OLO Report No. 91-2 September 24, 1991

Montgomery County Government

FEASIBILITY OF CONTRACTING OR PRIVATIZING ELEMENTS OF THE DEPARTMENT OF LIQUOR CONTROL

AUTHORITY: Council Resolution No. 12-144, CY 1991 Work Program of the Office of Legislative Oversight, adopted March 26, 1991.

SCOPE: This project reviews alternate methods employed by other control jurisdictions to accomplish alcohol beverage warehousing, delivery, and retail activities currently being performed directly by the Department of Liquor Control (DLC). A major objective of the study was to identify areas of DLC operations which have potential for cost efficiencies or revenue enhancements through contracting or privatization strategies that would translate into additional surplus funds for transfer to the County's General Fund.

The study was specifically directed toward the operational level of DLC activities, rather than a market approach which would be oriented toward product mix. Thus, the study does not address the financial viability of DLC operations related to handling the various alcohol product categories (liquor, fortified wine, table wine, and beer).

The study was designed as a first step to apprise the Council of the feasibility and applicability of contracting or privatization strategies for DLC operations. Since each feasible option was expected to generate numerous phase-in approaches, no cost-benefit analyses was attempted. Thus, any option identified as feasible in this study should not be implemented without first designing an implementation plan accompanied by thorough cost-benefit analyses.

METHODOLOGY: This report represents the joint efforts of Joan M. Pedersen, assisted by W. Robert Heckman, III, Public Administration Intern, and KPMG Peat Marwick Management Consultants (KPMG) John DiRenzo and Aaron Estis. Research for the project by the KPMG consultants included a review of relevant documentation, previous reports, and surveys of control jurisdictions; interviews of DLC and other County administrators; and analysis of responses to a KPMG questionnaire distributed to control jurisdictions. Research conducted by the Office of Legislative Oversight (OLO) included review of previous reports and surveys of control jurisdictions; review of the KPMG survey; conduct of follow-up activities related to the KPMG questionnaire and analysis of additional information received; and interviews with County administrators, licensees, and representatives of distributors and other businesses.

ACKNOWLEDGEMENTS: The Office of Legislative Oversight (OLO) acknowledges the prompt and courteous cooperation received from management and staff of the Department of Liquor Control, the Board of License Commissioners, individual licensees and representatives of licensee associations, other control jurisdictions, and representatives of distributors and other businesses. OLO extends special thanks to the many individuals, both within and outside of the County, who contributed a good deal of their time to gather and provide data for this project.

Office of Legislative Oversight

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OLO SUMMARY OF PRIVATIZATION AND CONTRACTING OPTIONS: In this section, OLO has summarized relevant information related to each of the contracting or privatization strategies reviewed as part of this project, and ranked each option as high, medium, or low risk to the County if implemented. The summary section represents the analyses, judgments, and conclusions of the writer. The County Attorney has been requested to provide legal advice regarding the contracting and revenue authority options, and such advice will be an addendum to the final report when received.

A. Full Privatization of Warehouse/Delivery Operations

1. Full privatization of the delivery operation alone is not particularly desirable since it would either cause the County to pay varying prices to private firms for delivering on its behalf, or place the burden and cost of arranging delivery from the County's warehouse on licensees. Thus, full privatization of the wholesale activity should also include transfer of responsibility for product delivery to private wholesalers.

2. Unless the County could limit wholesaling to one location, full privatization of the wholesale operation would be accompanied by an increase in the number of small warehouses located in the County to be used as distribution points.

3. Full privatization of the warehouse and delivery activities would potentially affect approximately 140 DLC employees.

4. Full privatization of the warehouse activity would require licensees to order and receive products from multiple suppliers, with a resulting increase in the number of delivery vehicles on County roads.

5. Businessmen argue that the County could make up DLC's annual $10 million contribution to the General Fund because alcohol taxes returned to the County by the State (50/50 ratio) would be higher due to increased sales of alcohol products in the County. (In FY90, the County received $811,977 from the State based on sales of 15.31 gallons per capita. At the current 50/50 ratio, tax revenue on alcohol products would need to increase by $20 million to generate $10 million to the County.)

6. Businessmen argue that sale of the County's warehouse and delivery vehicles would generate a large one-time revenue source for the General Fund, which could be invested to generate annual revenues. (The County would have to invest approximately $163 million to generate $10 million annually, using an interest rate of six percent compounded quarterly.)

7. None of the 18 state control jurisdictions has fully privatized its wholesale and delivery operations, whereas, two jurisdictions have taken advantage of partial privatization of their wholesale activities, four jurisdictions are either in the process or have partially privatized their combined wholesale and delivery activities, and eleven jurisdictions have partially privatized their delivery activities through contracts negotiated with the private sector to provide services on behalf of the state. Two states use the private sector for the delivery operation, passing the cost on to licensees.

Full privatization of the wholesale/delivery operations should be considered a high risk option:

a. It is unlikely that $10 million annually can be generated from investment income, additional shared taxes, and new licenses.

b. Because phase-in of this option would not be practical, full privatization of the warehouse and delivery activities would negatively affect approximately 140 DLC employees.

c. The County may not have complete control over the terms in State legislation passed to allow for full privatization of the wholesale operation.

d. If actual benefits to taxpayers, licensees, and consumers fall short of those expected, it may be difficult to return control to the County.

B. Full Privatization of the Retail Operation

1. Unless the County could limit the number of outlets, the number of locations where distilled spirits would be sold could increase substantially. (There are currently 22 County-operated stores; a 500 percent increase would result in 110 locations. If current beer/wine store licensees were to receive permission to sell distilled spirits, the number of locations would be 185, representing a 741 percent increase.)

2. Full privatization of the retail operation would potentially affect approximately 100 DLC career employees and 68 substitute employees.

3. Licensees argue that the County should not operate retail stores because the practice does not really control alcohol consumption and it sends the wrong message to the community. (Studies sponsored by the National Alcohol Beverage Control Association (NABCA) indicate that there are generally fewer retail outlets in control jurisdictions and consumption of alcohol is lower than in open jurisdictions.)

4. Licensees argue that the private sector can provide service more efficiently than the County's operation, and pass on savings to consumers. (Studies sponsored by the NABCA indicate that prices on alcohol products are somewhat higher in license jurisdictions than in control jurisdictions.)

5. Licensees argue that any fees generated from full privatization of the retail operation would increase County revenues because the current DLC retail operation is a negative influence on overall profits available for transfer to the General Fund.

6. Licensees argue that in-County purchases of alcohol products would increase under full privatization because of the broader customer convenience provided by having distilled spirits available for purchase at more locations, and would result in an increase in tax revenue returned by the State.

7. The County could design a licensing system to allow for sale of distilled spirits by the private sector, and receive annual license revenues. (Distilled spirits licenses in Baltimore City currently cost $5,000 each, which amount would generate $925,000 in additional license fees if 185 licenses were issued in the County.)

8. Five control states have fully privatized their retail operations by converting to licensing systems as a cost saving measure, while eight jurisdictions have taken advantage of semi-privatization through contracts negotiated with the private sector wherein the contractors act as agents to provide retail services on behalf of the jurisdiction.

Full privatization of the retail function should be considered a high risk option:

a. This option could dilute or eliminate County control over the number and location of retail outlets in the County, products carried and pricing, as well as advertising the sale of alcohol products.

b. The County may not have complete control over the terms in State legislation passed to allow for full privatization of the retail operations.

c. Unless phase-in of licensed operations is possible, full privatization of the retail operation could negatively affect approximately 100 DLC career employees and 68 substitute employees.

d. If actual benefits to taxpayers, licensees, and consumers fall short of those expected, it may be difficult to return control to the County.

e. However, the full privatization option would likely result in additional surplus revenue available for reinvestment in assets or transfer to the General Fund, due to the elimination of retail expenses and income from licensing fees.

C. Full Privatization of the Entire DLC Operation

1. Businessmen and licensees argue that government cannot serve the public as efficiently or effectively as private enterprise. (Studies sponsored by the NABCA observed fewer retail outlets, lower prices on alcohol products, and lower consumption rates in control jurisdictions than is experienced in open jurisdictions.)

2. Unless the County could limit the number of wholesale and retail outlets, full privatization of the entire DLC operation would result in an increase in both the number of warehouses or distribution centers located in the County and the number of outlets selling distilled spirits.

3. Full privatization of the entire DLC operation would potentially affect approximately 273 DLC career employees and 68 substitute employees.

4. Full privatization of the entire DLC operation would require licensees to order and receive products from multiple suppliers, with a resulting increase in the number of delivery vehicles on County roads.

5. Businessmen and licensees argue that the County could make up DLC's annual $10 million contribution to the General Fund through the increase in State-shared taxes on alcohol products which would be generated from increased annual sales in the County; sale of DLC assets with investment of the proceeds to generate annual revenue; and annual fees assessed for wholesale distribution center licenses and retail distilled spirit licenses.

6. None of the 18 control states has fully privatized all of their wholesale, delivery, and retail operations.

Full privatization of the entire DLC operation should be considered a high risk option:

a. It is unlikely that $10 million annually could be generated from investment income, shared taxes from increased sales, and additional license fees.

b. Because phase-in of this option would be difficult, full privatization of the entire DLC operation would potentially have a negative effect on approximately 273 DLC career employees and 68 substitute employees.

c. The County may not have complete control over the terms in State legislation passed to allow for full privatization.

d. If actual benefits to taxpayers, licensees, and consumers fall short of those expected, it may be difficult to return control to the County.

D. **Partial Privatization of the Warehouse and/or Delivery Operations**

1. Partial privatization of the warehouse, delivery, or combined warehouse and delivery operations could be accomplished by negotiating contracts with the private sector to provide services on behalf of the County, allowing the County to continue to control the number and location of wholesale outlets and, if desired, the maximum number of delivery vehicles in service.

2. Partial privatization of the warehouse, delivery, or combined warehouse and delivery operations could generate revenue for the County from the sale or lease of the DLC warehouse facility and/or delivery vehicles to the contractor.

3. Partial privatization of the warehouse, delivery, or combined warehouse and delivery operations could help the County contain costs because potential contractor(s) would bid in accordance with employment of personnel based on current market wages and benefits paid for similar employment in the private sector.

4. Partial privatization of the warehouse, delivery, or combined warehouse and delivery operations would allow the County to forgo costs relating to breakage and pilferage because the contractor(s) would be responsible for safekeeping of the inventory, the loss of which would directly affect contractor profits and encourage contractor vigilance.

5. Partial privatization of the combined warehouse and delivery operations would transfer to one contractor responsibility for safekeeping of inventory from point of receipt to point of delivery.

6. Partial privatization of the warehouse, delivery, or combined warehouse and delivery operations could be phased in to lessen the negative impact on current County employees.

7. Two jurisdictions have taken advantage of partial privatization of their wholesale activities, four jurisdictions are either in the process or have partially privatized their combined wholesale and delivery activities, and eleven jurisdictions have partially privatized their delivery activities through contracts negotiated with the private sector to provide services on behalf of the state.

Partial privatization of either the warehouse or combined warehouse and delivery operations should be considered medium risk options:

a. It is likely that the $10 million annual contribution to the General Fund could be maintained under partial privatization of the wholesale operation.

b. Partial privatization may result in lower costs to the County and generate additional surplus revenue for reinvestment in assets or transfer to the General Fund.

c. Depending on the method and timing of implementation, some added financial benefits could accrue to the County through sale or lease of the DLC warehouse and/or delivery trucks.

d. It is unlikely that legislative changes would be required to allow for contracting with the private sector to operate on behalf of the County.

e. However, phase-in to minimize the negative impact on DLC employees would require a long phase-in period and may still result in displacing a number of employees under the combined warehouse and delivery option.

f. A long phase-in period would increase the chances for confusion and disruption of service to licensees and other customers.

g. The level of private sector interest in providing warehousing services is unknown.

h. Outright sale of the DLC warehouse could make it extremely difficult for the County to re-assume the wholesale operation, should it become desirable.

i. If actual benefits to taxpayers, licensees, and consumers fall short of those expected, it may be difficult for the County to re-assume the operation(s) without disrupting service, especially under the combined warehouse and delivery option.

Partial privatization of the delivery operation alone should be considered a fairly low risk option:

a. The delivery operation alone has little impact on the $10 million annual contribution to the General Fund.

b. The contracting option may result in lower costs to the County and generate some small additional surplus revenue for reinvestment in assets or transfer to the General Fund.

c. The case beer, keg, and liquor/wine deliveries are currently handled as distinct activities, allowing for various phase-in options by product.

d. Phase-in could be accomplished through a combination of attrition and transfer of delivery employees to warehouse duties, thus guaranteeing continuation of current employees in the County's merit system.

e. Initial leasing of delivery vehicles to the contractor would ensure DLC maintains the assets necessary to re-assume the operation, should it become desirable.

f. It is unlikely that legislative changes would be required to allow for contracting with the private sector to operate on behalf of the County.

g. If the actual benefits to taxpayers, licensees, and consumers fall short of those expected, it would be fairly easy for the County to re-assume the operation without disrupting service.

h. While outright sale of DLC assets would make it more difficult for the County to quickly re-assume the operation, if necessary, delivery vehicles could be rented for short-term and purchased for long-term operation.

E. Partial Privatization of the Retail Operation

1. Partial privatization of the retail operation could be accomplished by negotiating contracts with the private sector to provide services on behalf of the County, allowing the County to continue to control the number and locations of retail outlets.

2. Partial privatization of the retail operation could help the County contain costs because potential contractors would bid in accordance with employment of personnel based on current market wages and benefits paid for similar employment in the private sector.

3. Partial privatization of the retail operation would allow the County to forgo costs relating to breakage and pilferage because contractors would be responsible for safekeeping of inventory, the loss of which would directly affect contractor profits and encourage contractor vigilance.

4. Partial privatization of the retail operation could be phased in to lessen the negative impact on current County employees.

5. Eight jurisdictions have taken advantage of partial privatization through contracts negotiated with the private sector wherein contractors act as agents to provide retail services on behalf of the jurisdiction.

Partial privatization of the retail operation should be considered a fairly low risk option:

a. The contracting option should result in lower costs to the County and generate additional surplus revenue for reinvestment in assets or transfer to the General Fund.

b. The County's 22 retail outlets are operated as distinct activities, allowing for various phase-in options.

c. Partial privatization of the retail operation would allow for DLC to establish a mixed system of County-operated stores and contracted stores, if desired.

d. Phase-in could be accomplished through a combination of attrition and transfer of retail employees to other stores, thus guaranteeing continuation of current employees in the County's merit system.

e. It is unlikely that legislative changes would be required to allow for contracting with the private sector to operate on behalf of the County.

f. If the actual benefits to taxpayers, licensees, and consumers fall short of those expected, it would be fairly easy for the County to re-assume store operations without disrupting service.

F. Establishment of a Liquor Control Authority

1. Establishment of a Liquor Control Authority would require changes to State and County laws to transfer existing control over wholesale, delivery, and retail operations to a revenue authority.

2. An authority is generally established to benefit the operations over which it has control. It is unknown whether the County can legally establish a Liquor Control Authority and require that surplus revenues be contributed to the General Fund.

3. A Liquor Control Authority would have the potential to establish greater control over employees and contain personnel costs by designing its own salary and benefits packages and creating a personnel system separate from the County's merit system.

4. A Liquor Control Authority would necessitate the hiring of additional personnel to handle activities currently provided other County departments and offices, including services provided by Facilities and Services, Procurement, Personnel, the County Attorney, and Information and Systems Management.

5. A Liquor Control Authority would operate independently of the County Executive and the Council and would not require review and approval of its budgets. However, establishment of a Council appointed board could provide for oversight of the authority.

Establishment of a Liquor Control Authority should be considered a high risk option:

a. It is unlikely that personnel costs in departments and offices which currently provide services to DLC could be reduced in proportion to the cost of additional personnel which would be needed by a Liquor Control Authority.

b. Both the County Executive and Council would have diminished control over expenditures of a Liquor Control Authority and the resulting transfer of funds to the General Fund.

c. Transferring DLC employees over to new personnel and pay systems would be disruptive to existing employees, and phase-in would be difficult.

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Montgomery County Office of Legislative Oversight

ADMINISTRATIVE REVIEW TO ASSESS THE FEASIBILITY OF CONTRACTING ELEMENTS OF THE DEPARTMENT OF LIQUOR CONTROL

Final Report
September 1991

September 10, 1991

Ms. Joan Pedersen
Program Evaluator
Office of Legislative Oversight
Stella B. Werner Council Office Building
100 Maryland Avenue
Rockville, Maryland 20850

Dear Ms. Pedersen:

KPMG Peat Marwick is pleased to submit this final report of an Administrative Review to Assess the Feasibility of Contracting Elements of the Department of Liquor Control.

We appreciate the assistance and cooperation provided by the Department of Liquor Control and the Office of Legislative Oversight during the course of this study.

We appreciate the opportunity to assist Montgomery County in addressing this important issue.

Very truly yours,

KPMG Peat Marwick

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EXHIBITS

EXECUTIVE SUMMARY

This study assesses the feasibility of contracting elements of the Department of Liquor Control (DLC) using the experiences of other control jurisdictions to support the analysis. This study addresses, but does not emphasize, privatization options because privatizing DLC operations could reduce Montgomery County's ability to control the wholesale, distribution, and retail of alcoholic beverages in the County. Maintaining such control is an essential element of Montgomery County's current policy regarding alcoholic beverage sales in the County.

Liquor Control in Montgomery County

In 1951, the State of Maryland passed a law creating the Montgomery County Department of Liquor Control (DLC). The Department assumed the monopoly powers of its predecessor the Liquor Control Board. State Law gives DLC the responsibility to:

- Sell all alcoholic beverages to licensees operating in the County - wholesale
- Sell all liquor[1] in the County for off-premises consumption - retail

The County exercises its "control" over alcoholic beverages through maintaining a monopoly on the wholesale of alcoholic beverages and the retail of liquor for off-premises consumption in the County. Control jurisdictions, like Montgomery County, are distinguished from non-control jurisdictions by the extent of government involvement in the wholesale, distribution, and retail of alcoholic beverages. Non-control jurisdictions allow the private sector to warehouse, distribute, and sell alcoholic beverages. Generally, the only involvement of the non-control jurisdiction in the alcoholic beverage business is through the issuance and renewal of licenses.

A 1982 report by the Task Force to Consider Government Philosophy for Liquor Control identified three objectives for liquor control: effective control, adequate service, and surplus revenue for the general fund. The report noted that costs might be reduced by the use of private contractors for selected units of the DLC operation.

The notion that costs can be reduced through contracting is supported by wage differentials between DLC employees and comparable private sector employees. Starting wages for check-out clerks at a major local grocery store are \$7.00 and hour and can increase to a maximum of \$12.65 an hour, while DLC liquor store clerks start at \$9.61 an hour and can increase to a maximum of \$16.77 an hour. One Washington area trucking company surveyed starts its drivers at \$11.60 an hour with increases up to \$13.55 an hour. Driver of DLC trucks start at \$10.43 but can go has high as \$16.77 an hour. These figures suggest that the use of contractors could lower personnel costs.

[1] Liquor includes distilled spirits, cordials, etc.

A review of DLC's 1990 financial performance indicates that the current level of surplus revenues generated from the alcoholic beverages sold through DLC's retail operations could be increased. Exhibit 1.1. shows that the Department made a greater return on merchandise sold through its wholesale operations (12.3 percent) than it did on merchandise sold through its retail operations (6.6 percent). These figures imply that retail operations reduce the overall profitability of the DLC operation. If all of the liquor that was sold through both the warehouse and retail stores in 1990 were sold through the warehouse only, DLC would have increased surplus revenue contributed to the general fund by an estimated $3.0 million.

Survey of Control Jurisdictions

Surveys were sent to the 18 other control jurisdictions to obtain information on their experiences with contracting and privatizing various liquor control functions. The survey requested that each jurisdiction indicate how it warehouses, distributes, and retails alcoholic beverages. The goal of the survey was to identify which functions tend to be contracted or privatized by other jurisdictions, and whether or not those jurisdictions have benefitted from the decision to make greater use of private sector resources.

Survey results were received from all 18 jurisdictions. The survey yielded the following results:

- **Alcoholic beverage warehouses are generally owned by the jurisdiction.** In 10 of the other control jurisdictions, the jurisdiction owns all the warehouses for controlled alcoholic beverages, in 5 jurisdictions, the private sector owns the warehouses, and in 3 jurisdictions the responsibility is shared between the jurisdiction and the private sector.

- **Alcoholic beverage warehouse operations are generally performed by the jurisdiction.** In 13 of the other control jurisdictions, the jurisdiction operates the warehouses with public employees, in 4 jurisdictions contractors operate the warehouses, and in 1 jurisdiction the responsibility is shared between the jurisdiction and a contractor.

- **Distribution of alcoholic beverages is generally performed by the private sector.** In 9 of the other control jurisdictions, distribution is handled by a common carrier, a contractor, licensees[2], or some combination of the three. In 2 jurisdictions distribution is handled by the jurisdiction, and in 7 jurisdictions it is shared between the jurisdiction and the private sector.

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[2] Licensee involvement in distribution of alcoholic beverages generally means that a licensee picks up its own supply from the warehouse or stores.

Exhibit 1.1
Analysis of Surplus Revenue
Generated by Wholesale and Retail Operations

	Fiscal Year 1990 Actual Expenditures		
	Wholesale	**Retail**	**Total**
Net Sales	$63,802,072 (1)	$35,438,411	$99,240,483
Cost of Goods Sold	49,099,705	24,312,334	73,412,039
Gross profit from sales	14,702,367	11,126,077	25,828,444
Operating Expenses	6,356,614	8,607,285	14,963,899
Depreciation	507,173	176,994	684,167
Net Operating Income	7,838,580	2,341,798	10,180,378
Other Income (2)	35,986	19,987	55,973
Other Expense (3)	15,814	7,830	23,644
Surplus Revenue for General Fund	7,858,752	2,353,955	10,212,707
Surplus Revenue as a Percentage of Net Sales	**12.3%**	**6.6%**	**10.3%**

Source: Montgomery County Recommended Fiscal Year 92 Budget

(1) "Net Sales" equals gross sales plus beverage container tax minus discounts.
(2) "Other Income" includes investment income and miscellaneous income.
(3) "Other Expenses" includes interest on bonds

- **Retail sale of alcoholic beverages is generally handled by both the public and private sectors.** In 8 of the other control jurisdictions, licensees, agents[3], and publicly operated stores sell alcoholic beverages. The beverages with higher alcoholic content (liquor) are usually sold in publicly operated stores, while licensees handle beer and wine. In 5 jurisdictions, retail operations are privatized.

Most control jurisdictions own and operate their own warehouse facility, and rely heavily on the private sector for distribution and retail sales. Many jurisdictions use agents to sell alcoholic beverages at the retail level. Montgomery County differs from most jurisdictions in that the County uses public employees to handle distribution, and it has an exclusive monopoly on the sale of liquor (it does not use agents to assist with retail sales). Exhibit 1.2 summarizes how functions are performed in other jurisdictions.

The survey results indicate that nine different jurisdictions have contracted or privatized various functions over the past 15 years.

- Three jurisdictions contracted their warehouse operations: Maine (1984), Ohio (1983), and North Carolina (1976)
- One jurisdiction increased contracting in the area of distribution: Oregon (1976)
- Three jurisdictions privatized all retail operations: West Virginia (1990), Michigan (1989), and Iowa (1987)
- Two jurisdictions contract for retail stores when surplus revenue generated by the store falls below a certain level: Idaho (since 1971), and Montana (since 1975)

Information on the cost savings generated by privatizing alcoholic beverage control functions is available for Iowa. According to figures from the Iowa Department of Commerce, eliminating state operated retail stores caused surplus revenues generated by the sale of alcoholic beverages to increase by over 50 percent in 1990. Exhibit 1.3 shows surplus revenue generated from 1988 to 1990 as a result of the privatization of Iowa retail stores.

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[3] The term "agent" is used here and throughout this report to denote a vendor that sells alcoholic beverages on behalf of a control jurisdiction. Exclusive agents sell only alcoholic beverages and possibly some related items. Using an exclusive agent to sell alcoholic beverages is virtually the same as contracting for retail operations. Non-exclusive agents sell alcoholic beverages in addition to other merchandise. The agent provides the facility, whether exclusive or non-exclusive, and the jurisdiction provides the alcoholic beverage inventory. The agent receives a portion of the revenue generated.

Exhibit 1.2
Summary of Public/Private Functions by Control Jurisdiction

Jurisdiction	Warehouse Ownership	Warehouse Operations	Distribution(1) from Warehouse	Retail
Montgomery County	Public	Public/Private (2)	Public	Public/Licensee
Alabama	Private	Public	Public/Private	Public
Idaho	Private	Public	Public/Private	Public/Licensee/Agent
Iowa	Public	Public	Public	Licensee
Maine	Private	Private	Public/Private	Public/Licensee/Agent
Michigan	Public/Private (3)	Public	Public/Private	Licensee
Mississippi	Public	Public	Private	Licensee
Montana	Public	Public	Private	Public/Licensee/Agent
New Hampshire	Public/Private (4)	Public/Private (4)	Public/Private	Public/Licensee
North Carolina	Public	Private	Private	Public/Licensee
Ohio	Private	Private	Private	Public/Licensee/Agent
Oregon	Public	Public	Public/Private	Public/Licensee/Agent
Pennsylvania	Public/Private (5)	Private	Private	Public/Licensee
Utah	Public	Public	Public	Public/Licensee/Agent
Vermont	Public	Public	Private	Public/Licensee/Agent
Virginia	Public	Public	Private	Public/Licensee
Washington	Public	Public	Private	Public/Licensee/Agent
West Virginia	Private	Public	Private	Licensee
Wyoming	Public	Public	Public/Private	Licensee
Total for Other Jurisdictions				
Public	10	13	2	1
Private	5	4	9	NA
Public/Private	3	1	7	NA
Licensee	NA	NA	NA	5
Public/Licensee	NA	NA	NA	4
Public/Licensee/Agent	NA	NA	NA	8

Source: KPMG Peat Marwick Survey of Alcoholic Beverage Control Jurisdictions, July 1991.

(1) "Private" distributors include contractors, licensees, and common carriers.
(2) Montgomery County uses a contractor to load beer for distribution to licensees and County stores.
(3) Michigan has three major warehouses and 73 mini-warehouses, two of the major warehouses and the 73 mini-warehouses are owned by the State; one warehouse is owned privately.
(4) New Hampshire has two warehouses, one owned and operated by the state and one owned and operated by the private sector.
(5) Pennsylvania has three warehouses, one owned by the state and two owned privately.
NA = Not applicable

Exhibit 1.3
Privatization of Iowa Retail Stores

	1988		1989		1990	
	Actual Results	**If State had Retail Stores**	**Actual Results**	**If State had Retail Stores**	**Actual Results**	**If State had Retail Stores**
Sales	$78,396,130	$91,984,791	$77,716,935	$91,187,870	$78,330,490	$91,081,459
Cost of Goods Sold	52,264,086	52,264,086	51,811,290	51,811,290	51,750,829	51,750,829
Gross Profit	26,132,044	39,720,705	25,905,645	39,376,580	26,579,661	39,330,630
Operating Expense (1)	4,023,246	21,566,855	4,207,205	22,645,198	4,720,337	23,777,458
Net Profit	22,108,798	18,153,850	21,698,440	16,731,382	21,859,324	15,553,172
Plus Class E License Fee	1,773,925	0	1,770,500	0	1,726,750	0
Total Revenue	23,882,723	18,153,850	23,468,940	16,731,382	23,586,074	15,553,172
Absolute Increase in Surplus Revenue	**5,728,873**		**6,737,558**		**8,032,902**	
Percent Increase in Surplus Revenue	**31.6%**		**40.3%**		**51.6%**	

Source: Iowa Department of Commerce, Alcoholic Beverages Division Reports for 1988, 1989, 1990.

(1) Operating expense for the "state had retail store" scenario is derived from the Division's FY86 budget appropriation, with a 5% adjustment for inflation.

Contractible Functions for the Department of Liquor Control
Contracting options, privatization, and one organizational option for DLC are assessed in this section. The options are:

- Contract warehouse operations
- Contract distribution
- Contract retail liquor operations
- Privatize all or part of DLC operations
- Change DLC to an independent authority

These alternatives were evaluated using the following criteria:

- Effective control
- Adequate service
- Surplus revenue
- Applicability to Montgomery County
- Implementation

Conclusions
Under the contracting options, the County can maintain effective control, adequate levels of service, and potentially increase surplus revenues through lowering costs. The contracting options are applicable to Montgomery County and could be implemented if phased in over time. Privatization of the warehouse would likely reduce surplus revenue to the County. Privatization of retail operations would probably increase surplus revenue, but would reduce effective control over the sale of liquor at the retail level. Creating an authority would retain government control over the wholesale, distribution, and sale of alcoholic beverages, but would diminish the Council's and the Executive Branch's control over those operations. In addition, creating an authority would require a change in Maryland State Law.

Contract Warehouse Operations Contracting for warehouse operations is a feasible option for Montgomery County, but may be more difficult to carry out than other contracting options. Although specific dollar savings have not been reported by other jurisdictions that have contracted warehouse operations, North Carolina indicates that it has realized a savings as a result of its decision to contract its warehouse operations in 1976. Iowa, in an effort to reduce operating expenditures, is in the process of contracting its warehouse operations. Contracting this function could be phased in by using a contractor for the loading function on the liquor/wine side of the warehouse. Contracting for other parts of warehouse operations could follow. Because a limited number of qualified contractors may be willing to bid on operating the warehouse, this option may be difficult to implement.

Contract Distribution Contracting for distribution of alcoholic beverages from the warehouse to retail outlets a feasible contracting option for the County. Comparison of the range of wage rates for drivers suggest that savings could be realized from contracting or privatizing distribution. Most control jurisdictions use private companies to distribute alcoholic beverages to retail stores. Because Montgomery County is part of a large metropolitan area, many trucking companies are potentially available to serve the distribution needs of DLC. To minimize any disruption caused by contracting this function, a private contractor could deliver kegs initially, then deliver kegs and beer, and finally deliver kegs, beer, and wine and liquor.

Contract Retail Operations Contracting for retail operations is the most feasible option for the County to consider. Indications from wage comparisons and financial performance of DLC suggests that the retail operations could generate additional surplus if made to operate more cost-effectively. To avoid layoffs that could result from contracting retail operations, the County could phase in contracted stores consistent with the attrition rate of County liquor store clerks[4]. To make the transition to contract stores more quickly, the County could transfer employees at County liquor stores to other positions in DLC or in other parts of County government or negotiate with the contractor to hire County employees displaced by the contract.

Privatize All or Part of DLC Operations Privatizing all DLC operations does not appear to be consistent with Montgomery County's policy toward liquor control. Other control jurisdictions have privatized retail and distribution as cost saving measures but not the warehouse. It is possible that Montgomery County would reduce operating expenditures by privatizing distribution and retail functions, but such options would likely reduce County control over the sale and distribution of alcoholic beverages in the County - especially control over retail liquor sales.

Change DLC to an Independent Authority Changing DLC to an authority, while not a contracting option per se, could potentially increase the net revenue generated by DLC operations. DLC operations are unique among County functions and much in the County's personnel system is not appropriate for the classification of employees used by DLC. If an independent authority, DLC could devise its own personnel system suited to its needs. Presumably such a system would include wages that reflect the market wages for warehouse

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[4] According to the Montgomery County Personnel Management Review, March 1991, the attrition rate for Montgomery County employees during fiscal year 1990 was 6.85 percent.

workers, drivers, and retail clerks. The current DLC entry level wages for these positions are generally above the market level. If personnel expenditures were reduced under an authority, the DLC operation would be able to increase surplus revenue.

If DLC were an authority, the County would have only indirect influence over internal expenditure decisions by the authority which could affect the amount of surplus revenue generated by the DLC. Currently, DLC generates about $10 million a year in surplus revenues for the County. The County's direct control and influence over that $10 million would diminish under an authority.

CONTENTS

INTRODUCTION

This section provides the background, objective, and approach used for the study.

Background

State Law established a Liquor Control Board for Montgomery County in December 1933, shortly after the end of nationwide prohibition. State Law gave the Liquor Control Board the responsibility to:

- Issue all beer, wine, and liquor[5] (by the drink) licenses to establishments operating in the County
- Sell all alcoholic beverages to licensees operating in the County - wholesale
- Sell all liquor in the County for off-premises consumption - retail

Having these responsibilities, gave the County a monopoly on the wholesale of alcoholic beverages in the County, and a monopoly on the retail of liquor for off-premises consumption.

In 1951, the State of Maryland passed a law creating the Montgomery County Department of Liquor Control (DLC) and the Board of License Commissioners. The Department assumed the monopoly powers of the former Liquor Control Board, while the Board of License Commissioners assumed the licensing authority of the former Liquor Control Board. In the early 1980s State Law established criteria for an advisory board for Montgomery County to report to the County Executive at least quarterly on recommendations for the improvement of alcoholic beverage control and enforcement activities of the County and the operations of DLC.

Montgomery County and Utah are the only jurisdictions in the United States that control the wholesale, distribution, and retail of beer, wine, and liquor. The County operation has a larger volume of sales than many of the 18 other control jurisdictions that have analogous liquor control systems.[6] The three objectives of the County's monopoly system for the distribution and sale of alcoholic beverages are: (1) effective control, (2) adequate service to the public and licensees, and (3) provision of general fund revenue to the County.

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[5] Liquor includes distilled spirits, cordials, etc.

[6] The eighteen control states are: Alabama, Idaho, Iowa, Maine, Michigan, Mississippi, Montana, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming.

Department of Liquor Control Under County Code, DLC is the sole authorized wholesaler of alcoholic beverages in the County. Wholesale service is provided to a wide variety of licensees including wine and cheese stores, beer-wine carryouts, restaurants, hotels, country clubs, and grocery stores.

The County is the sole authorized retailer of liquor for off-premises consumption. Because the County sells beer and wine along with liquor at its 22 retail stores[7], the DLC competes with privately owned businesses licensed by the County for the retail sale of beer and wine. It should be noted that most wine and cheese stores and other beer and wine retail establishments came into existence well after DLC was formed.

The DLC operates as a department within County government reporting to the Chief Administrative Officer of the County. It is subject to County administrative policies such as: procurement, personnel, financial management, and budgeting. DLC employees are part of the County personnel merit system.

Board of License Commissioners The Board of License Commissioners issues licenses for retail and restaurant (by the drink) sale of alcoholic beverages independent of the DLC. For administrative purposes, the Board reports directly to the Chief Administrative Officer. The Board consists of five members, appointed by the County Executive and subject to confirmation by the County Council. It is charged with approval, denial, revocation, suspension, and reclassification of alcoholic beverage licenses. The Board coordinates its activities with those of the Health Department and the Police Department to ensure that establishments that serve alcoholic beverages are operated in a lawful manner.

Community Views about Liquor Control The issue of liquor control is subject to many different views in the County. Some believe the County should be out of the business completely, while others favor maintaining existing controls. Some residents recommend contracting out portions of DLC, as a cost-effective way to maintain County control.

The County is pressured by alcoholic beverage related businesses to loosen its control over liquor. These businesses, which include wholesalers, distributors, and retailers, believe that the private sector is more responsive to the market and can serve the consumer better and more efficiently. These businesses stand to gain a larger share of the revenues generated by alcoholic beverage sales in the County if the County were to get out of the liquor business.

On the other hand, the County is pressured by civic groups that are concerned about the number of liquor stores in the County, their hours of operation, and the use of advertising for liquor. Such groups include Mothers Against Drunk Driving (MADD), Students Against Drunk Driving (SADD), local churches, and other community-based organizations. Those

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[7] The County is budgeted to operate 22 retail stores for fiscal year 1992.

interviewed for this study perceive that many County residents and County officials believe the County government should continue to maintain a strong role in the distribution and sale of alcoholic beverages.

Montgomery County Philosophy for Liquor Control A 1982 report by the Task Force to Consider Government Philosophy for Liquor Control identified three objectives for liquor control: effective control, adequate service, and surplus revenue for the general fund. The report noted that costs might be reduced by the use of private contractors for selected units of DLC operations. At the time, the County had just begun to use contractors to load trucks at night for next day delivery. The report expected the County to benefit from contracting the loading operation but indicated that larger benefits could potentially be achieved if contracting were expanded to include operation of the entire warehouse, distribution, or retail operations.

The report cautioned that any effort to use private contractors for DLC functions should consider the effect of a transition to a contractor with respect to County employees whose jobs would be affected by the change.

Objective

The objective of this study is to identify those areas of the DLC operation that have potential to generate cost savings that would translate into increased revenues for transfer to the County's general fund. The potential applicability of contracting and privatization strategies to achieve cost savings is the focus of this study. This study reviews alternative methods employed by other jurisdictions to accomplish warehouse, distribution, and retail functions similar to those currently being performed directly by DLC.

This study recognizes that the County intends to continue regulating and controlling the wholesale distribution of all alcoholic beverages and the retail sale of liquor by the bottle. For this study, privatization entails the transfer of responsibility for DLC functions to the private sector without the benefit of a contract between the private entities and the government. Consistent with the County's current policy regarding the control of alcoholic beverages in the County, this study gives greater consideration to contracting rather than to privatization.

Approach

The approach for this study consisted of the following:

- Reviewed documentation, previous reports, and surveys regarding DLC and other control agencies

- Interviewed selected County and DLC officials to identify potential cost savings and revenue enhancements

- Conducted field visit to DLC facilities

- Contacted National Alcoholic Beverage Control Association to obtain latest available information on the use of contracting or privatization in other jurisdictions

- Prepared a questionnaire for distribution to all control jurisdictions to confirm/identify:

    - Operations/functions contracted or privatized
    - Types of agreements made with private firms
    - Advantages and disadvantages of such arrangements
    - Costs savings and/or revenue increases realized
    - Implementation and operational problems encountered
    - Suggestions for County consideration

- Summarized survey responses and conducted required follow-up by telephone

- Identified potential contracting strategies and documented their advantages and disadvantages and potential applicability to Montgomery County

This analysis does not measure the benefits and costs of any of the contracting or privatization options. The evaluations are generally qualitative rather than quantitative, although some indicators of the revenue effect of various options were obtained such as: starting salaries for comparable private sector employment, savings reported by other jurisdictions, and a review of DLC's fiscal year 1990 financial performance. This evaluation is intended to assist the County in deciding whether to proceed with the development of an implementation plan for one or more contracting or privatization options discussed herein.

CONTENTS

DEPARTMENT OF LIQUOR CONTROL OPERATIONS AND FINANCES IN MONTGOMERY COUNTY

This section describes the organizational structure, legal issues affecting liquor control, contractible functions, summary of interviews with Department of Liquor Control (DLC) managers, and surplus revenue generated by DLC. The discussion of surplus revenue compares surplus revenue generated by wholesale and retail sales and estimates the potential increase in surplus revenue assuming a normal wholesale markup on alcoholic beverages sold in County stores.

Organizational Structure

The Department of Liquor Control functions as a department of the Montgomery County government. The Director of DLC reports to the County Administrator as do other departments in the County government. The organizational structure is shown in Exhibit 3.1.

The Department is composed of four divisions. They are:

- Office of the Director
- Financial and Systems Management
- Wholesale Operations
- Retail Operations

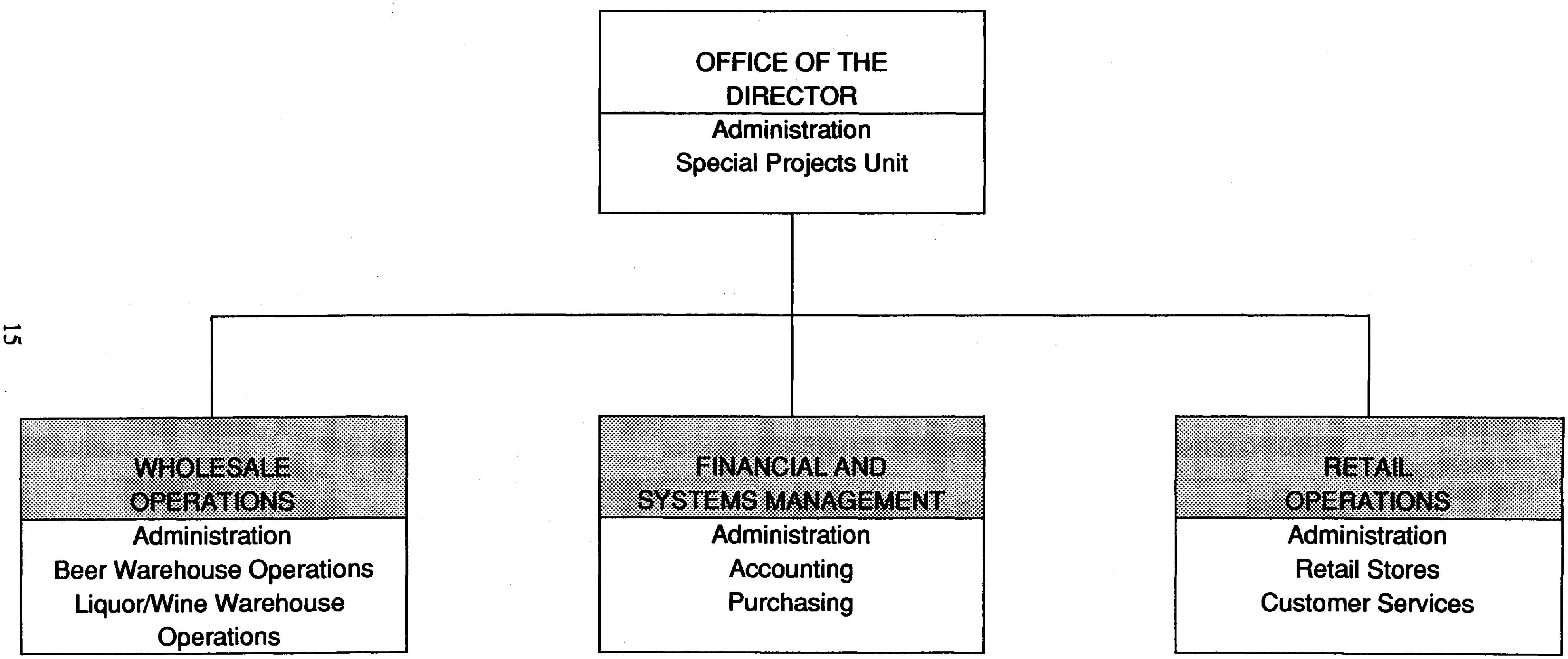
For fiscal year 1992, Montgomery County operates one warehouse and 22 retail stores. The Office and Divisions of DLC are housed in the same building as the warehouse. The 22 stores are located throughout the County.

Office of the Director For fiscal year 1992, the Office of the Director is budgeted for 11 full-time staff. The Office is responsible for overall direction and guidance of DLC operations. Functions within the Office of the Director include: central administration, data processing support, and office services.

Division of Financial and Systems Management The Division of Financial and Systems Management has 19 full-time and 2 part-time staff for fiscal year 1992. The Division prepares the annual budget and manages the financial operations of the Department. Organizational units within Finance and Administration include: accounting, purchasing, and cashiering.

Division of Wholesale Operations The Division of Wholesale Operations includes 128 full-time staff for fiscal year 1992. The Division is responsible for warehouse operations and fleet administration. Functions within Wholesale Operations include: receiving, storing, moving and loading, and distribution of goods.

Exhibit 3.1
Organization Structure for
Department of Liquor Control



Division of Retail Operations For fiscal year 1992, the Division of Retail Operations has 78 full-time, 27 part-time, and 68 substitute staff. Most of the staff in this division are located in the stores, but administrative staff are located in the central office. Functions within Retail Operations include: merchandising, customer service, and retail stores.

Legal Issues Affecting Liquor Control in Montgomery County

A 1958 federal court injunction against selected retailer associations, wholesalers, and manufacturers of alcoholic beverages is the major legal issue for alcoholic beverage sales in Montgomery County.

In 1958, the U.S. District Court in Maryland enjoined selected alcoholic beverage manufacturers, wholesalers, and retailer associations from fixing the price at which liquor is sold to consumers in Maryland. The Court found that manufacturers, wholesalers, and retailers had conspired to refuse to sell alcoholic beverages to monopoly counties in Maryland at prices less than their customary prices for retailers. For the past 33 years, Montgomery County has benefitted from this injunction by buying directly from the manufacturer at the same price paid by other wholesalers without the threat of having to purchase merchandise at the price paid by retailers.

The Justice Department is now considering whether or not to lift the injunction, citing concerns about restraint of trade. If this injunction is lifted, DLC officials believe that it could have major ramifications for the level of revenue generated through the County's operations. If the injunction is lifted, the County may be forced to buy alcoholic beverages from other wholesalers or exclusive distributors at a price higher than what it now pays. Under these circumstances, a case of liquor would cost the County roughly the same amount it now charges licensees to purchase that same case. The difference between what the County pays for a case of alcoholic beverages and what it sells that case for is primary source of the annual surplus generated by DLC.

Contractible Functions within DLC Operations

The County owns and operates one warehouse, through which all alcoholic beverages sold in the County pass, and leases 22 retail outlets that sell liquor, wine, and beer. DLC receives alcoholic beverages coming into the County and stores them until they are shipped to County-owned retail stores or businesses licensed to sell alcoholic beverages in the County. The warehouse storage area is about 140,000 square feet and is physically divided into a beer section and a liquor and wine section. The warehouse allows separate flow and control of liquor/wine products from beer products.

For the purposes of analyzing contracting options, DLC's operations can be divided into the following discrete functions:

- Receiving
- Loading
- Distribution
- Retailing

Receiving, loading, and distribution are carried out separately for the beer side of the warehouse and for the liquor/wine side of the warehouse.

Two shifts work in each warehouse section. Receiving and distribution occur during the first shift, and loading of trucks for distribution the next day occurs during the second shift. The first shift for both sides of the warehouse begins at 7:30 a.m. and ends at 4:00 p.m. The second shift for the liquor/wine side is from 10:00 a.m. to 5:30 p.m. On the beer side, the second shift starts at 4:00 p.m.

Receiving The Department of Liquor Control receives all incoming goods by rail or truck. County staff unload rail cars and trucks with forklifts and place the goods in the warehouse receiving area. After the count is verified, goods are moved to their assigned location in the warehouse. For fiscal year 1992, about 5 positions are assigned to this area. The exact number of positions assigned can vary from day to day based on the workload.

According to a recent Office of Legislative Oversight (OLO) study of the DLC warehouse operations, on average, six rail cars with liquor and wine and 10 rail cars with beer are received by the warehouse each month. That same study indicates that the liquor/wine section unloads six truck loads of regular stock and four truck loads of special order goods daily. DLC unloads an average of nine truck loads of beer products each working day.

DLC has always performed the receiving function with County staff.

Loading The Department of Liquor Control loads all goods onto DLC trucks to be delivered to licensees and to County-stores. County staff are used on the liquor/wine side, while a contractor is used to load on the beer side. For fiscal year 1992, 26 full-time positions are assigned to this function on the liquor/wine side. A contract crew of 13 to 26 persons perform this function on the beer side.

On the liquor/wine side of the warehouse, DLC uses two daytime crews (first shift and second shift) to pick, move and load goods for distribution. According to 1990 sales data from DLC, the average daily volume of liquor and wine cases loaded is over 3,000, and the average daily volume of beer cases is over 14,000.

In 1981, the County began contracting for both the liquor/wine loading and the beer loading. According to DLC officials, the contract for loading on the liquor/wine was discontinued in 1988 owing to high breakage rates and concerns over pilferage. DLC still uses a contractor for beer loading.

Distribution Except for a few small orders picked up at the warehouse by licensees, DLC transports all the alcoholic beverages sold in the County from the warehouse to their final point of sale. For fiscal year 1992, 90 full-time positions, including equipment operators and other warehouse workers are assigned to the distribution function. Truck driver and driver helper positions are classified such that they can also perform the duties of warehouse workers and helpers.

On average 32 vehicles are in operation each day. According to the OLO report, on a typical day, DLC uses 8 trucks to deliver liquor and wine, 20 vehicles to deliver case beer, and 4 vehicles to deliver keg beer.

DLC has always performed the distribution function with County staff.

Retailing The Department of Liquor Control operates 22 retail stores in Montgomery County. Legally these retail outlets are viewed as dispensaries for the warehouse. County stores are the only retail stores in the County that sell liquor by the bottle. For fiscal year 1992, 81 full-time and 32 part-time positions are assigned to retail operations, 5 full-time and 5 part-time positions are in administration - located at DLC headquarters - and 75 full-time, 27 part-time, and 68 substitute positions are located at the retail stores.

In 1990, DLC transferred over 550,000 cases of liquor, wine, and beer from its warehouse to 24 retail stores. Currently, most of the retail stores are open 6 days a week from 10:00 a.m. to 9:00 p.m. and closed on County holidays. A few stores open at 12 noon and close at 8:00 p.m. The County stores have no competition in the sale of liquor, however, they compete with licensees that sell wine and beer. In beer sales, the County stores are less competitive because DLC has chosen not to sell cold beer.

DLC has always performed this function with County staff.

Summary of Interviews with Department Managers

During the course of this study, we interviewed DLC's top managers to obtain their perspective on the advantages and disadvantages of contracting DLC functions. In general, DLC managers believe that contracting may reduce expenditures in the short-run, but contracting in their opinion reduces the County's ability to manage the day to day wholesale, distribution, and retail of alcoholic beverages and as a result may be less effective in the long-run. DLC managers interviewed supported the use of agents to improve DLC operations and financial performance. Specific issues noted by DLC managers are listed below:

- Use of agents to assist in the retail of liquor by the bottle could enhance County revenues, and improve service to parts of the County.

- The cost of beer loading (which is performed by a contractor) is about 12 percent less per case than the cost of liquor/wine loading (which is performed by County employees). The difference in loading cost per case has narrowed over the past several years with each contract renegotiation. DLC officials expect that the difference between the loading costs on the beer side of the warehouse and the liquor/wine side of the warehouse could diminish further with future contract negotiations.

- Contractors could hire employees at wage levels lower than those now paid to DLC employees thereby increasing surplus revenues to the general fund.

- Retail contractors hired to operate the County's 22 stores would buy liquor at normal wholesale markup price, potentially increasing surplus revenues by over $2.5 million a year.

- Being motivated by profit, a retail contractor may be less inclined to require a customer's identification before making a sale. The result could be increased sales of alcoholic beverages to minors.

- Choices offered to the consumer may be reduced if County liquor stores are operated by a contractor. Retail contractors are likely to stock only the most popular brands.

- For some functions, there is a limited number of qualified contractors willing to offer a bid to contract DLC functions (e.g., warehouse operations and liquor/wine loading).

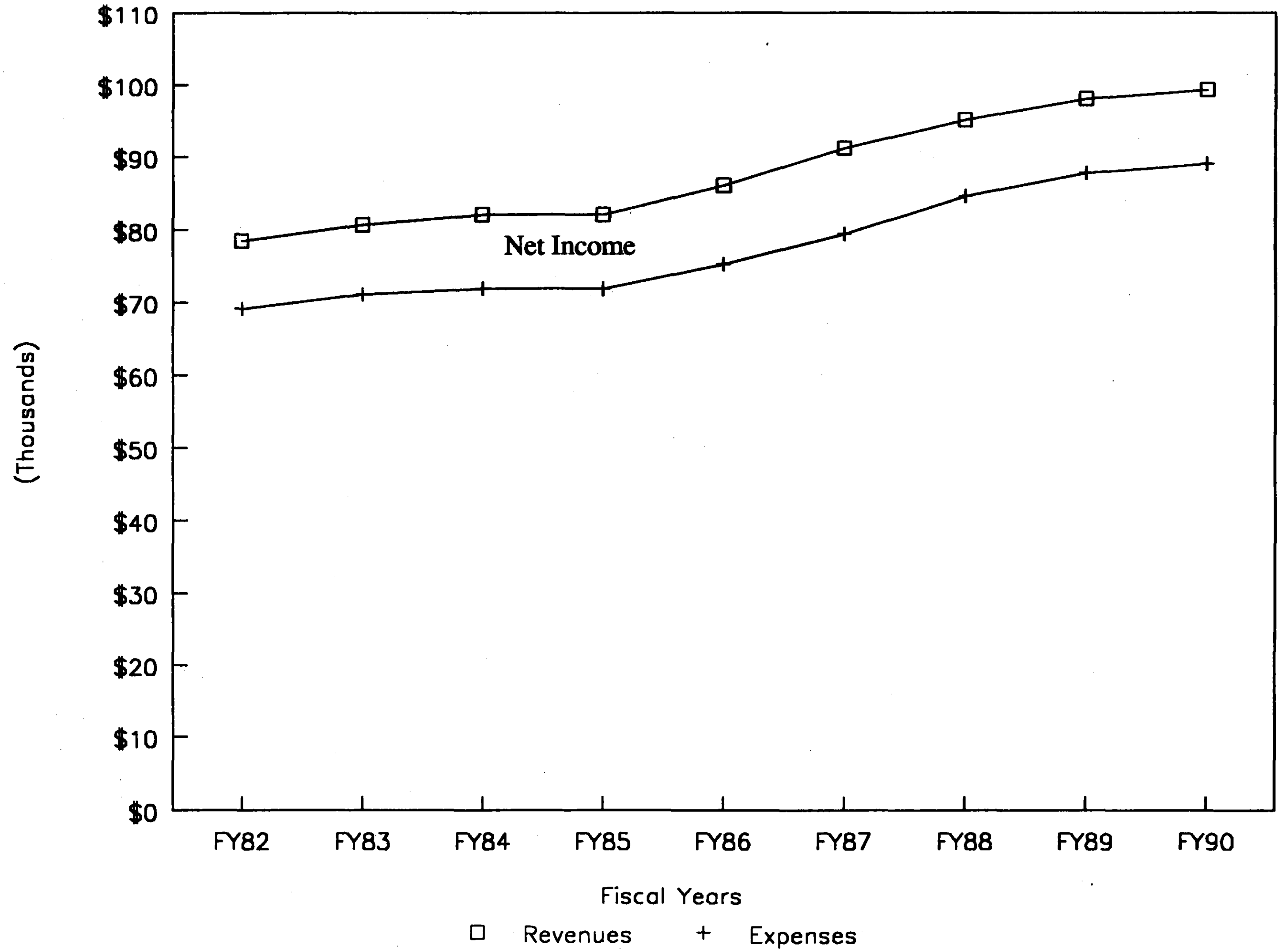
- Informal reports from other states indicate that with use of contractor for distribution, breakage and theft go up.

Generally, the managers at DLC do not support contracting as an effective way to improve DLC operations. Rather than contracting, the managers at DLC believe that the County can improve DLC operations by making the agency an independent authority.

Surplus Revenue

One of the objectives of County control of the sale and distribution of alcoholic beverages in the County is the generation of surplus revenue for the general fund. The Department of Liquor control has annually contributed about 10 percent of the value of its sales to the general fund. Exhibit 3.2 shows that the relationship between expenses and revenues for DLC has remained relatively constant over the period 1982 to 1990. This section discusses DLC as a surplus revenue generating enterprise and compares the surplus revenue generated through wholesale operations with the surplus revenue generated through retail operations.

Exhibit 3.2
Historical Revenues and Expenses for
Department of Liquor Control



Department revenues are generated through sales at the wholesale and retail levels. At the wholesale level, the Department sells beer, wine, and liquor to licensees. It sells beer, wine, and liquor to the public at its 22 retail stores. These sales, and investment income, are the primary sources of revenue generated by DLC operations.

Department costs are incurred through the purchase of alcoholic beverages (generally from the manufacturer) and operating expenses. For the purposes of this analysis, operating expenses are divided into three major areas: administration, wholesale (which includes distribution) and retail. Administrative expenses are allocated by DLC to wholesale and retail activities.

Exhibit 3.3 compares the surplus revenue generated by the wholesale operations with the surplus revenue generated by the retail operations. The table shows that surplus revenue as a percent of wholesale sales (12.3 percent) is nearly twice as large as surplus revenue as a percent of retail sales (6.6 percent). The disparity between the two suggests that perhaps more surplus revenue could be generated from the retail operations than is currently being generated. If the surplus revenue as a percent of retail sales equaled surplus revenue as a percent of wholesale sales, DLC surplus revenue for fiscal year 1990 would increase by $1.9 million.

Exhibit 3.4 provides one example of how much in additional surplus revenue the County could be increased. If retail operations were privatized, surplus revenue generated by DLC operations could increase by an estimated $3.0 million in fiscal year 1990.

Factors contributing to the relatively low net revenue generated by County retail facilities include:

- Classification and salary level for DLC liquor retail clerks is higher than comparable private sector positions
- Retail operating policies restrict the sale of cold beer, ice, cigarettes, and other high margin convenience items at County liquor stores
- The County owns the warehouse, while it leases its retail facilities
- County policy favors reduced advertising and limited marketing of liquor

DLC officials suggest that surplus revenues could be gained by closing smaller less profitable stores and consolidating them into larger existing stores. Contracting options that might address these issues are discussed in section 5 of this report.

Exhibit 3.3
Analysis of Surplus Revenue
Generated by Wholesale and Retail Operations

	Fiscal Year 1990 Actual Expenditures		
	Wholesale	**Retail**	**Total**
Net Sales	$63,802,072 (1)	$35,438,411	$99,240,483
Cost of Goods Sold	49,099,705	24,312,334 (2)	73,412,039
Gross profit from sales	14,702,367	11,126,077	25,828,444
Less: Operating Expense	6,356,614	8,607,285	14,963,899
Depreciation	507,173	176,994	684,167
Net Operating Income	7,838,580	2,341,798	10,180,378
Plus: Other Income (3)	35,986	19,987	55,973
Less: Other Expense (4)	15,814	7,830	23,644
Surplus Revenue for General Fund	7,858,752	2,353,955	10,212,707
Surplus Revenue as a Percentage of Net Sales	**12.3%**	**6.6%**	**10.3%**

Source: Montgomery County Recommended Fiscal Year 92 Budget

(1) "Net Sales" equals gross sales plus beverage container tax minus discounts.
(2) Figure does not include a wholesale markup.
(3) "Other Income" includes investment income and miscellaneous income.
(4) "Other Expenses" includes interest on bonds

Exhibit 3.4
Illustrative Schedule of 1990 Income and Expenses
Assuming All Alcoholic Beverages were Sold at Wholesale

	FY90 Actual		FY90 Illustrative	
Net Sales:				
Warehouse	$63,802,072		$63,802,072	
Retail Stores	35,438,411	(1)	29,904,171	(2)
Total Net Sales	99,240,483		93,706,243	
Cost of goods sold	(73,412,039)		(73,412,039)	
Gross Operating Profit	25,828,444		20,294,204	
Less:				
Operating Expenses - Warehouse	(6,356,614)		(6,356,614)	
Operating Expenses - Retail	(8,607,285)		0	(3)
Depreciation	(684,167)		(684,167)	
Other Expenses	(23,644)		(23,644)	
Plus:				
Other Income	55,973		55,973	
Net Income	**$10,212,707**		**$13,285,752**	
Additional Surplus Revenue			**$3,073,045**	

Source: Fiscal year 1990 figures are from Montgomery County Recommended Fiscal Year 92 Budget.

(1) Figure includes DLC retail markup of about 46 percent.
(2) Figure includes wholesale markup of 23 percent.
(3) Under this hypothetical scenario, retail liquor stores are privatized, therefore retail operating expenses would equal zero (0).

CONTENTS

CONTRACTING AND PRIVATIZATION EXPERIENCE IN OTHER CONTROL JURISDICTIONS

This section summarizes the results from a survey of other control jurisdictions concerning use of contracting and privatization to handle the wholesale, distribution and retail of alcoholic beverages. All 18 other control jurisdictions completed the survey. Montgomery County completed a survey which is used for comparison purposes. A copy of the survey is included in Appendix 1.

The survey results are presented in the following four sections:

- Warehouse ownership
- Warehouse operations (including receiving, storing, picking, and loading)
- Distribution
- Retail

Some jurisdictions responded to the request for sample contracts and for studies verifying savings resulting from contracting or privatization. Each section discusses the advantages and disadvantages of contractor agreements and the level of savings achieved through contracting where such information is available. Each section also indicates whether any implementation problems were encountered by jurisdictions in contracting or privatizing any portion of its alcoholic beverage control operations.

Warehouse Ownership

The 18 respondents use a total of 26[8] warehouses in their respective jurisdictions. Of these, 12 are owned by private interests and leased by the jurisdiction, while 14 are owned publicly. Ownership of alcoholic beverage warehouses by control jurisdictions is shown in Exhibit 4.1.

Advantages of leasing warehouse facilities from private interests as indicated from the survey responses include:

- Avoids the need for a large capital investment
- Avoids costs and staff for maintenance and upkeep
- Allows flexibility to change locations in response to changes in contract operators, demand, and in real estate markets

[8] This number does not include 73 mini-warehouses used by the State of Michigan.

Exhibit 4.1
Alcoholic Beverage Warehouse Ownership by Control Jurisdiction

	Number of Warehouses Owned by:		
Jurisdiction	**Jurisdiction**	**Contractor**	**Total**
Montgomery County	1	0	1
Alabama	0	1	1
Idaho	0	1	1
Iowa	1	0	1
Maine	0	1	1
Michigan	2	1	3
Mississippi	1	0	1
Montana	1	0	1
New Hampshire	1	1	2
North Carolina	1	0	1
Ohio	0	4	4
Oregon	1	0	1
Pennsylvania	1	2	3
Utah	1	0	1
Vermont	1	0	1
Virginia	1	0	1
Washington	1	0	1
West Virginia	0	1	1
Wyoming	1	0	1
Total for Other Jurisdictions	14	12	26

Source: KPMG Peat Marwick Survey of Alcoholic Beverage Control Jurisdictions, July 1991.

(1) Michigan has 73 mini-warehouses in addition to its three major warehouses.

- Frees assets for other state capital investments

Disadvantages of leasing a warehouse as indicated by survey responses include:

- Location of warehouse may need to change at the end of the lease

- Transition costs and disruption of service could occur with the change in leased facilities

- In the long-run, the cost of leasing a warehouse is greater than the cost of owning it

None of the jurisdictions surveyed have changed ownership of their warehouse in the recent past and none indicate that they are considering leasing warehouse facilities in addition to or as a substitute for warehouse facilities owned by the jurisdiction. Consequently, no leasing agreements were made available for this study, and no jurisdictions report any cost savings associated with such a change.

Warehouse Operations
Of the 26 warehouses used by other jurisdictions, 10 warehouses in five states are operated by contractors. (For the purposes of this discussion, warehouse operations include: receiving, storing, picking and loading.) The five states are: Maine, Ohio, New Hampshire, North Carolina, and Pennsylvania. New Hampshire has two warehouses - one operated by a contractor and the other operated by the state. None of the warehouses in other control jurisdictions is privatized, (i.e. operated by the private sector without a specific contract with the jurisdiction). A table of control jurisdictions indicating which ones contract for warehouse operations is shown in Exhibit 4.2.

Advantages of using contractors to operate warehouses as indicated by survey responses include:

- Contractor operating costs are lower than comparable state operated facilities

- Personnel and other logistical problems are transferred from the control agency to the contractor

Disadvantages of using contractors to operate warehouses as indicated by survey responses include:

- Periodic relocation of warehouse facilities when new contract is executed

- Potential for disruptions and loss of service with change in contractor

- Contractor labor problems can affect control agency

Exhibit 4.2
Alcoholic Beverage Warehouse Operations by Control Jurisdiction

	Number of Warehouses Operated By:		
Jurisdiction	Jurisdiction	Contractor	Jurisdiction & Contractor
Montgomery County	0	0	1
Alabama	1	0	0
Idaho	1	0	0
Iowa	1	0	0
Maine	0	1	0
Michigan	3	0	0
Mississippi	1	0	0
Montana	1	0	0
New Hampshire	1	1	0
North Carolina	0	1	0
Ohio	0	4	0
Oregon	1	0	0
Pennsylvania	0	3	0
Utah	1	0	0
Vermont	1	0	0
Virginia	1	0	0
Washington	1	0	0
West Virginia	1	0	0
Wyoming	1	0	0
Total for Other Jurisdictions	16	10	0

Source: KPMG Peat Marwick Survey of Alcoholic Beverage Control Jurisdictions, July 1991.

Iowa is in the process of contracting its warehouse function. West Virginia may investigate the possibility of contracting this function in the future if it appears that savings can be achieved. Although conceding that contracting is more economical, New Hampshire, which operates one warehouse directly and one through a contract, indicates that it would rather the state operate them both.

Three states in the past 15 years have contracted their warehouse operations based on projected savings. Maine contracted its warehouse operations in 1984 based on a determination that savings could be achieved through reduced personnel and inventory costs. Ohio contracted its warehouse operations in 1983 as a part of a decision to move to "bailment"[9] warehouse operation. North Carolina contracted its warehouse operation in 1976 when it determined that a contractor could operate the facility more efficiently than the state. None of these states report any significant implementation or operational problems with the use of contractors for this function.

The Pennsylvania Liquor Control Board contracts for the operation of three warehouse/distribution centers. Sample contracts for these facilities were provided with Pennsylvania's survey response. Key terms of these contracts include:

- Contract term is for five years
- Contractor provides security and maintenance for warehouse facility
- Contractor receives, unloads, stores, rotates, and distributes merchandise delivered to the warehouse facility
- Contractor is responsible for loss, shortage, breakage, burglary or theft of merchandise when such merchandise is in the contractor's custody
- The 1988 contractor compensation rate per case of liquor distributed ranged from about $0.72 to $0.93 depending on the distance between the warehouse and the store to which the merchandise was distributed
- The 1988 contractor compensation rate per case of liquor stored was $0.29

The key advantage of the Pennsylvania Liquor Control Board contract is that the contractor is responsible for losses, theft, and breakage of merchandise while it is in the contractor's custody. This term of the contract gives the contractor an incentive to minimize losses, theft, and breakage and to maintain strict control over inventory.

[9] A bailment warehouse operation is a warehouse in which the vendors own the products until they are withdrawn for shipment.

Distribution
Among other jurisdictions surveyed, only 2 perform the distribution function with state (i.e., government) employees only - Iowa and Montgomery County. In 9 states the function is performed entirely by the private sector which includes, common carriers, contractors, and licensees. (Although the use of common carriers suggests a privatized system, all but two of the jurisdictions that use contract carriers negotiate fixed rates with the carriers. With fixed rates, the jurisdictions' relationships with common carriers resembles that of a contract.) Seven jurisdictions use a combination of public employees and the private sector to perform the distribution function. A table of control jurisdictions indicating which ones use private sector resources to provide distribution is shown in Exhibit 4.3.

Advantages of using common carriers or contractors to assist in the distribution of alcoholic beverages as indicated by survey responses include:

- Title of goods passes to the distributor when goods leave the warehouse
- Cost of using a contractor is lower than cost of using state employees

Disadvantages of using common carriers or contractors to assist in the distribution of alcoholic beverages as indicated by survey responses include:

- Periodic minor lapses in service
- Minor short-term problems with the availability of alcoholic beverages at the retail level

Although most of the other control jurisdictions use the private sector to handle distribution of alcoholic beverages, none indicate that they are planning to expand their use of contractors for the distribution function.

Oregon is the only control jurisdiction that has moved toward private distribution operations. In 1976, Oregon began using the private sector to distribute fortified wines. The state still uses state employees to distribute liquor. The survey response from Oregon indicated that one motivation for beginning to use a contractor to distribute fortified wines was the desire to use the same mode for distributing fortified wine as is used to distribute table wine. Oregon did not report any significant implementation or operational problems with contracting a portion of its distribution function.

The key feature of distribution contracts, as indicated by the Pennsylvania Control Board contracts discussed above and from survey responses, is that ownership of the merchandise generally passes to the distributor once it leaves the warehouse until it is delivered to a retail outlet. While the merchandise is in the distributor's custody, the distributor is liable

Exhibit 4.3
Alcoholic Beverage Distribution by Control Jurisdiction

	Distribution Performed By:		
Jurisdiction	**Jurisdiction**	**Private Sector(1)**	**Jurisdiction & Private Sector**
Montgomery County	X		
Alabama			X
Idaho			X
Iowa	X		
Maine			X
Michigan			X
Mississippi		X	
Montana		X	
New Hampshire			X
North Carolina		X	
Ohio		X	
Oregon			X
Pennsylvania		X	
Utah	X		
Vermont		X	
Virginia		X	
Washington		X	
West Virginia		X	
Wyoming			X
Total for Other Jurisdictions	2	9	7

Source: KPMG Peat Marwick Survey of Alcoholic Beverage Control Jurisdictions, July 1991.

(1) Private sector includes contractors or common carriers.

for any loss, theft, or breakage. Transfer of ownership gives the distributor an incentive to minimize loss, theft and breakage of the merchandise and to maintain strict controls on inventory.

Retail

In five control states, all retail stores selling alcoholic beverages are privatized. The states are: Iowa, Michigan, Mississippi, West Virginia, and Wyoming. Iowa recently privatized their retail operations and reports increased surplus revenues for their wholesale operations. Idaho contracts state stores when they begin to generate less than $350,000 in sales. Montana converts state stores to contracts when the net income of a store falls below 10 percent of gross sales. A table of control jurisdictions indicating the types of alcoholic beverages monopolized by the jurisdiction and the control jurisdictions that use the private sector for all retail sales is shown at Exhibit 4.4.

Advantages of using contractors or privatizing all retail functions as indicated by the survey responses include:

- Retail operator is responsible for overhead costs at each location

- Personnel costs are lower for the retail operator than for the jurisdiction

Disadvantages of using contractors or privatizing all retail functions as indicated by the survey responses include:

- Introduction of profit motive at retail level may require additional enforcement to prevent abuses (e.g. sales to minors)

- Difficulty in making privately operated retail stores change their operations to conform to changes in policy, laws, or regulations

Except for Ohio, none of the other states indicate that they plan to contract for this function in the near future. There is a proposal before the Ohio State legislature to replace the remaining state liquor stores with contract agents. Ohio liquor control officials believe that increased use of agents will reduce state operating expenditures. Ohio already uses agents in conjunction with state liquor stores. Ohio is one of eight control states that uses agents to sell alcoholic beverages.

Two states, Iowa and West Virginia, recently curtailed all state-operated alcoholic beverage retail operations. Iowa ceased all its alcoholic beverage retail operations in 1987 and West Virginia did the same in 1990. Preliminary data from Iowa indicate that the decision to curtail its retail business has benefitted the state. A comparison of surplus revenues generated over the past three years in Iowa with what it would have been had the state continued its retail operations is shown in Exhibit 4.5. Iowa increased its surplus revenues by 31.6 percent in fiscal year 1988, 40.3 percent in fiscal year 1989, and by 51.6 percent in

Exhibit 4.4
Alcoholic Beverage Retail Operations by Control Jurisdiction

Jurisdiction	Wholesale Monopoly Products	Number of Stores Operated by: Jurisdiction	Contractor/Agent
Montgomery County	B,T,F,L	22	0
Alabama		151	0
Idaho	B,L	49	93
Iowa	L	All Retail Operations are Private	
Maine	F,L (5% +)	70	80
Michigan	L	All Retail Operations are Private	
Mississippi	T,F,L	All Retail Operations are Private	
Montana	F,L	30	96
New Hampshire	B (6% +),T,F,L	66	0
North Carolina	L	384 (1)	0
Ohio	F,L (21% +)	261	138
Oregon	L	0	235
Pennsylvania	T,F,L	681	0
Utah	B (3.2% +),T,F,L	36	98
Vermont	F,L	9	61
Virginia	T,L	242	0
Washington	L	172	175
West Virginia	F,L	All Retail Operations are Private	
Wyoming	T,F,L	All Retail Operations are Private	
Total for Other Jurisdictions		1,767	976

Source: KPMG Peat Marwick Survey of Alcoholic Beverage Control Jurisdictions, July 1991.

(1) Retail alcoholic beverage stores are operated by local governments.

B = Beer
T = Table Wine
F = Fortified Wine
L = Liquor
(% +) = Alcohol content above which the jurisdiction controls.

Exhibit 4.5
Privatization of Iowa Retail Stores

	1988		1989		1990	
	Actual Results	If State had Retail Stores	Actual Results	If State had Retail Stores	Actual Results	If State had Retail Stores
Sales	$78,396,130	$91,984,791	$77,716,935	$91,187,870	$78,330,490	$91,081,459
Cost of Goods Sold	52,264,086	52,264,086	51,811,290	51,811,290	51,750,829	51,750,829
Gross Profit	26,132,044	39,720,705	25,905,645	39,376,580	26,579,661	39,330,630
Operating Expense (1)	4,023,246	21,566,855	4,207,205	22,645,198	4,720,337	23,777,458
Net Profit	22,108,798	18,153,850	21,698,440	16,731,382	21,859,324	15,553,172
Plus Class E License Fee	1,773,925	0	1,770,500	0	1,726,750	0
Total Revenue	23,882,723	18,153,850	23,468,940	16,731,382	23,586,074	15,553,172
Absolute Increase in Surplus Revenue	**5,728,873**		**6,737,558**		**8,032,902**	
Percent Increase in Surplus Revenue	**31.6%**		**40.3%**		**51.6%**	

Source: Iowa Department of Commerce, Alcoholic Beverages Division Reports for 1988, 1989, 1990.

(1) Operating expense for the "state had retail store" scenario is derived from the Division's FY86 budget appropriation, with a 5% adjustment for inflation.

fiscal year 1990. Neither state reported any significant implementation or operational problems associated with privatizing the retail function.

Oregon provided a sample retail sales agent agreement for the operation of a retail liquor store which includes the following terms:

- Agent manages and operates the store
- Agent furnishes shelving, display counters, cash registers and other equipment necessary to operate the store
- Agent hires personnel to operate the store
- Agent assumes responsibility for shortages in inventory that occur in operation of the store
- Oregon Liquor Commission retains title to liquor while it is in the agent's custody
- Oregon Liquor Commission sets the terms, conditions, and price for which liquor is sold by the agent
- Oregon Liquor Commission compensates agent on a monthly basis according to the agent's compensation rate formula (the formula is based on general sales, dispenser sales, and counter sales at the store)

The terms listed above for a retail sales agent could be used by the County to contract for operation of its liquor stores.

This agreement, like the contracting agreements under warehouse operation and distribution, shifts the responsibility for losses, theft, and breakage to the contractor or agent even though the control jurisdiction owns the merchandise in the store. This creates an incentive for the contractor or agent to minimize loss, theft, and breakage of merchandise.

Summary and Conclusion
Control jurisdictions have taken a wide variety of approaches to performing the various functions of warehousing, distribution, and retail sales. A summary of jurisdictions' choices to use public or private resources to perform control functions is shown in Exhibit 4.6. Generally speaking, the control jurisdictions tend to own and operate their warehouses, use common carriers or contractors for distribution, and use both public employees and licensees to sell alcohol at the retail level. Montgomery County is among only three jurisdictions that use public employees to distribute alcoholic beverages, and the County uses both public and private employees in the same warehouse and to maintain control over inventory.

Exhibit 4.6
Summary of Public/Private Functions by Control Jurisdiction

Jurisdiction	Warehouse Ownership	Warehouse Operations	Distribution(1) from Warehouse	Retail
Montgomery County	Public	Public/Private (2)	Public	Public/Licensee
Alabama	Private	Public	Public/Private	Public
Idaho	Private	Public	Public/Private	Public/Licensee/Agent
Iowa	Public	Public	Public	Licensee
Maine	Private	Private	Public/Private	Public/Licensee/Agent
Michigan	Public/Private (3)	Public	Public/Private	Licensee
Mississippi	Public	Public	Private	Licensee
Montana	Public	Public	Private	Public/Licensee/Agent
New Hampshire	Public/Private (4)	Public/Private (4)	Public/Private	Public/Licensee
North Carolina	Public	Private	Private	Public/Licensee
Ohio	Private	Private	Private	Public/Licensee/Agent
Oregon	Public	Public	Public/Private	Public/Licensee/Agent
Pennsylvania	Public/Private (5)	Private	Private	Public/Licensee
Utah	Public	Public	Public	Public/Licensee/Agent
Vermont	Public	Public	Private	Public/Licensee/Agent
Virginia	Public	Public	Private	Public/Licensee
Washington	Public	Public	Private	Public/Licensee/Agent
West Virginia	Private	Public	Private	Licensee
Wyoming	Public	Public	Public/Private	Licensee
Total for Other Jurisdictions				
Public	10	13	2	1
Private	5	4	9	NA
Public/Private	3	1	7	NA
Licensee	NA	NA	NA	5
Public/Licensee	NA	NA	NA	4
Public/Licensee/Agent	NA	NA	NA	8

Source: KPMG Peat Marwick Survey of Alcoholic Beverage Control Jurisdictions, July 1991.

(1) "Private" distributors include contractors, licensees, and common carriers.
(2) Montgomery County uses a contractor to load beer for distribution to licensees and County stores.
(3) Michigan has three major warehouses and 73 mini-warehouses, two of the major warehouses and the 73 mini-warehouses are owned by the State; one warehouse is owned privately.
(4) New Hampshire has two warehouses, one owned and operated by the state and one owned and operated by the private sector.
(5) Pennsylvania has three warehouses, one owned by the state and two owned privately.
NA = Not applicable

Most control jurisdictions use the private sector to distribute and retail alcoholic beverages. In the past 15 years, eight jurisdictions have either privatized parts of their operations or have increased their use of contractors, and three jurisdictions are considering further contracting or privatization efforts. Three jurisdictions contracted for warehouse operations, two privatized part or all of their distribution, three jurisdictions privatized all retail functions, and two contract retail stores based on sales performance.

Warehouse Operations Three jurisdictions, Maine, Ohio, and North Carolina, have contracted warehouse operations in the past 15 years. The motivation for the change to a contractor was to reduce expenditures. Although no studies detailing the savings are available, these states indicate that they did experience savings as a result of their contracting efforts.

Distribution One jurisdiction has privatized distribution in recent years. Oregon began using contractors to distribute fortified wine. The survey response indicates that the motivation for the change related more to ending confusion over who was responsible for which types of alcohol. No data comparing the costs of distribution before and after the change are available.

Retail Operations Three jurisdictions, Iowa, Michigan, and West Virginia have privatized their retail operations. Iowa has shown significant savings as a result. It is still too early to analyze the effect of privatization in West Virginia and Michigan. Idaho and Montana have an ongoing policy of turning over low producing retail stores to the private sector.

Three states - West Virginia, Iowa, and Ohio, - are considering additional contracting or privatization efforts. West Virginia is considering whether to contract its warehouse operations, Iowa is in the process of contracting its warehouse operation, and Ohio is considering whether to replace all remaining state liquor stores with agents. In each case, the jurisdictions are looking to reduce costs and increase surplus revenue through contracting or privatization.

CONTENTS

CONTRACTING AND PRIVATIZATION OPTIONS FOR MONTGOMERY COUNTY

This section evaluates the merits of contracting and privatization options for the Montgomery County Department of Liquor Control (DLC) that are suggested by the experience of other jurisdictions. It also evaluates the merits of changing DLC to an authority. The evaluations are based on a set of criteria that are intended to reflect the interests and concerns of County residents and the stated purpose of the County's alcoholic beverage control policy.

Criteria

These criteria are developed consistent with the purpose of liquor control as stated in 2B § 1 of Maryland State Code and the report from the Task Force on County Government Philosophy for Liquor Control. The criteria on which the options presented in this section are evaluated consist of the following:

- **Effective Control** To meet the criterion for effective control, an option must not hinder the State and County efforts to foster and promote moderation in the use of alcohol.

- **Adequate Service** To meet the criterion of adequate service, an option must ensure that the public and licensees are provided with at least the current level of service if not improved service. Adequate service to the public includes competitive pricing, variety of product choices, and consistent hours. Adequate service to licensees include maintaining stock levels, quick resolution of issues or problems, and responsiveness to changing customer demands.

- **Surplus Revenue** To meet the criterion of surplus revenue, an option must at least maintain, but preferably increase the amount of operating surplus generated by DLC operations and transferred to the general fund.

- **Applicability to Montgomery County** To meet the criterion of applicability to Montgomery County, an option for contracting DLC functions must be applicable to the particular circumstances and conditions in Montgomery County. Montgomery County is distinguished from other control jurisdictions in several ways. Montgomery County is the only control jurisdiction that is a county, all others are states. The County is generally smaller and more densely populated than other control jurisdictions. Montgomery County is the only control county in a non-control state. Finally, the County is adjacent to two other jurisdictions - Virginia and the District of Columbia - which have different laws and policies governing the sale of alcoholic beverages. Virginia is another control jurisdiction, but the District of Columbia is an "open" jurisdiction where government involvement in the distribution and sale of alcohol is limited to the licensing function.

- **Implementation** To meet the criterion of implementation, an option must be feasible to implement and avoid major disruptions in service. Legal considerations, such as whether or not state or local laws would need to be changed are part of this criterion.

These criteria can conflict. For example, broad advertisement of County retail liquor stores could increase surplus revenue, but might promote the use of alcoholic beverages. To be useful to the County, contracting options must balance all the criteria discussed above.

Based on the surveys, and the particular circumstances in Montgomery County, contracting, privatization, and one organizational option for DLC were identified. The options are:

- Contract entire warehouse operation
- Contract distribution
- Contract retail liquor operations and/or use retail sales agents to sell liquor
- Privatize all or part of DLC operations
- Make DLC an independent authority

Any of these options may implemented in part or in whole, phased in, or combined with other options to minimize their effect on County staff and service to the public.

Contract Warehouse Operation

Contracting the entire warehouse operation would entail a major change in DLC. Although five other control jurisdictions have contracted this function with apparent success, Montgomery County has always used County employees to perform this function.

- **Effective Control** According to states that use contractors to operate their warehouses, contracting warehouse operations does not prevent the jurisdiction from controlling the key aspects of the operation. The incentive to receive payment for every case of alcohol received at the warehouse encourages contract operators to maintain strict control over their operations. This incentive encourages contractors to minimize losses, theft, and breakage in the warehouse.

- **Adequate Service** If the contractor successfully carries out the requirements of the contract, there should be no reduction in the level of service. Arguably, the level of service might increase under a contractor which could use flexible work schedules to fill unanticipated changes in demand.

- **Surplus Revenue** This option increases surplus revenue, provided the cost of using a contractor is less than the cost of using public employees. According to DLC, the warehouse cost per case for loading beer (using a contractor) is about 12 percent less than the cost per case for loading wine/liquor (using public employees). From this comparison it appears that contracting the warehouse function could reduce operating expenses.

- **Applicability to Montgomery County** Other than the relatively low unemployment level in the County, the particular circumstances of Montgomery County present no obstacles to contracting this function. The low level of unemployment in the County may make it difficult to find warehouse workers, however, contract employees can be recruited from adjacent markets with higher unemployment rates.

- **Implementation** Based on the experiences in other control jurisdictions, contracting the warehouse function could be carried out without major implementation or operational problems. Although implementing this option could affect the 31 DLC employees budgeted for fiscal year 1992 (5 in receiving and 26 for storing and loading), the County could minimize the impact on individuals by negotiating with the contractor to hire County employees first for a six-month probationary period, transfer displaced employees to other County agencies, or phase in operations to take advantage of attrition rates. To phase in contracting this function, the County could begin by contracting the loading function on the wine/liquor side of the warehouse. The County Attorney has not issued a final opinion on this issue, but it is our understanding from discussions with County staff, that implementing this option should not require changes in State Law or County Code.

  The County's agreement with the contractor should include financial incentives that assist in the control and profitability of the operation. Such incentives could include payment by the case received, stored, and shipped successfully. The agreement should also make the contractor pay for any losses in inventory that occur while the merchandise is in the warehouse. Alternatively, the County could establish a bailment operation.

Contract Distribution
Many other control jurisdictions use private sector resources to provide distribution services. Control jurisdictions use a combination of common carriers or contractors to perform the distribution function. This function is more often contracted by control jurisdictions than any other function.

- **Effective Control** The survey indicates that many states use contractors or common carriers to distribute alcoholic beverages. The contract mechanism gives the jurisdiction control over the distribution function. The County could maintain effective control over the distribution function if it executes a contract with a private distributor.

- **Adequate Service** Retailers expect products to be delivered promptly and undamaged. Private distributors have an incentive to provide quality service to licensees to maintain their reputation in the business. None of the survey respondents complained of poor service from their common carriers or contractors that deliver alcoholic beverages to retail stores. Normal market incentives should encourage any contractor to provide adequate distribution service to retailers.

- **Surplus Revenue** This option increases surplus revenue provided the cost of using a contractor is less than the cost of using public employees. One Washington area trucking company surveyed starts its drivers at $11.60 an hour with increases up to $13.55 an hour. Drivers of DLC trucks start at $10.43 but can go has high as $16.77 an hour. From this comparison it appears that the County has options for reducing the cost of distribution.

- **Applicability to Montgomery County** Because Montgomery County is part of a major metropolitan area, private companies should be available to provide shipping services for the County. This option is applicable to Montgomery County.

- **Implementation** Based on the experiences in other control jurisdictions, contracting the distribution function could be carried out without major implementation or operational problems. Although implementing this option would affect 90 DLC employees including equipment operators and other warehouse personnel budgeted for fiscal year 1992, the County could minimize the impact on individuals by negotiating with the contractor to hire County employees first for a six-month probationary period, transfer displaced employees to other County agencies, or phase in operations to take advantage of attrition rates. To phase in contracting this function, the County could begin by contracting keg distribution, then keg and beer distribution and finally all distribution from the warehouse. The County Attorney has not issued a final opinion on this issue, but it is our understanding from discussions with County staff, that implementing this option should not require changes in State Law or the County Code.

Contract Retail Operations
Contracting retail operations would eliminate County staff at DLC's retail stores. In recent years, some other control jurisdictions have curtailed their retail operations and instead either licensed facilities to sell liquor and fortified wines or used existing stores as agents to sell controlled beverages for the jurisdiction. The survey indicates wide use of the private sector to sell controlled beverages at the retail level.

- **Effective Control** Through the terms of the contract or the retail sales agent agreement, the County can exercise control over contractors and agents. Terms could be included in the contract to allow periodic inspection of the premises and to prohibit certain types of advertisement at or near the stores. Privatizing all retail operations, as has been done in West Virginia and Iowa, limits the ability of the control agency to affect the number of retail stores selling alcoholic beverages, their location, hours of operation, and advertising policies. Contracting for the retail function allows the County to maintain its direct influence over aspects of alcoholic beverage retail activities that are important to many County residents.

- **Adequate Service** Introducing the profit motive at the retail level could potentially enhance service and improve efficiency. Businesses have an incentive to serve the public. Flexibility in the way services are delivered at the retail level may allow contractors to offer better service.

- **Surplus Revenue** This option increases surplus revenue provided the cost of using a contractor is less than the cost of using public employees. Starting wages for check-out clerks at a major local grocery store are $7.00 and go up to a maximum of $12.65 an hour, while DLC liquor store clerks start at $9.61 an hour go up to a maximum of $16.77 an hour. From this comparison it appears that this option could reduce operating expenses.

- **Applicability to Montgomery County** Contracting existing retail stores may be more consistent with the philosophy of liquor control in Montgomery County than licensing vendors to sell liquor by the bottle. By contracting existing stores, the County can control the number, size, location and advertizing policies of the stores. Government constraints on private contractors can limit the contractors' flexibility to respond to changes in consumer demand. Flexibility contributes to a contractor's efficiency. In placing limits and controls on the contractor, the County could potentially affect DLC contributions to the general fund.

- **Implementation** Based on the experiences in other control jurisdictions, contracting retail operations could be carried out without major implementation and operational problems. Although implementing this option would potentially affect 76 full-time and 26 part-time DLC employees budgeted for fiscal year 1992, the County could minimize the impact on individuals by negotiating with the contractor to hire County employees first for a six-month probationary period, transfer displaced employees to other County agencies, or phase in operations to take advantage of attrition rates. To phase in contracting this function, the County could begin by contracting for one store at a time. This would have minimal effect on current staff, and could work in tandem with natural attrition at DLC[10]. The County Attorney has not issued a final opinion on this issue, but it is our understanding from discussions with County staff, that implementing this option should not require changes in State Law or the County Code.

Privatize all or Part of DLC Operations
Privatization of DLC operations would entail transferring all or part of the functions now performed by DLC to the private sector. Unlike contracting a function, privatizing does not involve a signed agreement between a private company and the jurisdiction. In privatizing a function, the jurisdiction relies on the market to supply the goods and services needed to meet a given demand. If the County transfers all DLC functions to the private sector, it would in effect be abandoning its liquor control function in favor of a licensing function similar to other non-control jurisdictions. A jurisdiction that privatizes its retail, and distribution operations, but still controls wholesale of all alcoholic beverages is still considered a control jurisdiction. Because complete privatization would only be feasible with a major change in the County's current policy, it is not discussed further in this section. Privatization of distribution and retail operations is considered in the remainder of this section.

Effective Control Privatizing retail operations could allow anyone to apply for a license to sell liquor, and thereby reduce control over the retail sale of liquor in the County. The County could maintain some control over privatized retail operations by limiting the number of retail liquor (by the bottle) licenses and distributing them through an auction or a lottery. Privatization of distribution should not diminish the County's control as long as the distributor is held liable for any loss, theft, breakage of merchandise while it is in the distributor's custody.

Adequate Service Privatized retail and distribution operations would have normal market incentives to serve their customers well. Under privatization, service should equal or exceed their current levels.

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[10] According to the Montgomery County Personnel Management Review, March 1991, the attrition rate for Montgomery County employees during fiscal year 1990 was 6.85 percent.

Surplus Revenue If the County privatized retail only, it would likely increase surplus revenues as shown previously in Exhibit 3.4. Comparisons of hourly wages for County truck drivers and private sector truck drivers suggests that the County could reduce expenditure by using private distributors as well.

Applicability to Montgomery County Privatizing distribution could work in a jurisdiction like Montgomery County given the availability of private carriers in the area that could supply distribution services for the County. Privatization of retail liquor sales (by the bottle) could raise concerns in the community about the number, location, hours and advertizing associated with private liquor stores.

Implementation Privatization would affect County employees now working for DLC. The County cannot require private firms, that do not have a contract with the County, to hire displaced County workers. Phasing-in can be used to minimize the impact of privatization, but the County's options would be limited.

Make the Department of Liquor Control an Independent Authority
An independent authority could be established by means of a specific State Law. The authority would act as an independent legal entity separate from County government. The authority would be managed by a board appointed by the County government. The employees of the authority would not be included in the County's merit system and the day to day operations of a liquor control authority would resemble current DLC operations. Some arrangement would have to be made in creating the authority to ensure that surplus revenue generated through the sale of alcoholic beverages is transferred to the general fund annually.

- **Effective Control** An authority would have the same responsibility for the wholesale, distribution, and retail of alcoholic beverages in the County as the County does now. An authority could render effective control over the operations, but the Executive Branch and Council would have limited direct influence over the way in which alcoholic beverages are warehoused, distributed, and retailed in the County.

- **Adequate Service** An authority could render the same level of service that is currently being provided by DLC. Arguably, an authority with its autonomy and flexibility should be able to respond to changes in customer demands better than DLC.

- **Surplus Revenue** An authority could generate increased surplus revenue through implementing a personnel system with wages consistent with comparable private sector positions. Exactly how the surplus revenue is expended is largely up to the authority. Authority decisions to invest in physical plant, enhance its working environment, or upgrade its facilities could affect the level of surplus revenue available for the general fund. The

Executive Branch and the Council would have little direct influence over day to day operating decisions that could affect the level of surplus revenue going to the general fund from liquor sales.

- **Applicability to Montgomery County** Several public functions affecting Montgomery County residents are carried out by authorities and other semi-autonomous bodies. The County has a housing authority and a revenue authority. An authority appears to be an acceptable mechanism for carrying out selected public functions in Montgomery County.

- **Implementation** Creating an authority is a feasible option for the County to consider. The creation of an authority would affect current DLC employees who could lose their status as County employees. DLC employees could face a reduction in benefits and perhaps even a reduction in salary if they continue in their same jobs under an authority. The transition to an authority could be smoothed by grandfathering all current employees working for DLC at the time that DLC is established as an authority. Although this would ease the transition to an authority, it would delay for several years any potential savings to be realized from creating an authority.

  Creating an authority is likely to require a change in State Law.

Summary and Conclusion
Under the contracting options, the County can maintain effective control, adequate levels of service, and potentially increase surplus revenues through lowering costs. The contracting options are applicable to Montgomery County and could be implemented if phased in over time. Privatization of the warehouse would likely reduce surplus revenue to the County. Privatization of retail operations would probably increase surplus revenue, but would reduce effective control over the sale of liquor at the retail level. Creating an authority would retain government control over the wholesale, distribution, and sale of alcoholic beverages, but would diminish the Council's and the Executive Branch's control over those operations. In addition, creating an authority would require a change in Maryland State Law.

Contract Warehouse Operations Contracting for warehouse operations is a feasible option for Montgomery County, but may be more difficult to carry out than other contracting options. Although specific dollar savings have not been reported by other jurisdictions that have contracted warehouse operations, North Carolina indicates that it has realized a savings as a result of its decision to contract its warehouse operations in 1976. Iowa, in an effort to reduce operating expenditures, is in the process of contracting its warehouse operations. Contracting this function could be phased in by using a contractor for the loading function on the liquor/wine side of the warehouse. Contracting for other parts of warehouse operations could follow. Because a limited number of qualified contractors may be willing to bid on operating the warehouse, this option may be difficult to implement.

Contract Distribution Contracting for distribution of alcoholic beverages from the warehouse to retail outlets a feasible contracting option for the County. Comparison of the range of wage rates for drivers suggest that savings could be realized from contracting or privatizing distribution. Most control jurisdictions use private companies to distribute alcoholic beverages to retail stores. Because Montgomery County is part of a large metropolitan area, many trucking companies are potentially available to serve the distribution needs of DLC. To minimize any disruption caused by contracting this function, a private contractor could deliver kegs initially, then deliver kegs and beer, and finally deliver kegs, beer, and wine and liquor.

Contract Retail Operations Contracting for retail operations is the most feasible option for the County to consider. Indications from wage comparisons and financial performance of DLC suggests that the retail operations could generate additional surplus if made to operate more cost-effectively. To avoid layoffs that could result from contracting retail operations, the County could phase in contracted stores consistent with the attrition rate of County liquor store clerks[11]. To make the transition to contract stores more quickly, the County could transfer employees at County liquor stores to other positions in DLC or in other parts of County government or negotiate with the contractor to hire County employees displaced by the contract.

Privatize All or Part of DLC Operations Privatizing all DLC operations does not appear to be consistent with Montgomery County's policy toward liquor control. Other control jurisdictions have privatized retail and distribution as cost saving measures but not the warehouse. It is possible that Montgomery County would reduce operating expenditures by privatizing distribution and retail functions, but such options would likely reduce County control over the sale and distribution of alcoholic beverages in the County - especially control over retail liquor sales.

Change DLC to an Independent Authority Changing DLC to an authority, while not a contracting option per se, could potentially increase the net revenue generated by DLC operations. DLC operations are unique among County functions and much in the County's personnel system is not appropriate for the classification of employees used by DLC. If an independent authority, DLC could devise its own personnel system suited to its needs. Presumably such a system would include wages that reflect the market wages for warehouse workers, drivers, and retail clerks. The current DLC entry level wages for these positions are generally above the market level. If personnel expenditures were reduced under an authority, the DLC operation would be able to increase surplus revenue.

If DLC were an authority, the County would have only indirect influence over internal expenditure decisions by the authority which could affect the amount of surplus revenue generated by the DLC. Currently, DLC generates about $10 million a year in surplus

[11] According to the Montgomery County Personnel Management Review, March 1991, the attrition rate for Montgomery County employees during fiscal year 1990 was 6.85 percent.

revenues for the County. The County's direct control and influence over that $10 million would diminish under an authority.

CONTENTS

Liquor Control Functions
Questionnaire

6/21/91

1. State:______________________________
2. Name of Control Agency:______________________________
3. Name of person responding to survey: ______________________________
4. Title: ______________________________
5. Phone Number: ______________________________
6. Please indicate with a check mark the alcoholic beverages and the aspects of sale and distribution that are controlled by your agency.

	Wholesale	Retail	Distribution
Beer	_____	_____	_____
Table wine	_____	_____	_____
Fortified wine	_____	_____	_____
Liquor	_____	_____	_____

WHOLESALE

Warehouse Ownership

7. Please indicate the number of warehouse facilities owned by:
   State _____
   Private interests _____

8. What are the advantages and disadvantages of leasing rather than owning a warehouse facility?

____
____
____

Warehouse Operations

9. Please indicate the number of warehouses operated by:
   State _____
   Contractor _____
   Jointly _____

10a. What are the advantages and disadvantages of the way your agency performs this function (using state employees, a contractor, or a combination of both)?

____
____
____

10b. What implementation or operational problems, if any, are associated with using a contractor for warehouse operations?

____

____

____

11a. If your agency **has not** partially or fully privatized this function, is it planning to do so in the future, and why?

____

____

____

11b. If your agency **has** privatized this function, when and why was the decision made to contract all or part of warehouse operations?

____

____

____

Unloading Incoming Shipments

12. Please indicate with a check mark who unloads incoming shipments of alcoholic beverages (check all columns that apply).

	State	Contractor	Other
Beer	____	____	____
Table wine	____	____	____
Fortified wine	____	____	____
Liquor	____	____	____

13. Please indicate the number of employees used to unload incoming shipments:

    State employees: ______

    Contract employees: ______

    Other: ______

14a. What are the advantages and disadvantages of the way your agency performs this function (using state employees, a contractor, or a combination of both)?

____

____

____

14b. What implementation or operational problems, if any, are associated with using a contractor for the unloading process?

____

____

____

15a. If your agency **has not** partially or fully privatized this function, is it planning to do so in the future, and why?

____

____

____

15b. If your agency **has** privatized this function, when and why was the decision made to contract all or part of the unloading process?

____

____

____

Outloading of Alcoholic Beverages to Delivery Trucks

16. Who loads alcoholic beverages from the warehouse onto delivery trucks?

	State	Contractor	Licensee	Other
Beer	_____	_____	_____	_____
Table wine	_____	_____	_____	_____
Fortified wine	_____	_____	_____	_____
Liquor	_____	_____	_____	_____

17. Please indicate the number of employees responsible for loading alcoholic beverages:

    State employees: _____
    Contract employees: _____
    Other: _____

18a. What are the advantages and disadvantages of the way your agency performs this function (using state employees, a contractor, or a combination of both)?

____

____

____

18b. **What implementation or operational problems, if any, are associated with using a contractor for the loading process?**

19a. If your agency **has not** partially or fully privatized this function, it is planning to do so in the future, and why?

19b. If your agency **has** privatized this function, when and why was the decision made to contract all or part of the loading process?

RETAIL

20. For those retail facilities that are your agency's responsibility, please indicated the number that are:

Owned and operated by your agency	_____
Owned by your agency & operated by a contractor	_____
Owned & operated by private interests	_____
Other (please specify):______________________________	_____
Total agency retail under your responsibility	_____

21. What are the advantages and disadvantages of the retail facility operating strategies pursued by your agency?

____

____

____

22. If your agency **has not** partially or fully privatized this function, is it planning to do so in the future, and why?

____

____

____

23. If your agency **has** privatized this function, when and why was the decision made to contract all or part of retail management an operations?

____

____

____

DISTRIBUTION

25. Is your agency responsible for delivery of alcoholic beverages to your own stores, licensees or both? ____________________

26. Please indicated with a check mark who handles wholesale distribution of alcoholic beverages to **your own retail stores** (check more than one column if applicable).

	State	Contractor	Other
Beer	_____	_____	_____
Table wine	_____	_____	_____
Fortified wine	_____	_____	_____
Liquor	_____	_____	_____

27. Please indicated with a check mark who handles wholesale distribution of alcoholic beverages to **licensees** (check more than one column if applicable).

	State	Contractor	Licensee	Other
Beer	_____	_____	_____	_____
Table wine	_____	_____	_____	_____
Fortified wine	_____	_____	_____	_____
Liquor	_____	_____	_____	_____

28. Please indicate the number of employees used for this operation:
    - State employees: _____
    - Contract employees: _____
    - Other: _____

29a. What are the advantages and disadvantages of the way your agency performs this function (using state employees, a contractor, or a combination of both)?

____

____

____

29b. What implementation or operational problems, if any, are associated with using a contractor for distributing alcoholic beverages?

____

____

____

30a. If your agency **has not** partially or fully privatized this function, is it planning to do so in the future, and why?

____

____

____

30b. If your agency **has** privatized this function, when and why was the decision made to contract all or part of distribution?

____

____

____

31. Please indicate the key terms of the agreement with the distributor(s), (e.g. on what basis is the contractor paid?)

____

____

____

Please include any studies or evaluations that compare the cost and efficiency of contractors with state employees for any liquor control function.

Please include copies of the scope of work and payment terms for contractors used by your agency.

Return completed questionnaire to:

Mr. Aaron A. Estis
KPMG Peat Marwick
8150 Leesburg Pike #800
Vienna, VA 22182
703 442 0030