

# **BEMIDJI CITY COUNCIL**

## ***Work Session Agenda***

**Monday, August 9, 2010**

**City Hall  
Conference Room  
5:30 P.M.**



1. CALL TO ORDER / ROLL CALL
  
2. DISCUSS LIQUOR STORE OPERATIONS
  
3. ADJOURNMENT

# MEMORANDUM

**TO:** Honorable Mayor and City Council  
**FROM:** Ron Eischens, Finance Director *Ron*  
**REVIEWED BY:** John Chattin, City Manager *John*  
**DATE:** August 9, 2010  
**RE:** Liquor Operations

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## Current Operations

Last fall long time Liquor Store Superintendant, Dan Bahr, retired. This presented an opportunity to change organizational structure for liquor operations in order to save money. The senior liquor clerks at both stores, with nearly 30 years of experience, were put in charge of daily operations including scheduling, pricing and purchasing. Finance staff provide daily deposit and cycle inventory assistance while the finance director provides general overall direction. This structure has worked due to dedicated and experienced staff and saves the city approximately \$75,000 annually. Operating under this model will continue until such time it fails to work effectively.

My concerns and challenges relate to four areas:

- 1) **Staff Transition** – Our on-site senior clerks both have 30 plus years of work experience at City liquor stores, which has been invaluable in a smooth transition after Dan's retirement. We are working towards developing other staff but replacing these employees may require hiring from outside and changes in organizational structure once again.
- 2) **Marketing** – there remains much to be done in this area that time does not allow for. As an example, staff met with Council member Johnson some time ago, regarding marketing, and since then has had no time to follow up on the items discussed.
- 3) **Pricing** – formal pricing policies, while remaining competitive, is an area staff do not have adequate time to develop nor maintain at this time
- 4) **Staff Development** – staff training and development translates into excellent customer service if done properly. Customer service and store locations are the City's marketing advantage we must capitalize on to improve operations.

Financial Results - Historically Bemidji ranked high compared to other outstate municipal liquor stores. Based on 2008 information provided by the state auditor, Bemidji ranked 16<sup>th</sup> in gross sales **for all Minnesota liquor stores**. Only four non-Metro cities, Detroit Lakes, Hutchinson, Fergus Falls and Alexandria had higher sales. Bemidji was tied with Fergus Falls for gross profit percentage. Attached is a comparison of Bemidji operations to other non-metro off-sale stores.

Bemidji's 2008 net operating income was 7.8%, or \$356,068. In the past, Bemidji's profit margins have been in the 10% range. One reason for the decline was the increase in credit card usage with their fees reducing net profit by approximately 1%. The Council recently approved changing credit card processors to reduce fees.

In 2009 liquor sales increased substantially by \$360,000, or 8%. Net income increased to \$481,000, or 9.8%. Some of these increases can be attributed to pipeline activity during this time frame. Liquor staff is commended for handling the sales increase while increasing the bottom line.

During 2010 capital upgrades have been made to both store locations including flooring, counter tops, painting, lighting and exterior building improvements. Future improvements in 2011 and beyond include cooler door/shelving replacement, HVAC system replacement and security system upgrades.

Future goals and objectives for liquor operations include:

1. Increase gross profit margins to 26%
2. Maintain net income margins at 10%
3. Develop strategic pricing policies
4. Staff training and development
5. Improved marketing and advertising
6. Plan for staff transition and loss of experience due to retirements

### Potential Expansion Opportunity

Staff was directed to research expanding City liquor operations to a portion of the Cenex Convenience Store located on Highway 71 South. The Cenex store has approximately 650 square feet of available space to rent, with room for expansion if desired.

The opportunity to add a third City liquor store must be evaluated carefully as adding store locations does not guarantee additional profits or increased market share. In fact, profits could be reduced. In addition to potential financial risks, other issues to consider are:

- Additional social and law enforcement impacts and costs
- Infringement on private sector

- Cenex property is not currently in City limits; in order for the City to operate a liquor store at this location the property must be annexed. Indications are that Bemidji Township is open to discussing this matter.

#### Financial Projections/Issues with expansion

In order to analyze this opportunity certain assumptions were made as follows:

**Personnel Costs** – The location would be staffed 13 hours per day (9:30 am to 10:30 pm), six days per week with 1.5 part time liquor clerks at an average hourly rate of \$12, which is midpoint of the current pay range. Staffing at this level is considered minimal and would eliminate carryout service and reduce customer sales assistance. Daytime staffing levels at the other stores include 2 staff until noon, when additional staff is added, depending on the day of the week and time of year.

**Inventory Storage/Transfer** – The available square footage does not allow for storage of inventory. Therefore, inventory would most likely be stored at the current Lakeview store. Inventory would be transferred as needed, which may be several times daily depending on sale levels. In addition, administrative time is required to track inventory transfers and make purchases for the new store. The labor to do these tasks is estimated at 8 hours per day, 6 days per week at \$12 per hour. Our current stores spend between 4 to 8 hours per day performing similar tasks.

**Rent** – Initial verbal discussions with Cenex manager indicated a monthly rent of \$1,000

**Equipment Costs** – Cash register set up \$8,000, walk in beer cooler \$13,000, delivery truck \$25,000 and shelving \$4,000, total costs of \$50,000 amortized over 10 years. Based on our current locations, 80% - 90% of our beer sales are cold beer, therefore a walk in beer cooler was an assumption staff felt necessary for purposes of this projection.

#### Summary

Based on the above assumptions, the proposed location needs to generate \$676,000 in sales to break even, amounting to over \$1,000 in sales per square foot. According to the Minnesota Municipal Beverage Association, once sales reach \$600 per square foot you can no longer keep up with demand or product selection. Our current stores have sales of \$400 per square foot.

If the location was expanded to 2600 square feet, which is equivalent to half the size of the current Lakeview location, sales need to be \$982,000 to break even assuming expenses are 50% of those at the Lakeview location and this doesn't include the significant costs associated with such an expansion.

Regardless of the size or location of a third store, the amount of revenue necessary to break even is significant. Revenue from a third location must be sales to new customers or to customers shopping at privately owned stores, otherwise the third location will cannibalize operations of our current two stores. A market study may answer the question of whether the amount of revenue is feasible considering the area market and potential future growth.

Minnesota Municipal Beverage leadership stated the Cenex site was too small and too far off the highway to be profitable. They felt we should concentrate our efforts on improving operations at our current locations.

### **Recommendation**

When this opportunity was initially presented I was enthusiastic about it. However, my excitement dimmed once financial requirements were analyzed.

Based on the assumptions described above, it would be difficult for a third City liquor store to be profitable due to the finite market for liquor sales. Generating \$676,000 to \$982,000 in "new" revenue to break even puts the expansion risk in perspective. Sales at the Lakeview store in 2009 were \$2 million. A third location, depending on its size, would need to generate between 33% and 49% of Lakeview revenue in new sales to cover projected costs of the additional store location.

The funding to expand liquor operations is not readily available unless the council commits future liquor profits or sell bonds with no guarantee the expansion will be successful. Also, liquor profits may be required to fund SE Shore development and bonding costs due to shortfalls or revenue timing delays. An update on these matters will be presented to council shortly.

Concentrating on improving current store operations, in both sales per square feet and operating margin may be a better use of staff resources. Doing so also leaves liquor profits available for other council priorities rather than tied up funding liquor expansion.

The bottom line is this decision is a policy matter to be decided by Council. Staff has provided input and information allowing the council to make an informed decision. If further information or a market study is desired, direct staff accordingly.

### **City Manager's Comments**

This is not the time to take the risk of establishing a third store. All the knowledgeable operators and consultants we have contacted suggest that this is a bad idea. With future City funding in question, we cannot afford to risk this essential revenue stream.

**CITY OF BEMIDJI**  
**2008 LIQUOR OPERATIONS**

DESCRIPTION	Bemidji		Hutchinson		Marshall		Fergus Falls		Alexandria Lakes		Detroit Lakes		Fairmont		Thief River Falls		Worthington	
<b>SALES</b>	4,545,246		4,756,381		3,397,248		4,961,277		4,985,136		4,688,732		2,771,049		3,958,940		2,292,461	
<b>COST OF GOODS</b>	3,390,579		3,694,232		2,522,685		3,701,564		3,954,661		3,569,142		2,048,014		3,045,795		1,710,762	
<b>GROSS PROFIT</b>	1,154,667		1,062,149		874,563		1,259,713		1,030,475		1,119,590		723,035		913,145		581,699	
<b>GROSS PROFIT %</b>	25.4%		22.3%		25.7%		25.4%		20.7%		23.9%		26.1%		23.1%		25.4%	
<b>OPERATING EXPENSES</b>	798,599		729,640		337,872		832,634		634,488		360,057		417,588		549,805		344,476	
<b>OPERATING PROFIT</b>	356,068		332,509		536,691		427,079		395,987		759,533		305,447		363,340		237,223	
<b>OPERATING %</b>	7.8%		7.0%		15.8%		8.6%		7.9%		16.2%		11.0%		9.2%		10.3%	