

2016-18 Executive Progress Report

Commonwealth of Virginia
Secretary of Public Safety and Homeland Security
Virginia Alcoholic Beverage Control Authority

At A Glance

The mission of the Department of Alcoholic Beverage Control is to generate a reliable stream of revenue for Virginia and promote public safety through the responsible sale and regulation of alcoholic beverages.

Staffing 1037 Salaried Employees, 8 Contracted Employees, 0 Authorized, and 2241 Wage Employees.

Financials Budget FY 2017, \$680.34 million, 0.00% from the General Fund.

Trends Legend
↑ Increase, ↓ Decrease, → Steady

Key Perf Areas
↑ Increase Transfers of Profits
↑ Increase Compliance UAB
Productivity → Maintain accuracy of warehouse shipments while average number of cases shipped per day increases
Legend
↑ Improving, ↓ Worsening, → Maintaining

For more information on administrative key, and productivity measures, go to www.vaperforms.virginia.gov

Background and History

Agency Background Statement

The Department of Alcoholic Beverage Control (ABC) was formed in 1934 after the repeal of Prohibition. With the passage of the 21st Amendment to the Constitution, power for the regulation of alcoholic beverages reverted to individual states. Virginia's model was patterned after the Canadian provinces where a government agency assumes a role in the distribution of alcoholic beverages. In Virginia's case, ABC became the sole wholesaler and retailer of distilled spirits and the primary regulating authority for the manufacture, distribution, transportation, sale and consumption of other alcoholic beverages.

The primary intent was to use public policy as a way to moderate consumption and keep the number of establishments selling alcohol and the related ancillary impacts to a minimum. Temperance and ethical business practices, particularly where the distribution and consumption of distilled spirits (or hard liquor) was concerned, were valued above all other goals including the generation of revenues and equitable service. Even today, the density of outlets selling distilled spirits in Virginia is less than a third of similar open states and per capita consumption of distilled spirits is nearly 20 percent less than the national average.

The primary mandates for agency operations are found in state statutes. Title 4.1 of the Code of Virginia is known as the Alcoholic Beverage Control Act and includes:

Chapter 1: Definitions & General Provisions

Chapter 2: Administration of Licenses

Chapter 3: Prohibited Practices

Chapter 4: Wine Franchise Act

Chapter 5: Beer Franchise Act

ABC's Mission is to generate a reliable stream of revenue for Virginia and promote public safety through the responsible sale and regulation of

alcoholic beverages. Today, ABC operates more than 365 retail stores and nine regional offices across the Commonwealth. Made up of a team of more than 3,200 employees, the agency is a leading revenue producer and source of future economic growth and innovation for Virginia. The profits ABC contributes to the General Fund are collected from sales of distilled spirits at ABC stores, taxes collected on beer and wine sales, violation penalties and license fees. This revenue provides much needed funding for use in programs across secretariats, thus benefiting citizens in all areas of the state whether or not they choose to drink alcoholic beverages. Since its establishment in 1934, Virginia ABC has contributed more than \$9.5 billion to the Commonwealth's General Fund, which supports state services, including substance abuse prevention and treatment. Profits transferred to the General Fund during fiscal year 2016 were almost \$169 million based on \$897 million in gross revenue from store sales. Total Contribution to the General Fund in the form of profit and taxes amounted to \$433.4 million.

Major Products and Services

The public safety mission of ABC results directly from being the primary agency to regulate the manufacture, distribution, sale, transportation and consumption of alcoholic beverages. Services include the annual issuance or renewal of almost 19,000 licenses for retail establishments to sell wine, beer and spirits. In addition, over 24,000 licenses were issued in FY 2016 for one day banquet and special events to sell wine, beer and spirits. ABC monitors compliance of licensees with Virginia ABC laws and regulations and issues violations for non-compliance. Approximately 70% of agent activity is spent on regulatory compliance, conducting background investigations, license suitability and inspections of licensed establishments. When violations occur or license applications are contested, ABC conducts administrative hearings to adjudicate these issues. ABC conducts aggressive compliance monitoring efforts related to the underage sale of alcohol by licensees and state stores in addition to underage sales of tobacco products by retail businesses. In FY 2016, the alcohol compliance rate for retail licensees was 91%, an increase from 87% in FY 2015.

ABC is responsible for a wide range of other compliance activities including illegal manufacturing and distribution (stills and nip joints), financial investigations and numerous other violations of state laws and regulations. ABC agents work collaboratively with local, state and federal law enforcement groups in these investigations. Agents also serve on state and federal task forces investigating drugs, gangs, and other criminal activity.

Customers

Customer Summary

Population shifts, economic growth and changing demographics are the primary driver of changes to ABC's customer base. Approximately half of the 6.2 million legal-age Virginians consume alcoholic beverages and are direct customers of ABC stores. In the next 10 years, the census bureau forecasts Virginia's overall population to grow by over 900,000 people. The growth in the number of people as well as the location of such growth has a direct impact on ABC's ability to provide services such as the number and location of ABC stores. Historically, this growth has been focused between Northern Virginia and Tidewater, leading to a significant expansion of the store network in these areas. Consumption patterns also play an important role in ABC services. The number of distilled spirit products available in the marketplace has grown tremendously in recent years, which is contributing to slight increases in store size to ensure enough space is available to carry products to meet customer demand. At the same time per capita dollar and volume purchases have increased slightly in recent years and are expected to continue.

As the sole regulatory authority over the manufacture, transportation, distribution, sale and consumption of alcoholic beverages in Virginia, primary customers also include the 21,900 establishments licensed to sell alcoholic beverages in the Commonwealth. Among these are 4,656 mixed beverage restaurants required by statute to purchase distilled spirits from ABC stores. Population growth, as well as economic factors, influences the growth in the number of licensed establishments. The location of this growth has a significant influence on the number of ABC special agents needed in specific localities. While ABC conservatively forecasts that the number of licensees will grow by approximately 1,000 during the next ten years, the health of the economy can influence workload through license turnover, increased crime, etc.

ABC promotes zero tolerance for the underage consumption of alcoholic beverages and thus focuses on the 2.2 million Virginians under the age of 21. Previous reports from the Centers for Disease Control and Prevention (CDC) find that those under 21 consume 11 percent of all alcoholic beverages sold in the United States. While significant strides have been made in licensee compliance with underage sales laws, most underage drinkers report older siblings and friends as the primary source of alcoholic beverages.

Virginia ABC also believes that a multi-faceted approach to alcohol education and prevention is more effective and should include individuals, families, licensees and communities. The agency offers education and prevention across the lifespan and is proud to provide programming for elementary schools, middle schools, high schools, college students and professionals, parents, those 21 and older, older adults and ABC licensees.

ABC's external stakeholders include consumers, local, state, and federal government agencies, including community service boards, law enforcement agencies, public and private K-12 schools and colleges, the military, and numerous alcohol education, prevention and treatment communities representing parents, educators and non-profit organizations. In addition, ABC has a significant number of customers including the real estate community, the distilled spirits and wine industries, trade associations and media representatives, and other special interest groups.

Customer Table

Predefined Group	User Defined Group	Number Served Annually	Potential Number of Annual Customers	Projected Customer Trend
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Finance

Financial Summary

The Department of Alcoholic Beverage Control operates as a Non-General/Enterprise Fund Agency which means the cost of providing goods and services are recovered solely through the sale of alcoholic beverages, license fees and other revenues. The state budget gives ABC the authority to spend in four services areas: Enforcement and Regulation of Alcoholic Beverage Control Laws, Administration and Support, Alcoholic Beverage Retail Stores, and Alcoholic Beverage Purchasing, Warehousing and Distribution. The Appropriation Act mandates a series of profit transfers to other state agencies as well as the Virginia State General Fund.

Fund Sources

Fund Code	Fund Name	FY 2017	FY 2018
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Revenue Summary

The vast majority of the Department’s revenues come from the sale of alcoholic beverages. These revenues are achieved through 365 state run stores located throughout the commonwealth. Gross sales including state sales tax in Fiscal Year 2016 reached an all-time high of \$897.8 million, up almost \$50 million over Fiscal Year 2015. Gross revenues after state tax on sales of alcohol increased from \$708.4 million to \$749.9 million or 5.9 percent. License and permit fees slightly increased in Fiscal Year 2016 totaling \$13.3 million. While federal grants and miscellaneous revenue increased from the previous year, there was a decrease in lottery ticket sales and penalty fees collected. Other sources of revenue include a wine wholesaler’s tax and a mixed beverage tax on common carriers.

Performance

Performance Highlights

The Department of Alcoholic Beverage Control has a very diverse mission with an even more diverse customer base. Value creation activities, or those that provide direct services to customers, include: the control and distribution of alcoholic beverages, processing license applications, conducting enforcement and adjudication activities, accurately accounting for almost \$900 million dollars in revenues and a host of integrated internal support processes. Contributions to the Commonwealth in FY 2016 totaled \$164.8 million in profit transfers, \$147.8 million dollars in state taxes, \$41.3 million dollars in general sales tax, \$36.2 million dollars in wine liter taxes and \$43.1 million dollars in malt beverage taxes.

Since 2010, compliance rates with youth access to alcohol and tobacco have ranged between 85% and 91%. In ABC stores, compliance rates are even higher, exceeding 97 percent in FY 2016. Related to ABC’s regulatory compliance role, the Hearings and Appeals Division collected \$708,050 in civil penalties in 2016.

Most Recent Accomplishments

Fiscal Year 2016 marked ABC’s 18th consecutive record-setting year with gross sales of almost \$898 million, a \$49 million increase over last year. Profits also rose to \$164 million, an increase of \$13 million over the previous fiscal year. ABC profits, combined with state taxes, sales tax, and wine and beer taxes, resulted in an all-time high of \$433 million transferred to Virginia’s general fund - up \$24 million from the previous year. The eight new stores that opened during the fiscal year generated a total of \$4.3 million in sales.

ABC achieved its first milestone of the Authority Transition at the end of FY 2016 with the completion of the initial phase of the project. Phase 1 involved agency partner, Human Dynamics Consulting, meeting individually with the Board, executive leadership and directors to 1) get a better sense of the agency’s objectives, 2) document key roles and responsibilities and objectives, and 3) identify organizational opportunities as a result of the upcoming transition to an Authority structure.

In FY 2016, ABC opened eight new stores resulting in an ABC store being conveniently located within 10 minutes for more than 93% of Virginians. During this time, ABC continued to expand the number of products available for sale in its retail stores, including special orders and products available to order on-line via the agency’s newly-redesigned website. In addition to modernizing four stores and expanding three stores, ABC opened an additional Premier store in FY 2016, for a grand total of four premier stores throughout the state (Leesburg, Williamsburg, Richmond, and Virginia Beach). Premier stores feature design themes reflective of the unique characteristics of the stores’ locations and incorporate innovative retail space planning techniques. The increase in service quality has generated significant increases in revenues and profitability.

House Bill 896, passed during the 2012 legislative session, allowed the Board to open any ABC retail location on Sunday. In Fiscal Year 2016, all ABC stores were open on Sundays with the exception of three primarily licensee stores. Total Sunday sales increased by \$3.2 million, or 6.5%, from Fiscal Year 2015 to Fiscal Year 2016. A retail division process improvement in the management of closeout merchandise resulted in the movement of over 488,000 bottles, for a total of \$3 million in sales. The number of designated “Special Order Stores” that regularly carry specialty items (previously available only by request) was also expanded in an effort to make them more accessible to customers and to increase sales.

On the marketing front, ABC’s new Spirited Virginia consumer-facing brand, promoted through a quarterly magazine, monthly e-newsletters and a social media campaign, was developed as part of the agency’s commitment to inform consumers about the wide range of products sold in

stores. The e-newsletter has drawn approximately 20,000 subscribers.

ABC's Bureau of Law Enforcement received accreditation from the Virginia Law Enforcement Professional Standards Commission (VLEPSC) in late 2015. Administered through the Virginia Department of Criminal Justice Services, the accreditation process is a thorough inspection and review of agency policies, procedures, processes and operations as defined by 190 stringent standards. With this accreditation, the Bureau joined an elite group of less than 100 accredited law enforcement agencies in the Commonwealth.

Finally, the agency was the recipient of three technology awards in FY 2016. The 2015 VITA Project Excellence Award was presented to ABC for its Point of Sale (POS) Environment Upgrade, a project which began with extensive research in 2013 and was tasked with bringing store point-of-sale systems up to date with modern technology and safety protocols and in line with Commonwealth security requirements. The agency also won the Governor's Technology Award in the Innovative Use of Big Data and Analytics category at the 2016 Commonwealth of Virginia Innovative Technology Symposium (COVITS). The winning project provided ABC cost savings and risk mitigation through the elimination of outdated information technology reporting software. It also reduced paper reports, increased information sharing among divisions, eliminated repetitive work and decreased data request bottlenecks. ABC also won the Web Marketing Association's 2015 Web Award for Outstanding Achievement in Web Development. The agency, in conjunction with its CapTech Consulting partners, won the award in the categories of Government Standard of Excellence and Shopping Standard of Excellence, and was mentioned for the website serving as an outstanding tool for customer service, alcohol awareness and more.

Selected Measures

Measure ID	Measure	Alternative Name	Estimated Trend
99980102.002.003	ABC store density rate based on the population	Maintain statewide ABC store density rate	Maintaining
99980101.001.004	Amount of profits & taxes annually transferred from ABC to the General Fund.	Increase Transfers of Profits	Improving
99980102.002.001	Percentage of stores meeting service standards compliance rate.	Increase percentage of ABC stores meeting service standards	Improving
99980102.001.001	Underage buyer compliance rate for ABC Stores	Increase Compliance UAB	Improving
99930403.001.001	Underage buyer compliance rate for retail alcohol licensees	Increase Compliance UAB	Improving
M999AG12001	Cases shipped per warehouse labor hour	Maintain accuracy of warehouse shipments while average number of cases shipped per day increases	Maintaining

Key Risk Factors

Appropriation Act profit transfer requirements for Fiscal Year 2017 are \$152.4 million. Risks to meeting this profit requirement include economic declines and weather fluctuations, particularly during the holiday season, unforeseen increases in expenses as ABC transitions from a state agency to an Authority, projected increases in expenses in improving information technology infrastructure and related audit points, and the central office and warehouse facility reaching capacity.

The General Assembly approved multiple projects to upgrade ABC's infrastructure and further invest in business operations. These projects include the implementation of retail and marketing strategies to increase customer service and enhance revenue, increased website capabilities, the procurement of a new financial management system, the procurement of a new licensing system, and the upgrade of electrical circuitry in agency facilities. These projects are a considerable undertaking, but are imperative to further solidify ABC as a continued source of significant revenue for the Commonwealth.

ABC expects expenses to continue to increase in Fiscal Year 2017. Expenses such as store rents will increase because of contractual escalation clauses and the addition of new stores. Employer portion of health insurance cost will also increase about 9.5% over Fiscal Year 2016. ABC also expects an increase in logistics related expenses, such as additional staff and freight charges, due to the continued expansion of stores and increasing sales volume. The expectation for significant and continued investment in information technology continues as ABC advances existing and future systems and associated infrastructure

Agency Statistics

Statistics Summary

Fiscal Year 2016 marked another record year for the Virginia Department of Alcoholic Beverage Control (ABC)'s Retail Operations Division. The year ended with \$897.8 million in gross sales, \$49 million higher than last year, and \$24 million higher than the projected \$710 million target. Retail dollars were up 5.4 percent and mixed beverage licensee dollars were up 7.4 percent. Eight new stores that opened in Fiscal Year 2016 generated a total of \$4.3 million in sales. Commitment to public safety dictates selling responsibly and according to the commonwealth's related laws. Vigilance by ABC sales associates resulted in an almost 98 percent compliance rate (i.e. denying sales to underage buyers). ABC store employees conducted more than 4.5 million ID challenges in Fiscal Year 2016 and provided service to 30 million buying customers.

Statistics Table

Description	Value
Number of ABC Stores	359
Number of Regular Items for Sale in ABC stores	2,581
ABC Store Customer Transactions	30,398,994
Number of Bottles Sold	58,058,001
ABC Store Underage Buyer Compliance Rate (%)	98
Point-of-Sale ID Checks	0
Total Number of Licensees	18,947
Number of Hearings held	179
Operating Profits	165,192,687
Total Tax Collections	268,546,222
Number of retail licenses Issued	0
Number of Employees (Full-time and Part-time)	3,278

Management Discussion

General Information About Ongoing Status of Agency

The Virginia Alcoholic Beverage Control Authority Act of 2015 mandated that ABC transition its operating structure from that of an executive branch agency to a codified Virginia Authority. The authors of the legislation intended for it to permit ABC to provide greater value to citizens of the Commonwealth through enhanced service and profitability enabled by an Authority structure. Per the Act and a subsequent amendment to the law, this transition will begin January 15, 2018 and run through December 31, 2018. As stated in the Authority Transition Act and the strategic plan, the goal of this transformation process is to better enable Virginia ABC to best meet the needs of ABC stakeholders in a more agile, efficient and profitable manner.

With help from the Community College Workforce Alliance, ABC undertook a four-month strategic planning cycle in October 2015. This planning process paired employees with previous experience in strategic planning with division directors to explore strategic opportunities from a divisional perspective. Through stakeholder analysis and environmental scanning, each division identified opportunities to support strategic pillars established by the ABC Board. A total of 71 initiatives with varying degrees of complexity were initially submitted to a committee of six agency senior leaders who evaluated and prioritized the initiatives. The committee selected 41 initiatives to be executed by the agency over the coming two and a half years, assuming funding for initiatives remains a part of the agency's budget.

The ABC Board met with executive leadership to understand top strategic concerns gathered from division directors and established the following strategic pillars to serve as guideposts for the strategic plan:

- Authority: Execute a seamless transition to an Authority structure
- Brand: Develop ABC brand to balance revenue creation and public safety
- Infrastructure: Reinvest in our people, technology and facility infrastructure
- Public Safety: Regulate and educate ABC licensees to ensure public safety
- Sales and Profits: Achieve \$1 billion in sales by the end of fiscal year 2018

Under the Authority Strategic Pillar, ABC expedited an initiative to redesign the organizational structure and processes to assume an effective operating authority structure. It was decided that this procedure would be expedited to a business already under contract with the Commonwealth. Considerations for the restructure include personnel capabilities, potential fiscal and human capital required to achieve goals, and proper planning to communicate with the statewide budget planning process. The agency will be integrating financial management systems to capitalize on efficiency of policy and procedure changes throughout the organization. In compliance with the changes to the Authority Act, the ABC Board will be a part-time board of five members including a Chief Executive Officer (CEO) position.

Under the Brand Strategic Pillar, the agency will continue to develop its brand image through the success of its newly designed website, communicating alcohol education initiatives, and effectively increasing product knowledge by providing distilled spirits expertise to retail store customers. The agency has started brand development by embarking on an exploratory brand research project, scheduled for the summer of 2016. The exploratory brand research will solicit feedback from the agency's various stakeholder groups, to include retail customers, citizens, licensees and ABC employees.

Under the Infrastructure Strategic Pillar, ABC will systematically consider changes in internal structure needed to most effectively and efficiently meet strategic and operating objectives. A Center of Excellence will be created for project portfolio management, policy development, and data analysis. This process will result in more rapidly communicating business decisions. A project management office will be created to be the center of initiation and management of enterprise level IT projects. The central office and warehouse facility are currently nearing the maximum capacity and

serviceability. A space utilization project and logistical capacity study was completed in 2016 to find alternative options for the future. Then, the Appropriations Act of 2017 (Item C-52.45) directed DGS and ABC to develop a plan to provide cost-effective, efficient, turnkey options for a new ABC warehouse and administrative offices. The plan may include leasing existing facilities, building new facilities, or renovating the existing facilities. In conjunction with DGS, two Request for Proposals (RFPs) were released on June 9, 2017 with responses due back to DGS by August 11, 2017. The plan is due to the General Assembly on November 1, 2017.

Under the Public Safety Strategic Pillar, ABC will continue to achieve and maintain directives adopted by the Governor. Recommendations that will be executed in the upcoming years include prioritizing regulatory activities with licensees, agent training, maintaining accreditation, increasing higher education outreach, implementing body cameras, and expediting license suspensions in the case of immediate public safety concerns. As of June 2017, ABC has issued a total of 5 summary suspensions that ultimately ended in the voluntary surrender of licenses. The agency's Education and Prevention section will collaborate with the Bureau of Law Enforcement to encourage licensees to engage in responsible serving practices through online training. Additionally, the Hearings, Appeals, and Judicial Services Division will increase the efficiency of Judicial Affairs to more efficiently process cases.

Under the Sales and Profits Strategic Pillar, ABC will continue to focus on improving customer satisfaction by opening new stores, improving the number of stores meeting service and design standards, and ensuring that products in demand are available for sale. ABC will increase incremental sales and profits through several changes to include emphasizing special order product management, enhancing the portfolio of existing products for retail stores and the website, and taking advantage of industry trends toward premium products. A comprehensive real estate plan will be updated to ensure the proper number of stores to maximize potential revenue. In the next two years, ABC plans to open 20 new profitable stores in strategic locations to grow incremental sales rather than cannibalizing sales from existing stores.

Information Technology

In FY 2016, ABC kicked off the ABC Modernization and IT Reinvestment program which focuses on updating many core legacy systems to improve reliability and flexibility of the enterprise. Over the next five years, several major sequential projects will replace the majority of the agency's technology portfolio with a goal to reduce long-term cost and risk. Large-scale modernization projects currently underway include the implementation of retail and marketing strategies to increase customer service and enhance revenue, the procurement of a new financial system, and the procurement of a new licensing system. ABC continues its focus on expanding online services for additional customer groups, automating manual processes and enhancing e-commerce capabilities. Though a considerable undertaking, these efforts are imperative to solidifying ABC as a consistent source of revenue for the Commonwealth. Furthermore, requirements exist for improving computer security from both administration mandates and external sources such as the Payment Card Industry requirements. ABC must meet new higher information security standards set by COV-ITRM and the payment card industry data security standards (PCI-DSS) for control of sensitive information (credit card data). Requirements include upgrades to networks, firewalls, POS equipment, and ABC applications and programs. ABC must continually maintain compliance with PCI-DSS standards. Reaching compliance with these requirements has significant cost implications; however severe penalties for violations and infractions.

Workforce Development

ABC has initiated strategic workforce planning that addresses current gaps in the organization's workforce as well meets future staffing demands of the Authority. Approximately 11.2% of ABC employees were retirement eligible as of June 30, 2016 and 22.3% are eligible for retirement within five years. It is believed that there may be significant attrition due to retirements as of the effective date of the Authority transition. The agency will need to take steps to ensure that the necessary organizational knowledge is retained with operational documentation and appropriate cross-training.

The Authority transition gives ABC the opportunity to examine how it compensates its employees. As part of this process, the Authority is exploring compensation methods that tie into individual and organizational performance. Additionally, the agency is exploring government and private industry best practices for compensation, paid time off and holidays. In analyzing workforce needs, ABC has also conducted a salary survey of a cross section of positions to benchmark current compensation levels.

ABC expanded its leadership training to include an exclusive program for supervisors and managers. Following a pilot program for 18 managers in March 2016, the Human Resources Division launched its Supervisor Academy in June. The academy provided participants with the tools and resources necessary to enhance their knowledge and skills in the methods they use to communicate with and supervise others. The LAMP (Leadership and Management Program) program, designed to build leadership skills for current employees who possess the competencies required to perform in key roles and to foster a culture conducive to the agency's forward movement, graduated its fourth annual cohort of participants in 2015.

Physical Plant

The Central Office and warehouse facility currently in use by the agency is nearing the end of its useful life in terms of serviceability and capacity. To prepare options for the future, the agency commissioned a space utilization and logistical capacity study to identify and analyze alternative options for central office and warehouse facility going forward. The study, conducted by F. Curtis Barry & Co., reviewed the requirements for warehouse and central office operations and weighed the options for extending the life of the current facility versus the construction of a new facility. The findings concluded that a new facility would need to consist of more square footage and accommodate modern office and warehousing concepts. The findings also supported language found in the Appropriations Act of 2017 (Item C-52.45) which directed DGS

and ABC to develop a plan to provide cost-effective, efficient, turnkey options for a new ABC warehouse and administrative offices.

ABC opened eight new stores in 2016, including one additional premier store for a total of four larger, upscale premier stores. In addition, four stores underwent modernization, three were expanded, and ten stores were relocated. ABC plans to open 20 new profitable stores during fiscal years 2017 and 2018.
