



Annual Report on Method & Rationale for Product Pricing

As Prescribed by Act 39 of 2016



April 1, 2024



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA LIQUOR CONTROL BOARD
Northwest Office Building
Harrisburg, Pennsylvania 17124-0001

April 1, 2024

The Honorable Mike Regan
Majority Chairman
Senate Law & Justice Committee
171 Main Capitol Building
Harrisburg, PA 17120

The Honorable James Brewster
Minority Chairman
Senate Law & Justice Committee
458 Main Capitol Building
Harrisburg, PA 17120

The Honorable Daniel Deasy
Majority Chairman
House Liquor Control Committee
304 Irvis Office Building
Harrisburg, PA 17120

The Honorable Mindy Fee
Minority Chairwoman
House Liquor Control Committee
43 East Wing
Harrisburg, PA 17120

Chairmen Regan, Brewster and Deasy, and Chairwoman Fee:

Enclosed is the Pennsylvania Liquor Control Board's (PLCB) Annual Report on Method and Rationale for Product Pricing as required by Act 39 of 2016. This report summarizes the PLCB's pricing standards and processes during calendar year 2023.

Like many retailers and wholesalers, the PLCB contended with the continued impact of persistent inflation rippling through the global economy in 2023. As a result, in 2023 the agency initiated its first broad-based retail price increase since 2019. During 2023 we also made changes to aspects of the Special Order program, which included adjustments to the logistics, transportation and merchandising factor and conversion of high-volume Special Order items to the stock portfolio.

This report includes historical background regarding the agency's statutory pricing authority; the methodology that guides product evaluation and retail pricing decisions; product portfolio and retail price adjustment data; and our strategy for the remainder of 2024.

We hope this report is informative to the members of the Senate Law and Justice and House Liquor Control Committees.

Sincerely,

Tim Holden
Chairman

Randy Vulakovich
Board Member

Darrell Clarke
Board Member

STATUTORY PRICING REQUIREMENTS

Historical Background

The pricing structure for wine and spirits sold by the PLCB has evolved throughout the history of the agency. The Liquor Code authorizes the PLCB to establish prices for the beverage alcohol products it sells. The retail price is the shelf price paid by individual customers at Fine Wine & Good Spirits (FW&GS) stores and online at FWGS.com. Certain licensees receive a statutorily established 10% discount off the retail price.

Prior to the pricing reforms included in Acts 39 and 85 of 2016, section 207 of the Liquor Code mandated that retail prices had to be proportional with prices paid by the PLCB to its suppliers. This provision required the agency to use a proportional markup to price products. The PLCB's markup structure, prior to the enactment of Acts 39 and 85, consisted of two straight percentage markups (a 1%, then a 30% markup), as well as a handling fee called the logistics, transportation and merchandising factor (LTMF). Subsequently, the 18% liquor tax was applied, then the price was rounded to determine the retail shelf price.

The uniform markup structure prevented any consideration of supply and demand or other marketplace factors in the PLCB's pricing decisions. Consequently, a mass-market chardonnay had the same markup as a highly sought-after limited-release bourbon. The proportional markup also allowed suppliers to set the retail price of products and maximize their margin by using the markup structure to work backward to calculate their product acquisition cost to the PLCB.

The PLCB did have the authority to set the markup, and it varied throughout the history of the agency. Prior to the enactment of Act 39, the 30% markup had not changed in more than two decades.

Pricing Reforms Under Acts 39 and 85 of 2016

Act 39 significantly modified the PLCB's pricing authority. Specifically, section 207 of the Liquor Code was amended to allow the agency to "price its best-selling items and limited purchase items in a manner that maximizes the return on the sale of those items" and to "discount the price of discontinued items." Limited purchase items include products "that the Board purchases on either a one-time or nonrecurring basis due to the product's limited availability or finite allocation," and discontinued items include products the PLCB "has voted to delist at a public meeting." Subsequently, Act 85 of 2016 – which amended the Fiscal Code but contained provisions impacting the Liquor Code – defined "best-selling items" as "the 150 most sold brands and product types of wine and the 150 most sold brands and product types of liquor as measured by the total number of units sold on a six-month basis calculated every January 1 and July 1." The expanded pricing authority authorized by Acts 39 and 85 is commonly referred to as "flexible pricing." The

PLCB is required to sell products, except for items offered through a customer relations management program, at the same retail price across Pennsylvania. All wine and spirits products sold by the PLCB remain subject to the 18% liquor tax, which is included in the product’s retail shelf price. This liquor tax is transferred to the General Fund and does not support the PLCB’s operations or annual cash transfers to the General Fund.

The PLCB’s Special Order portfolio, which includes approximately 50,000 specialty items not stocked in FW&GS stores or licensee service centers (LSC), is not subject to flexible pricing. However, Act 39 did alter the pricing structure for these products. The markup on Special Order products was reduced from 30% to 10%. Pricing for Special Order products delivered to FW&GS stores or LSCs for customer pickup includes the LTMF. Special Orders direct-delivered to customers are not assessed the LTMF, but suppliers may impose delivery fees on direct-delivered Special Orders. Such delivery fees are at the discretion of suppliers, both in terms of amount and order applicability. As established by statute, Special Order products are not eligible for the 10% licensee discount. While both retail customers and licensees can obtain products through Special Order, licensees generally account for 98% to 99% of Special Order sales annually.

METHODOLOGY & RATIONALE

The PLCB’s overall pricing strategy and individual product management decisions continue to reflect the agency’s mandate to provide value and variety to customers while fulfilling financial commitments to numerous state, local and other beneficiaries. To achieve these goals, the agency remains committed to using its flexible pricing authority to maximize the return to the Commonwealth on the sale of wine and spirits, and to work with suppliers and producers from across the globe to obtain a diverse range of quality items that respond to customer demand and marketplace trends.

Product Portfolio

The below chart reflects the PLCB’s product portfolio for calendar year 2023.

	Item Count	Dollar Sales	Unit Sales
Spirits	3,151	\$1,822,476,327	103,771,294
Wine	8,355	\$1,002,100,307	72,142,922
Total	11,506	\$2,824,576,634	175,914,216

In conjunction with the agency’s implementation of a new enterprise resource planning platform that separated the PLCB’s retail, wholesale and e-commerce lines of business, the Bureau of Product Management transitioned away from historical distinctions between listed and luxury portfolios for the purpose of data reporting. As a result, product portfolio data above is aggregated simply into wine and spirits.

Product Evaluation & Negotiation Process

The PLCB generally purchases wine and spirits products through either a regular listing process or as a one-time buy (premium and Chairman's Selection® products). Regular stock items consist of the most common and popular wine and spirit items across the state and are available at most FW&GS stores, LSCs, FWGS.com and through the licensee delivery program. Premium wine and spirits products are generally items characterized by high quality, niche market and/or limited supply. These products are most frequently purchased as one-time buys and are offered for sale at a smaller number of locations than regular stock products.

Proposals from suppliers for regular stock listing are generally reviewed twice a year. New submissions for listed products are initially assessed based on expected value of the product to Pennsylvania retail customers and licensees; existing item saturation at the proposed price point; and how closely the submission fits categories sought by Product Management. Suppliers with items that pass initial evaluation are asked to submit a product sample for review. Suppliers with items that perform well in the sample review are asked to present cost and other information to the PLCB's product category managers.

The Bureau of Product Management uses a variety of market-based criteria to assess products. Some of these metrics include current and historical category sales data, price and segment growth trends, product quality, consumer value proposition, product innovation and supplier-proposed marketing support. Additionally, consideration is given to how an item would contribute to the product portfolio. For example, segment underrepresentation, line or size extension of a successful brand, customer trade-up opportunity and other factors are all considered. Marketing support and sales data for new regular stock products is periodically reviewed to identify, and potentially remove underperforming items from the portfolio.

Premium and Chairman's Selection® products are purchased on a one-time-buy basis, so each purchase order for these products represents a new negotiation with the supplier. Consequently, the PLCB can leverage its buying power and relationships with wineries, distilleries and suppliers all over the globe to purchase high-quality wine and spirits. One-time buys do not have regularly scheduled review periods and are considered throughout the year.

To participate in the Chairman's Selection® program, a supplier must provide a minimum 35% discount from a nationally quoted or winery retail price. Every wine that makes it into the program is evaluated for quality and offers compelling value to customers.

For all products in the regular stock, premium and Chairman's Selection® portfolios, the PLCB negotiates product acquisition costs with suppliers and establishes retail prices by considering a variety of metrics and market-based criteria. For example, gross margin potential, gross margin

percentage relative to comparable items within a category, manufacturer’s suggested retail price and the impact of key threshold price points on sales are considered during the negotiation process.

The PLCB uses a tiered review process to establish product acquisition costs and retail prices for wine and spirits. Category managers initially negotiate product acquisition costs and retail prices with suppliers. Subsequently, these recommendations are reviewed by the division chief, director of product management, chief merchandising officer, executive director and, finally, the three-member Board. A pricing coordinator also evaluates pricing decisions across various categories and portfolios to ensure consistency in the agency’s pricing practices. Generally, new listings are considered by the three-member Board at public meetings.

As required by Act 39 of 2016, [quarterly product price lists](#) dating back to October 2016 are posted at lcb.pa.gov under the News/Reports section. Current retail prices can be viewed at FWGS.com.

Retail Price Adjustments & Planned Sales Events

The below chart details changes to product acquisition costs and retail prices during calendar year 2023, including changes associated with planned sales events (PSE).

	<i>Cost</i>		<i>Retail</i>	
	Increases	Decreases	Increases	Decreases
Regular Changes	941	336	5,071	242
PSE Changes	534	398	642	223
Total	1,475	734	5,713	465

PSEs are item-specific temporary sale pricing by which the regular retail price of an item is discounted a set amount for a set period of time.

The agency funds sale prices through PSEs – negotiations with suppliers that result in adjustments to a product’s acquisition cost, retail price or both, in order for the PLCB to fund discount prices on an item. Simply put, the anticipated cost of a temporary discounted retail price promotion, based on unit sales, is used to adjust the longer-term product acquisition cost and/or retail price. The agency works with suppliers to coordinate PSEs with suppliers’ product marketing plans. Since there are a significant number of PSE changes over a year, the 2023 price adjustment data separates PSE changes from regular pricing changes to provide additional perspective into the adjustments.

In January 2023, the PLCB initiated its first broad-based retail price increase since 2019. A majority of the 2023 regular retail price increases are attributable to this 4% increase on the most popular and commonly available wines and spirits across Pennsylvania. The 4% increase was effective Jan. 15, 2023, on 3,554 items. Retail prices of an additional 397 items, which had been on sale in January, increased by about 4% effective Jan. 30, 2023. The price increase did not impact

approximately 5,600 one-time buys (seasonal and premium items), 2,700 items on clearance, 100 PA Proud (Pennsylvania producers) items in 10 or fewer FW&GS stores and all Special Order products.

Prior to this price change and dating back to 2019, the agency only passed along supplier-requested cost increases to customers, resisting initiating price increases itself, especially considering the effect of the COVID-19 pandemic on retail customers and licensees. In some cases, despite a cost increase from a supplier, the PLCB maintained the retail price rather than pass the increase on. However, inflation persists and has impacted the PLCB as it has manufacturers and retailers across the world. Operational expenses related to personnel, distribution, leases, credit card fees and other costs have increased substantially. While the agency works diligently to limit expense growth, some costs are outside of the PLCB's control. The agency did not make the decision to effectuate an across-the-board increase in retail prices lightly, but the PLCB must balance its responsibility to provide value to our customers with our financial commitments to all Pennsylvanians. Further, the January 2023 price increase was consistent with the agency's commitment to using flexible pricing in a fair manner that does not favor any single supplier, product or customer.

Special Order

Prior to July 2023, LTMF, or the handling fee assessed by the PLCB on Special Orders that come to rest at one of its facilities for customer pickup, was a variable fee based on product type and size. In July 2023, the PLCB changed the LTMF to a flat, \$2.47 per-unit fee. Following consideration of stakeholder comments on the change – and in light of the popularity of Special Order direct delivery among suppliers and licensees, which decreased the operational impact of Special Orders on the PLCB – the LTMF was reduced from \$2.47 to \$2 per unit, effective with orders placed on or after Jan. 1, 2024. Special Orders directly delivered to customers are not assessed the LTMF.

In 2023, the PLCB transitioned a few dozen high-volume Special Order items – those with annual sales of 15,000 units or more the prior year – to regular stock items. After feedback from stakeholders, these items were converted back to Special Order in March 2024, and the sales threshold for consideration of conversion from Special Order to stock was increased to 36,000 units a year. The Special Order portfolio will be evaluated twice a year, in January and July. When an item reaches this threshold, the agency will engage in a collaborative discussion with the supplier to determine whether the product would benefit from moving from Special Order to stock, or if it should remain a Special Order item.

FORWARD-LOOKING STRATEGY

The PLCB's pricing and product selection strategies will continue to balance our financial responsibilities to the people of Pennsylvania with our commitment to providing excellent quality,

variety and value to our customers. While inflation has slowed from the prior years, it will likely continue to pressure suppliers, through increased costs related to manufacturing and raw materials, and result in higher product acquisition costs for the PLCB. The agency does not plan a broad-based retail price increase in 2024 but does anticipate retail price adjustments on an item-by-item basis in response to product acquisition cost changes and other market factors.

In 2024, the PLCB plans to continue to distribute the rarest, most in-demand and limited supply products to retail customers and licensees through Limited-Release Lotteries, use planned sales events for discounted pricing and offer special discounts including clearance pricing and FW&GS store grand opening sales. The PLCB will also continue to price limited-release products competitively, often far lower than they are priced in other states.

The PLCB remains committed to working collaboratively with suppliers. As evidenced by Special Order policy changes in 2023, the agency is receptive to constructive feedback and amenable to addressing concerns. This year marks eight years since implementation of Acts 39 and 85, and flexible pricing continues to help the agency provide value to customers while also meeting its financial commitments to the Commonwealth.