and cordials led the spirits category.

Spirits

Total U.S. alcohol case sales in 2005 topped 170 million. Case sales increased 2.6 percent over 2004. Total dollar sales toped $53.9 billion, an increase of six percent over 2004. Beer continued to dominate case sales with nearly 86 percent of the market share. However, beer sales represented only 52 percent of total sales dollars. Spirits, which represented 5.5 percent of case sales, accounted for 33 percent of dollar sales.

About 30 percent of the growth in spirit sales occurred in the vodka category, which has led the number of new spirit product introductions for the last three years. The dollar sales increase was realized on relatively flat case sales indicating a continued consumer preference for premium-priced products. Wine consumption continued to grow, but at a slightly slower rate than in 2004. About 274 million cases of wine were sold in 2005.

Wines

The U.S. wine market has been dominated by Chardonnay, Merlot and Cabernet Sauvignon varietals that accounted for 51 percent of all dollar sales and 43 percent of all volume sales of wine in large U.S. food and liquor stores, according to AC Nielsen. The top 10 varietals – which also include White Zinfandel, Pinot Gris/Grigio, Syrah/Shiraz, Sauvignon Blanc, Pinot Noir, Zinfandel and Riesling, in descending order – represent about 70 percent of wine sales by volume and 81 percent of dollar sales.

National volume sales of Chardonnay, the best-selling varietal wine, grew 14 percent between September 2003 and February 2006. Chardonnay claims a 21.5 percent volume market share, nearly double that of any other varietal. Though its market share is declining, Merlot is still the most popular red varietal, with an 11.8 percent share by volume and 13.5 percent share by dollar sales.

In contrast, since September 2003, third-place Cabernet Sauvignon has grown 50 percent in volume sales and 65 percent in dollar sales across the U.S. Because of its low prices, White Zinfandel is considered the fourth-largest varietals despite the fact that it outsells Cabernet Sauvignon by volume. By dollar sales, White Zinfandel may be surpassed by Pinot Grigio/Gris in the next several months.

Washington Sales / Consumption Trends

Washington sales trends in 2005 were similar to those in the national market. Beer lost market share to wine. The popularity of new flavored spirit brands and growth in the drinking-age population drove a 4.5 percent increase in spirit case sales in 2005. Washington's top-performing spirit brands remained Monarch Vodka, Black Velvet, and Canadian Rich & Rare. Washington consumers showed a slightly greater preference for wine than the national trend. Washington ranked among the top 10 wine markets in the United States with total case sales of 7.9 million in 2005, an increase of 2.7 percent from the previous year.

GROSS DOLLAR/BOTTLE SALES FY 2004/2005

Dollar Gross Sales	FY 2005	FY 2004	% Inc. (Dec.)
Spirits	$606,997,698	569,606,566	6.56%
Wines	38,609,253	37,840,521	2.03%
Cider	36,215	33,042	9.60%
Malt	884,353	926,179	(4.52%)
Alcohol	508,549	372,706	36.45
Sub-Total	**$647,036,068**	**$608,778,014**	**6.28%**
Lottery Tickets	$2,578,572	$2,598,916	(0.78%)
Grand Total	**649,614,640**	**611,376,930**	**6.25%**

Gross Bottles	FY 2005	FY 2004	% Inc. (Dec.)
Spirits	48,204,896	44,950,954	7.24%
Wines	5,318,889	5,186,652	2.55%
Cider	18,377	16,855	2.55%
Malt	741,095	219,932	236.97%
Alcohol	10,000	7,700	29.87
Grand Total	**54,293,257**	**50,382,093**	**7.76%**

Distilled Spirits Sales Trends

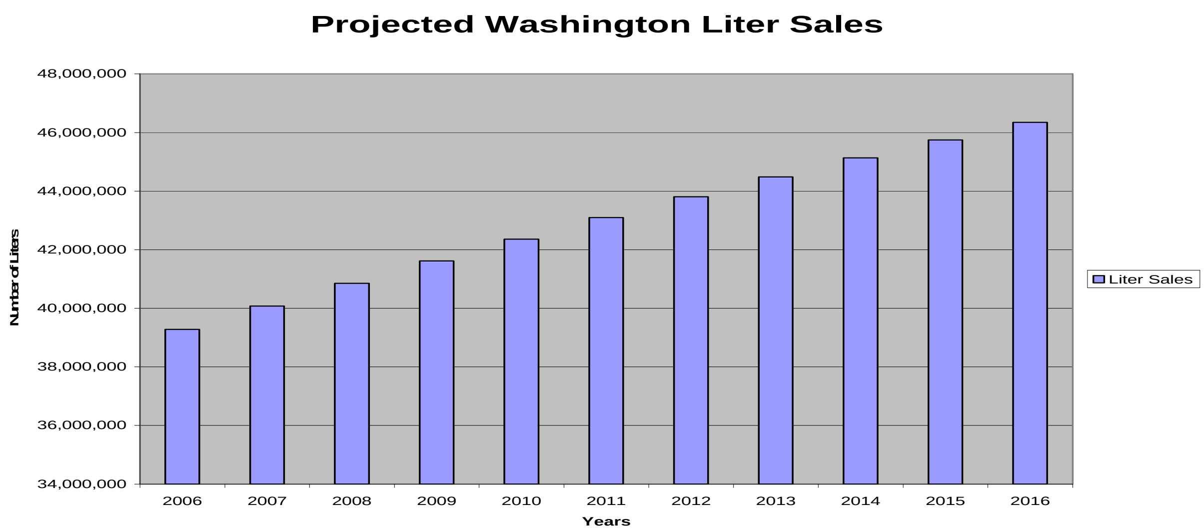
The trend of "buying up" to brands that are more expensive is represented in Washington liquor stores. Over the last twelve months, the highest growth category for spirit case sales is in premium products.

Wine Sales Trends

The WSLCB's wine market share dropped from 9.9% to 8.2% in 2005, a reduction of about 134,000 cases and $1.5 million in revenue. This occurred, in part, because the agency raised its prices on its 100 top-selling wines to balance them with the larger retail market. The wine pricing strategy will be regularly reviewed and adjusted as necessary to achieve the aforementioned goal.

Sales Forecast

The following chart provides a projection for liter sales growth from 2006 to 2016. The trend to more liter sales is being caused primarily by growth in the number of drinking-age adults, not by increasing consumption levels. The number of liters sold statewide is expected to exceed 48,000 by 2016 as more than a million new drinking-age adults enter the population. Additional stores and store employees will be needed to accommodate this growth.



Factors Affecting Sales

Price: In the 1980's when the price of liquor increased sharply due to large increases in the federal excise tax and in Washington State spirit taxes. This drove down per-capita consumption levels. Recently, liquor prices have played a minor role due to relative small price increases and the fact that spirits are inelastic.

The Economy: Since 1960, only twice has there been a decrease in sales during an economic downturn. This occurred in 1970 and again in 1982.

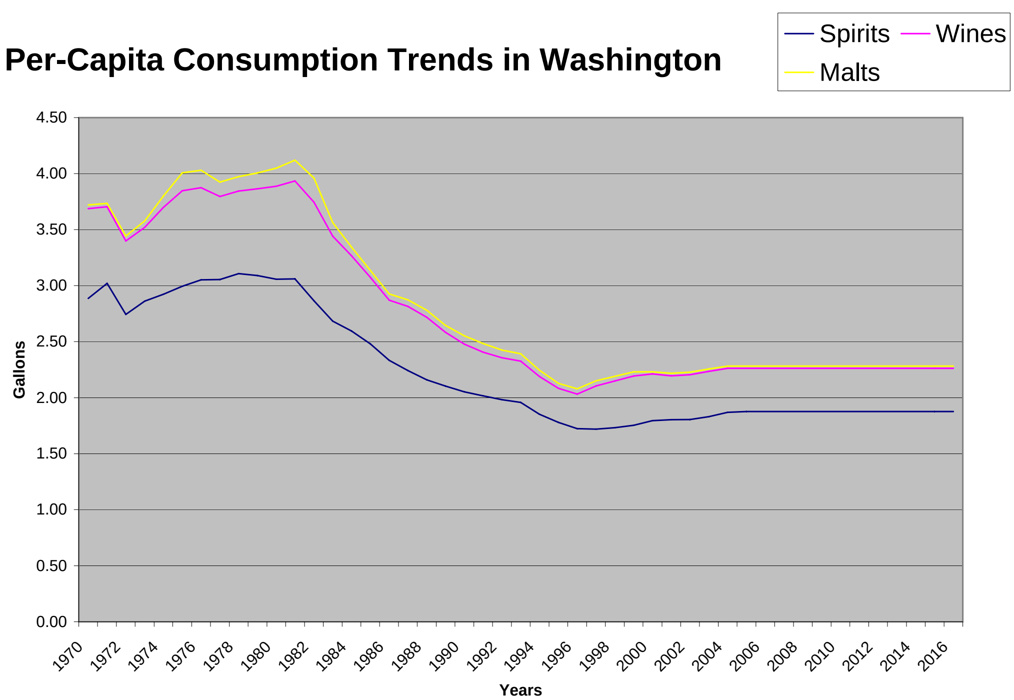
Social Preferences: These played a major role from 1983 to 1996. During this period the drinking population consumed less liquor because of health concerns and stronger DUI laws.

Drinking-age Population: Except for the period 1983 to 1996, growth in the drinking-age population has been the primary driver in liquor sales growth. The drinking-age population is expected to increase 11 percent over the period 2004 to 2011, from 4,376,123 to 4,868,568.

State Consumption Trends

Although gross spirit sales increased in 2005, due in part to tax increases, per-capita consumption trends in Washington were slightly lower than the national average for licensed states and were 12th out of 18 for control states.

Peak annual per-capita consumption of spirits occurred in 1981 at 4.12 gallons. Per-capita consumption of spirits reached its lowest point in 1997 at 1.72 gallons per person and has been relatively stable since. In 2005, the rate was 1.88 gallons per person. Per capita consumption of wine reached its lowest point in 1995 at 0.30 gallons per capita and increased slightly to 0.44 gallons in 2005. The following chart shows consumption trends over time in the three categories of beer, wine and spirits.



Factors Affecting Alcohol Consumption in Washington

Principal factors affecting consumption in Washington are growth in the state's total population and the percentage of the total population of drinking age. An increase in the number of drinking-age adults will produce greater product demand. If current population growth trends continue, more bottles of liquor will be sold in state stores and there will be increased demand for licenses to sell liquor by the drink. This will produce increased revenue if proper investments continue to be made. Following is a chart showing population projections for the state.

Washington Population Growth Estimate

The 2005 population estimate, prepared annually by the State Office of Financial Management, gives Washington's population as 6,256,400 as of April 1, 2005 with 4,456,540 of the state's citizens age 21 years or older. By 2016, Washington's population is expected to increase to 7,738,774, with 5,366,801 of our citizen's 21 years or older. The following tables illustrate population growth predictions.

State of Washington Projection of Over 21 Population Growth			
Year	**Over 21 Population**	**Population Change**	**Percentage Change**
2005	4,456,540	-	-
2006	4,547,825	91,285	2.05%
2007	4,640,221	92,396	2.03%
2008	4,729,892	89,671	1.93%
2009	4,818,798	88,906	1.88%
2010	4,904,532	85,734	1.78%
2011	4,989,867	85,335	1.74%
2012	5,072,010	82,143	1.65%
2013	5,150,591	78,581	1.55%
2014	5,225,918	75,327	1.46%
2015	5,297,169	71,251	1.36%
2016	5,366,809	69,640	1.31%
Total Increase		**910,269**	**20.42%**

Customers

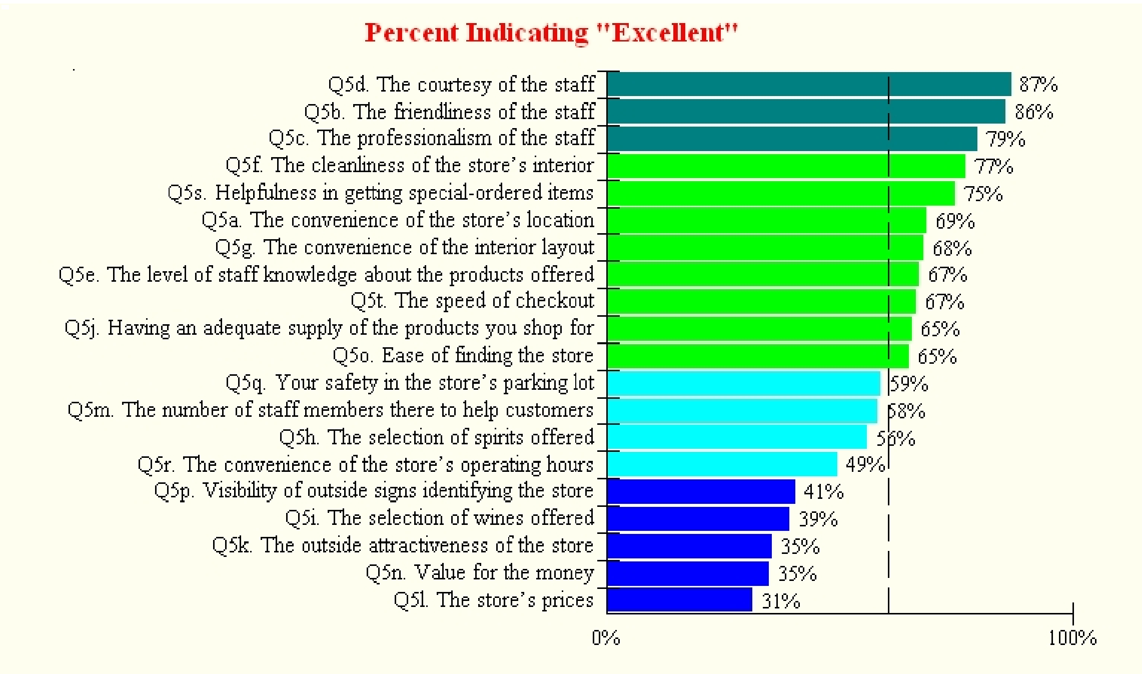
Our customer base is represented in five segments.

Customer Segmentation			
Customer	**2004**	**2005**	**Characteristics**
Retail	73.74%	68.63%	Over 21. Buying in state store.
Wholesale	23.18%	26.70%	4,455 licensed venues statewide.
Tribal	1.34%	2.80%	9 tribal establishments statewide.
Military	1.66%	1.79%	27 military bases statewide.
Hospitals, etc.	0.08%	0.08%	130 customers purchasing industrial alcohol.
Total	**100.00%**	**100.00%**	

Customer Service Survey
In fiscal year 2006, Strategic Research Associates conducted a survey of our retail customers. The following chart provides insight into our retail customers' impression of our liquor stores. Each colored bar represents a different level of achievement relative to industry benchmarks.

Excellent (Turquoise)	Above Average (Light Green)	Below Average (Blue)
Courtesy, friendliness, and professionalism	Cleanliness, staff helpfulness, convenience of location/layout	Signage visibility, wine selection, value, prices

These findings validated our current focus in terms of customer service improvement initiatives. We will use this data to further refine our business strategy as we strive to increase customer satisfaction and revenues.



Customers Favor More Store Activities
The numbers below represent favorable responses to an additional question about customer preferences. The question asked whether customers would be more likely to shop if we offered the items/services shown. The results indicate customers would like us to offer more products and services in our stores.

Type of Activity	#	% Who Answered More Likely or Little More Likely	
Wine Tasting	381	58%	
Spirit Tasting	348	53%	
Gift Cards	256	39%	
Accessories	250	38%	
Media	184	28%	Books, magazines, CDs
Apparel	138	21%	

Financial Plan

Overview

The agency's Financial Division provides forecasting, budgeting, and administrative support for the Supply Chain operation. A financial forecast presented to the Washington State Forecast Council in February 2006 provided in-depth analysis of current and projected financial trends.

The agency's business planning process has focused on maintaining and increasing revenue distributions and reinvesting a percentage of our profits back into the operation so that we can sustain the revenue growth.

- The Construction and Maintenance Account (Fund 335) is established to pay for the construction of the new Distribution Center.
- The Liquor Revolving Account (Fund 501) is established to manage all the revenue and expenses of the agency's operations. The majority of both revenue and expenses are associated with Retail Services operations.

Projected Revenues FY 2008/2009

Account	FY 2008	FY 2009	Total
Fund 335	$6,659,698	$6,792,892	$13,452,590
Fund 501	770,485,128	799,067,759	1,569,552,887
Totals	**$777,144,836**	**$805,860,651**	**$1,583,005,477**

Revenues Distributed to State and Local Governments

Fiscal Year	Amount	Change
2006	$302,857,057	
2007	315,354,339	$12,497,282
2008*	329,692,487	14,338,148
2009*	344,716,983	15,024,496

* Projected

Proprietary Fund 355

Background

The Liquor Control Board's Seattle Distribution Center was financed in 1996 by means of a Certificate of Participation instrument. With the issuance of this COP, proprietary fund 335 – Construction and Maintenance Account – was created as a funding mechanism for the repayment of the debt.

The COP was financed by a $.20 per liter surcharge that was place on the sale of spirits. Earnings from the surcharge are placed in Fund 355 and construction debt payments are paid from these earnings. Revenue generated above the debt payment by the surcharge is distributed to the state and cities and counties as excess revenue.

The Seattle Distribution Center was designed to ship 17,000 cases of liquor in an 8-hour day or 22,000 cases in a 16-hour day. The LCB has implemented several new strategies over the last three years to grow the business. Growth has exceeded expectations and the Distribution Center has reached its design limits.

Current Situation

In 2005, the Liquor Control Board was authorized by the State Legislature to enter into a new COP to finance the construction of an extension of the Seattle Distribution Center in an amount not to exceed $17,000,000. With the assistance of the Office of the State Treasurer, LCB is proceeding with the establishment of the terms of financing this expansion. Repayment of the debt from this expansion would come from the $.20 per litter surcharge established with the original construction project.

Also in 2005, the Liquor Control Board was authorized by the State Legislature the right to use this fund for the early redemption of the original COP. Early redemption of the original debt will save the state $390,000 in interest expense.

Both funding the debt for the expansion and early redemption of the original COP will be paid from revenues generated from the existing surcharge. Once the original debt is eliminated, the LCB has the option to reduce the surcharge to simply cover the repayment of the expansion construction, or leave the surcharge in place and distribute earnings above the debt repayment as excess revenues. Options at that time will be discussed with the Office of Financial Management.

Expense and Revenue Generation

The $.20 per liter surcharge will generate $9.8 million dollars during the current biennium, with a projected $10.1 million projected in 07-09. The Office of the State Treasurer has estimated funding for the expansion project at $1.4 million per year over a 20 year repayment period. Additionally, the payoff of the original debt is expected to be $7.3 million in FY 07. As can be seen, the revenues generated by the surcharge exceed the operating expenditures for this fund.
This is a dedicated fund that is used only for construction and maintenance expenses for the Distribution Center.

WSLCB Store Performance Comparisons

- Washington ranked third among all control states in FY 2005 in sales and revenue returned.[1]
- Average per-store net income was 10.7 percent in FY 2005. Private liquor stores report averages of between 2.1 to 2.8
- Sales per FTE of $891,000 in FY 2005 were higher than other control states and much greater than many retail businesses. Private liquor stores report sales of $174,000 per person. [2]

- LCB's inventory turns were 11.0 in FY 2005 compared to industry averages of 6.3 to 7.7 for private liquor stores.[2]
- Order fill rates match the industry average of 95 percent.[2]
- Average per-square-foot sales in state stores of $681 (2005) exceed many retail businesses. For example, Wal-Mart is $422, Costco is $771, and Safeway is $443. [2]

[1] Stateways, November/December 2005 [2] Bizstats.com/liquor.htm

Alternative Funding Models

Going forward, the business planning process needs the added flexibility of an *Enterprise Funding Model*. This would allow us greater flexibility to reinvest a percentage of the revenues generated from liquor sales into critical business operations. The ability to make timely investments needed in our $650 million annual business is hampered by current biennial funding processes. Added funding flexibility is needed to help us meet the challenges of the future and maximize revenue return to the state.

The 2005 Legislature approved a number of key investment strategies to help the agency build a firm foundation for future growth. These included investments in new technology, distribution system enhancements, infrastructure, staffing and training. The Legislature has required us to report in 2007 on how well the Sunday sales project is meeting its revenue goals. A similar report due in October 2006 will chart increased revenue related to additional store staffing.

Preliminary study results indicate both the store staffing and Sunday sales initiatives are meeting their sales performance expectations. We anticipate requesting additional funding in 2007-2009 to fully implement these programs. Without additional investment in store personnel, the agency will not be able to meet future demand growth on the front line of its operation. This will result in a loss of revenue to the state. If the state fails to act now, this revenue loss will be compounded over time.

An overview of reinvestment opportunities is presented in the following tables.

WSLCB Agency Business Plan
2007-09 Biennium

Strategy	Estimated Cost		Estimated Benefit				
	FTEs	Appropriated Dollars	Type	Gross Revenues	Distributable Revenue After Expenses	RCW, WAC and/or decision package required	How Well It Fits With LCB Strategic Plan
Revenue Enhancements							
Increase Store Staffing to Meet Growth Following completion of report on store staffing due Oct. 6, 2006, recommend increases in store staffing.	TBD	TBD	Increase revenue, customer satisfaction	TBD	TBD	Decision package	Maximize financial return to the state
Add Six New Stores Following report due Oct. 6, 2006, recommend adding six new stores during the 2007-2009 biennium.	24.00	$3,500,000	Increase revenue, customer service	$22,000,000	$11,000,000	Decision package	Maximize financial return to the state
Relocate Six State Stores New store locations will achieve greater profibility.	2.00	$200,000	Increase revenue and customer service	$3,600,000	$1,800,000	Decision package	Maximize financial return to the state
Allocate Money for Increased Lease, Tax Costs Allot additional dollars to meet costs over current carry-forward level.	0.00	$2,000,000	Maintain revenue			Decision package	Maximize financial return to the state
Sunday Sales Expansion Increase number of state stores open on Sunday based on the findings of report due January 2007 and Legislative action.	TBD	TBD	TBD	TBD	TBD	TBD	Maximize financial return to the state
Increase Inventory Turns Increase inventory turns to 11.5 inventory turns by June 30, 2008 and to 12 inventory turns by June 30 2009.	0.00	$0	Increase revenue		One-time savings of $5,000,000	Use existing resources	Maximize financial return to the state
Promote Washington Wine Promote Washington Wine sales to achieve greater revenue and customer satisfaction.	0.00	$50,000	Increase revenue	$500,000	$250,000	Decision package	Maximize financial return to the state
Introduce Liquor-Related Products in State Stores Consider selling products that compliment liquor (mixers, corkscrews, gift bags, media etc).	0.00	$400,000	Increase revenue	$2,000,000	$660,000	RCW	Maximize financial return to the state
Wine & Spirit Tastings Consider offering wine and spirits tastings to state store customers.	TBD	TBD	Increase revenue	Under Review	Under Review	RCW	Maximize financial return to the state
Gift Card Program Consider offering the sale of gift cards for spirits purchases.	TBD	TBD	Increase revenue	Under Review	Under Review		Maximize financial return to the state
Efficiencies							
Further Develop Retail Decision-Making Capacity Create Financial Research Unit, add District Managers, add support staff.	TBD	TBD	More timely, accurate business decisions			Decision package	Maximize financial return to the state
Create New Business Unit Create a new Business Enterprises organization to encompass Retail, Distribution and Purchasing.	2.00	$250,000	Increase coordination, efficiency			Decision package	Maximize financial return to the state.

WSLCB Agency Business Plan
2007-09 Biennium

Strategy	Estimated Cost		Estimated Benefit				
	FTEs	Appropriated Dollars	Type	Gross Revenues	Distributable Revenue After Expenses	RCW, WAC and/or decision package required	How Well It Fits With LCB Strategic Plan
Sales, Inventory, Operations Planning (SIOP) Implement Sales, Inventory, and Operations Planning (SIOP) process to improve forecasting and execution of financial and operational activities.	1.00	$0	Increase coordination, efficiency			Use existing resources.	Maximize financial return to the state
In-Store Merchandising Program Improve process and compliance for the shelf schematic and display activities	2.00	$140,000	Increase Revenue and Customer Service	$1,000,000	$500,000	Decision Package	Maximize financial return to the state
Business Enterprise Funding Pursue market funding models -non-appropriation, franchise and other models - tying performance to timely funding.	0.00	$0	Increase coordination, efficiency			Decision package, Legislative approval	Maximize financial return to the state
Technology							
Store Staffing Software Develop software to allocate store hours more efficiently to the 161 state stores.	0.00	$50,000	Maximize limited resources			Decision package	Maximize financial return to the state
POS Enhancements Continue to upgrade current system to provide better access to data for making timely business decisions.	1.00	$1,100,000	Increase accuracy of financial data and managerial data			Decision package	Maximize financial return to the state
Time/Attendance Software Purchase and install time-and-attendance software at our 161 state stores.	1.00	$400,000	Increase payroll record accuracy & maximize resources		$0	Decision package	Maximize financial return to the state
Enhance Security Cameras Create more effective and comprehensive coverage in current store security system.	0.00	$150,000	Increase payroll record accuracy & maximize resources		$0	Decision package	Ensure highest possible level of public safety
Customer Service							
EmployeeTraining Retail employees receive customer service and product knowledge training to improve store performance.	0.00	$300,000	Increase customer service		$0	Decision package	Recruit, develop, retain and value a highly competent workforce
Online Ordering - Licensees Create a Web-based online ordering system for licensees.	0.00	TBD	Increase customer service	TBD	TBD		Maximize financial return to the state
Online Ordering - Retail Create on-line ordering for retail customers.	0.00	TBD	Increase customer service	TBD	TBD		Maximize financial return to the state
Totals	33.00	$8,540,000		$36,100,000	$22,710,000		

Strategic Objectives

Summary

During the next decade (2006-2016), the Washington State Liquor Control Board has the opportunity to make an even greater contribution to the state. A stable and well-run business operation is essential to accomplish the agency's balanced mission. This agency business plan outlines the path to success for that business operation. The most important components of this plan are listed below.

Store staffing	Improved merchandising	Supplier scorecard
Store relocations	Improved employee training	Business intelligence
Store technology	Improved distribution operations	Inventory management
New store development	Improved supplier accountability	Infrastructure upgrade

As the Retail, Purchasing and Distribution Center divisions are reorganized under a Director of Business Enterprises, their major strategic objectives will continue to evolve. Following is a summary of the key factors driving change in each of these areas and a summary of their strategic objectives for 2007-2009.

Retail Services

The Retail Services Division is responsible for operating 161 state stores and overseeing the operation of 154 contract stores. Some state liquor stores serve as retail and wholesale outlets, providing spirits, beer and wine for retail customers and for restaurants and clubs. Liquor is also sold at wholesale prices to military and tribal stores throughout the state. These stores operate independently of the state system.

The Retail Services Division has about 800 full- and part-time employees. More than 780 of them work in the stores providing direct service to customers by stocking shelves, arranging special displays, operating checkout stands with a POS sales system, providing product information to customers, re-ordering inventory, keeping stores clean and presentable and other duties common to retail environments.

The Retail Services Division is responsible for all strategic planning related to the stores. With the approval of the Board, the division makes proposals to the Legislature for new store development, engages in an ongoing program of store re-location, selects all contract store managers, maintains accurate accounting and inventory controls and engages in management strategies to ensure maximum store profitability.

District Managers

There are 10 District Managers assigned to assist state and contract store employees in operating their stores successfully. The District Managers allocate staffing and budget to district stores and make modifications as needed to this allocation. They hire, promote and transfer employees and initiate corrective/disciplinary actions. They monitor state and contract employees for performance and compliance with agency policies and procedures and state laws. The District Managers also make monthly visits to their assigned state stores, quarterly visits to contract stores and assist tribal and military stores as needed. They help store managers and employees implement strategies to improve store performance, such as in-store merchandising displays, and work closely with managers and assistant managers to improve store performance by analyzing data on inventory, compliance, sales and other activities.

Store Leasing

With Board approval, Retail Services negotiates all new state-run store leases and all renewals. Traffic patterns for all new facilities and possible relocations are analyzed. This data indicates about how many potential customers a new store can attract. Leasing experts also develop proposals for new or alternate store locations.

Store leasing personnel study store locations to determine the best venues for new stores and for stores whose leases are about to expire. Often, significant sales increases can be achieved if an existing store is relocated to a more accessible location. This enables the state to serve an increasing customer base more efficiently. Store Leasing provides all supporting legal documentation for leasing decisions and contracts.

Evidence of the success of this program can be found in the earnings records of three recently moved stores in the cities of Chehalis, Moses Lake and Puyallup. Total sales for these stores increased from $5.5 million to $7.3 million between 2004 and 2005, or an average of 31 percent

Site Development

Site development experts help determine and monitor modifications to existing stores and all new facilities. Site development experts work closely with store leasing personnel to prepare store remodel plans and new store layouts. They monitor progress and completion of these projects by meeting regularly with contractors, building inspectors and others whose jurisdictions affect store locations. The Site Development Manager supervises a carpentry crew responsible for installing new store fixtures.

Strategic Objectives

Study Examines Need for More Store Employees / Stores

In 2005, the Legislature appropriated $2.7 million to fund an increase of 28 FTEs for Retail Services. Twenty-six FTEs were assigned to the stores and two were allocated to retail budget analysts. The appropriation bill required the agency to conduct a study to determine the impact of additional store hours on sales and customer satisfaction. A report on the results of the study is due in October 2006.

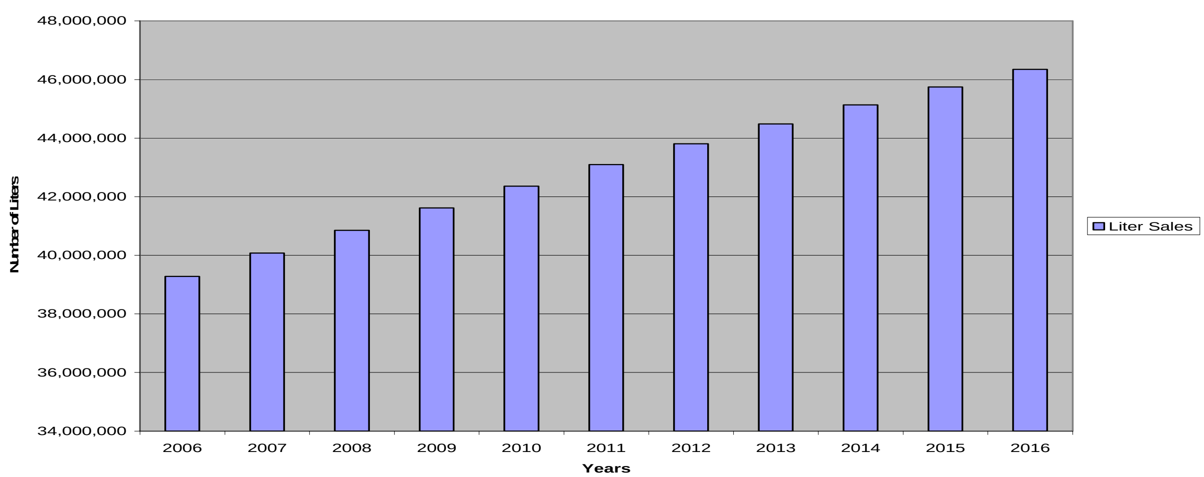
The study is being conducted in 49 state stores. A baseline allotment of hours was given to all stores. Ten stores, selected randomly, were given additional hours beyond the baseline. Ten others, also selected randomly, were given fewer than the baseline hours. The test will be complete in July 2006. The results of the test along with research done by the consultants will be the basis for our recommendations to the Legislature. The customer service study noted in the in the Marketing Analysis section of this document was employed to gauge customer satisfaction with state and contract liquor stores.

The study is also intended to identify new business practices to increase the effectiveness and efficiency of all retail-related activities. Using best practices and benchmarks from comparable retail organizations, the analysis will help the agency determine optimal staffing levels, store locations, numbers of stores (both state and contract), the retail organizational structure and organizational resources needed to support retail activities.

More State Stores Needed to Serve Growing Population

Strategic store location and store staffing are of great importance in Washington, which limits the number of stores as part of its overall strategy to limit consumption. Because the number of stores are limited, it is necessary to carefully analyze where stores should be located, how many stores there should be and how those stores should be staffed to provide optimal service. The following chart shows the estimated un-stimulated projected growth of liter sales over the next decade being driven by population growth. This forecast demand is particularly important in planning for future stores and personnel allocations.

Projected Washington Liter Sales



To meet expected growth in demand, the Legislature approved funding in 2003 for the first four new state liquor stores to be opened in more than 20 years. These stores were opened by mid-2005, bringing the total number of state and contract stores to 315. These four stores have earned more than $9 million in the last 18 months, substantially exceeding their projected sales.

Between 1980 and 2006, the number of state and contract liquor stores declined from 355 to 315, or by about 13 percent. This reduction, plus population growth, has dramatically increased the number of people served by each state and contract store. The following chart illustrates how the number of state stores has declined as the population has grown. The shaded part of the graph represents an estimate of the optimal number of stores needed to serve increasing numbers of drinking-age adults. The store performance study will provide a fully accurate estimate when it is completed in October 2006.

Customers Served Per Store

Year	Over 21 Population	Spirit Licensees	State Stores	Contract Stores	Total Stores	Population Served per Outlet
1980	2,759,552	2,279	173	182	355	7,773
1990	3,387,546	2,673	171	176	347	9,762
2006	4,547,825	4,455	161	154	315	14,437
2007	4,640,221	4,642	164	157	321	14,437
2008	4,729,892	4,836	167	160	327	14,437
2009	4,818,798	5,039	170	163	333	14,437
2010	4,904,532	5,250	173	166	339	14,437
2011	4,989,867	5,470	176	169	345	14,437
2012	5,072,010	5,699	179	172	351	14,437
2013	5,150,591	5,938	182	174	356	14,437
2014	5,225,918	6,187	185	177	362	14,437
2015	5,297,169	6,446	188	179	367	14,437
2016	5,366,809	6,716	190	181	371	14,437

The chart above shows how many additional stores will be needed to maintain the current level of service as the state's population continues to grow. The recommended number of stores will be part of the study due in October 2006.

Additional Store Employees

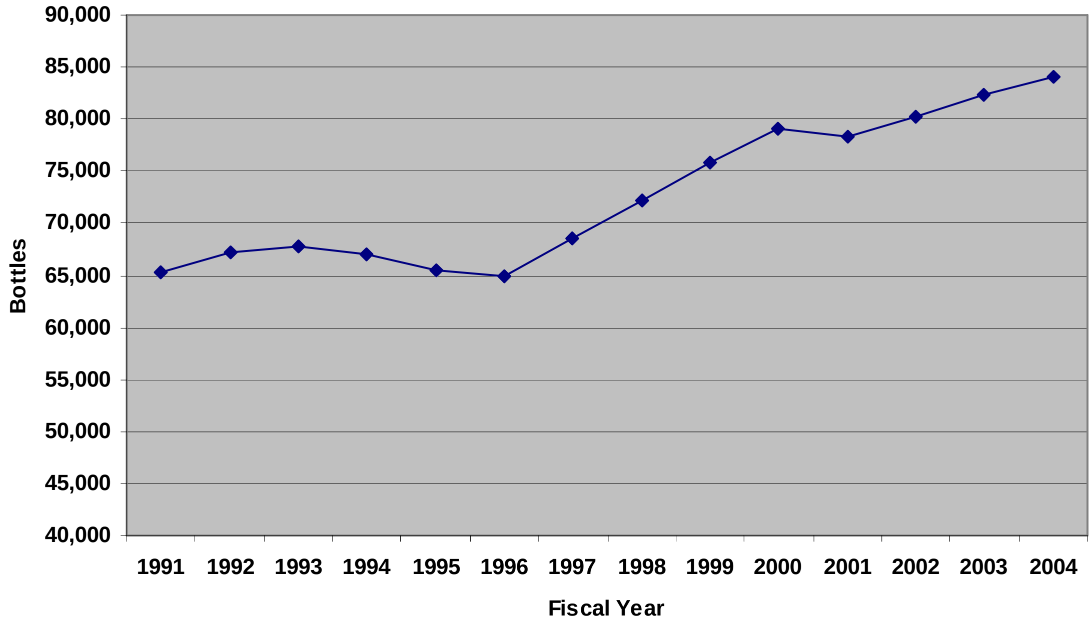
The chart above shows how the average a number of bottles sold by each FTE employee increased between 1991 and 2004. During that period, total Retail Services staff declined by two.

One way of determining the optimal number of store employees needed to manage increased product demand is to compare the number of bottles being sold to the number of employees selling those bottles. Between 1991 and 2005, bottle sales per FTE increased 35 percent – from 55,519 per year to 74,739 per year.

To achieve this net sales increase, the agency had to reduce store scheduling flexibility. This, in turn, reduced time available for employee training and cut into managers' business planning time. Additional store employees are needed to help store employees manage their increasing workload. When compared to other control states, WSLCB staff-to-bottle sales ratios are the highest in the nation.

Even with the new hours approved in 2005, stores have reached a point at which the employees can no longer maintain basic, required duties. Employees who lack training are less effective in answering customer questions, introducing customers to new products and wine selections, creating effective in-store merchandising displays, helping manage inventory, keep shelves re-supplied supplied and other important tasks. An important goal in the 2007-2009 biennium is to achieve 100 percent required core training for all store employees.

Bottle Sales Per FTE Have Increased



Summary of Retail Strategic Objectives

Revenue Generation

- A report due in October 2006 will recommend increases in store staffing and in agency staffing needed to provide internal support for the stores, including Retail Management, Information Technology and Human Resources.
- The report on store development due in October also will recommended adding six new stores to meet increases in demand being driven by population growth.
- The strategic relocation of six state stores to major retail-anchored centers will be recommended to increase customer service and accessibility and improve revenue generation.
- Due January 2007, a report on Sunday sales will provide information on the economic feasibility of expanding Sunday sales. The report will recommend whether additional stores should be opened. A Legislative appropriation will be needed to continue and/or expand the program.
- In collaboration with the Marketing Manager, the liquor stores will continue a month-long program to promote Washington Wines.
- Increase inventory turns to 11.5 by June 30, 2008 and to 12 by June 30, 2009.

Efficiencies

- Strategies to increase store decision-making capacity will be implemented: Financial Research Unit, additional District Manager, additional support staff.
- Additional business-driven data will be needed to manage the Retail Division on a store-by-store basis to evaluate and measure store performance.

- Retail, Purchasing and the Distribution Center divisions will be reorganized into a Business Enterprise unit. This consolidation was recommended in the Public Knowledge LLC report on the WSLCB issued in September 2005.

Technology

- Continuing upgrades to the store point-of-sale system will improve functionality and secure maximum profitability.
- A new software application will be needed to help the Retail Division allocate store hours more efficiently.
- Time and attendance software also will be needed for state stores to ensure accurate reporting of hours for all employees and improve store operations.
- Additional cameras will be installed in state stores to reduce both internal and external theft and the risk associated with operating a retail business.

Customer Service

- Store employees will be required to participate in a comprehensive training program to learn more about all categories of liquor and the level of customer service needed to improve customer satisfaction. Additional IT Training of store staff also will be recommended.
- Online ordering for licensees and retail customers is being considered to keep pace with private retail organizations.
- Offering wine and sampling opportunities to state store customers, a proposal to issue 'gift cards' and a proposal to introduce the sale of liquor-related products into the stores also are under consideration.

Purchasing

Product selection, supplier management and in-store merchandising are the key activities within the Purchasing Division. This team is responsible for ensuring that a diverse portfolio of products is made available to meet the changing interests of our customers. These products must also generate appropriate levels of revenue and profitability for the state. Category strategies are used to strike the balance between selection and financial return. Progressive supply management techniques are used to drive accountability, efficiency, and value across the supply chain.

Customer Service / In-Store Merchandising

A new Customer Service work group is responsible for providing our stores a broad portfolio of products to meet customers needs and interests. The purpose of this initiative is to increase customer satisfaction with the shopping experience while maintaining a focus on public safety and responsible consumption. This strategy will be based on analysis of the following seven factors.

- Targeting
  To whom will we market our products.
- Positioning
  How we differentiate ourselves from our competitors.
- Product Attributes
  The attributes/features of our products.
- Customer Communications
  How we reach the target and with what message.
- Pricing

What price we charge.
- Distribution
  What channels we use to sell the product or service.
- Customer Service
  How we manage additional customer needs.

In 2007-2009, we will continue to improve store planning and product placement strategies. New shelf management software; new strategies for concept stores and seasonal promotions; and improved category management will increase customer satisfaction and shopping ease. This marketing strategy will help us create and deliver additional value for distinct groups of customers.

Pricing

The retail price of liquor is determined by five elements:

1) Distiller's, brewer's, or vintner's price to the Board
2) Federal taxes: Excise tax on all liquor & custom duty rates on imported liquor.
3) Freight costs: From the suppliers to the Distribution Center and to the stores.
4) Markup: As established by the Board
5) State sales and liter taxes as established by the State Legislature

Purchasing strives to provide a good value for the products offered while not stimulating demand. Wholesale customers are assessed a lower state tax rate (they are exempt from the $1.33 liter tax imposed by the Legislature in 2005) and receive a 15 percent discount. Military Bases are tax exempt and receive a discount. Tribal Establishments prices are set by agreement with each Tribe.

Purchasing maintains a broad portfolio of products to meet the changing interests of customers and generate revenue for the state. Many products not available in stores may be special ordered. Consumption trends are monitored and recommendations for listing and de-listing products are based on sales, price, type, and supplier performance. In-store merchandising programs provide a convenient and informative shopping experience for the retail customers.

Summary of Purchasing Strategic Initiatives

Strategic initiatives set in motion in 2006 will continue throughout the 2007-2009 strategic planning period as the Purchasing Division works to advance overall business and operations. Highlights of four major efforts follow.

Supplier Scorecard

- A Supplier Scorecard program is recommended to provide objective and timely feedback to the supplier community by measuring suppliers' ability to meet pre-established performance targets and encouraging supplier competition based on value delivered. The program is intended to focus on continuous improvement to core areas of supplier-related activities.

Supply Chain Management

- A study of how best to reorganize the management of the three divisions is under way. In 2007-2009, the study results will be used to create a new, more unified management structure, which will promote improved short- and mid-range retail business planning. This new business management model will make the entire supply chain process more transparent and coordinated. This, in turn, will help us reduce out-of-stocks and excess inventory and achieve many other efficiencies. A team from Distribution, Finance, Purchasing, and Retail is working on all aspects of this new management model. Metrics will be created to chart progress in achieving the agency's financial and operational goals.

New Inventory Management Model

- The forecasting methodology used to drive the product replenishment process will be analyzed and updated to reduce the amount of inventory on hand and ensure better product flow to the stores. Current levels of inventory prevent a fully efficient shipping and receiving operation.
- A 'demand-pull' delivery strategy will be initiated with major suppliers. Suppliers will replenish stock from their warehouses based on signals of real time inventory consumption (i.e.: shipment to stores). This will reduce the amount of on-hand inventory, increase DC storage capacity and support improved order fill rates by creating a more responsive delivery system.

Business Intelligence / Data Warehousing

- There are several systems used to support daily business operations, including the AS/400, WMS, NABCA, and the POS system. While each of these generates volumes of valuable data independently, our current architecture does not allow us to easily cross-reference this data for use in running the business. In essence, we are data rich and information poor. This is not an uncommon challenge facing businesses today. The selection of specialized IT solutions to accomplish specific tasks has made it more difficult to facilitate communication across various platforms. To address this issue, many businesses are now using data warehouses seek to help bridge the gaps among otherwise isolated systems.

- Developing a fully functioning data warehouse might take some time. Therefore, in the interim, the supply chain team will use other tools to improve how data is gathered, stored, analyzed and made accessible. This will lead to more informed and strategic business decisions. The use of technology also will help us develop greater awareness about how individual roles and responsibilities can be linked to the achievement of major agency goals and objectives. Cross-divisional key performance indicators will provide timely and meaningful feedback to the management team on the effectiveness of team tactics and strategies.

Distribution Center

The Distribution Center ensures the timely, safe and efficient receipt, storage and shipment of spirits, wine, and beer to the 315 state-run and contract liquor stores and to 9 tribal and 27 military outlets located throughout the state.

The DC is housed in a 159,000 square-foot Seattle facility. It is being expanded by 62,000 square feet in 2006-2007. The DC's material handling system is designed to process the 17,000 cases of liquor shipped out of the facility each day. When the expansion is complete, the center will be able to ship more than 28,000 cases per day.

The Distribution Center maintains a daily inventory level of between 400,000 and 500,000 cases of liquor, depending on peak periods. The receiving department processes receipts from about 330 domestic and international shippers. Local freight carriers redistribute product weekly to the 315 retail outlets. Shipments from the DC increased 11.1 percent - from 3,748,028 to 4,163,707 cases – between 2001 and 2005. Shipments during the holiday period (October-December) increased 1.5 percent between 2004 and 2005.

Summary of Distribution Center Strategic Initiatives

Having a reliable and responsive distribution system is essential to the success of the overall operation. As such, the following strategies have been established to support this goal:

Complete DC Expansion

- The 2005 Legislature approved more than $20 million to expand and improve the Distribution Center. The project includes 62,000 square feet of additional space, two new shipping doors, eight new receiving doors, additional storage racks and other equipment. Expansion and upgrading are necessary to meet a forecasted 4 percent annual increase in the number of cases the DC must ship.

Expand Material Handling System Reliability

- Key motorized equipment used to move product in the warehouse will require replacement in 2007-2009. This includes turret trucks and fork lifts. These expensive pieces of equipment have been used twice as much as originally planned because the DC has operated two shifts consistently since it opened.
- A comprehensive preventative maintenance program, begun in 2006, will be expanded and refined in 2007-2009. The DC relies on automated equipment and operating systems to achieve high levels of productivity. Equipment breakdowns can significantly disrupt the center's ability to respond to peak demand and lead to many other inefficiencies. Improved purchasing and procurement methods, a new parts inventory management system, new supply-chain management principles, better scheduling and increased training will improve system reliability.

Improve In-Bound Logistics

- The ability to know in real time what product is being shipped to the DC, when it was shipped and when it will arrive will increase efficiency. Improved supplier and carrier performance are a key element of this initiative. To accomplish this, the DC is working closely with suppliers and carriers to improve scheduling, shipment tracking and reporting processes. Additionally, we are exploring the use of Just-In-Time (JIT) delivery methods on a demand-pull basis, which will reduce necessary product storage time and requirements.

Optimize Customer Order Fill Rates

- The Distribution Center and Purchasing are collaborating to maximize customer order fill rates by carrying out the strategies named above: product availability, daily replenishment of all carousels, and full equipment availability.