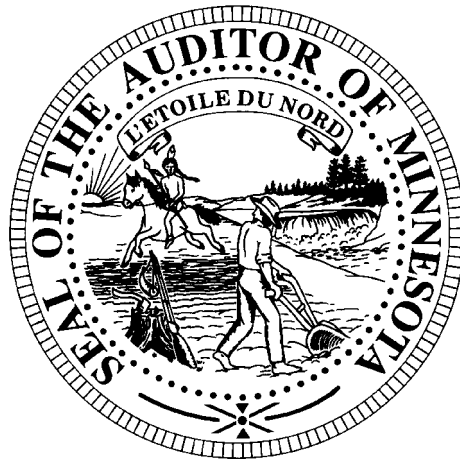


MINNESOTA OFFICE OF THE STATE AUDITOR

**AN ANALYSIS OF MINNESOTA
MUNICIPAL LIQUOR STORE
OPERATIONS IN 1996**

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An Analysis of Minnesota Municipal Liquor Store Operations in 1996



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An Analysis of Minnesota Municipal Liquor Store Operations in 1996

Overview

Minnesota's municipally owned and operated liquor stores reported an increase in net income for the third straight year. Municipal liquor stores reported an increase of 15.2 percent in net income for 1996, which was more than the 3.8 percent increase posted in 1995. Cities transferred \$10.8 million in liquor store profits to other municipal accounts in 1996.

Minnesota municipal liquor stores transferred profits of \$10.8 million to other municipal accounts in 1996. This represented a decrease of 8.6 percent from what was transferred in 1995.

This represents a decrease of 8.6 percent from the \$11.9 million transferred in 1995. While the majority of municipal liquor stores were profitable in 1996, 23 cities reported a net loss in their municipal liquor operations. Thirty cities report a net loss in 1995.

During 1996, Minnesota's municipally owned liquor stores reported:

- gross sales of \$174.4 million, which was an increase of \$10.2 million over 1995 gross sales;
- a net income of \$14.4 million, which was \$1.9 million more than the total net income reported in 1995.

Background on Minnesota's Municipal Liquor Stores

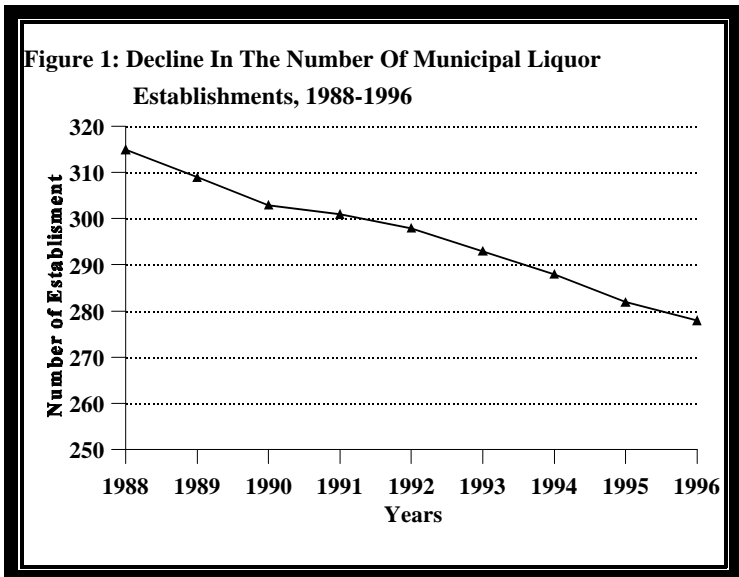
Minnesota law authorizes cities with fewer than 10,000 people to own and operate on-sale and off-sale liquor establishments.¹ During 1996, 252 Minnesota cities operated municipal liquor stores, with 158 cities operating both on-sale and off-sale liquor establishments and 94 cities restricting their municipally-owned establishments to off-sale liquor stores. While the majority of municipally owned liquor stores are located in small cities in Greater Minnesota, 21 cities within the Twin Cities metropolitan area own and operate liquor establishments.

Originally, Minnesota municipalities were authorized to own and operate liquor establishments as a means of controlling the sale of alcohol. Municipally-owned liquor stores also provided, and continue to provide, an added convenience for residents of small communities that might be unable to attract a privately-run establishment. However, as fiscal pressures on Minnesota municipalities have grown, the primary purpose for many of the current municipal liquor establishments has shifted to providing additional revenues to support public services.

The number of cities operating municipal liquor stores has steadily declined for many years. In 1995, three cities discontinued their liquor operations; in 1996, six more cities discontinued their liquor operations. The six cities that opted to discontinue their municipal liquor stores in 1996 were:

¹ Once a city with a population under 10,000 people has established a municipal liquor store, it may continue to operate the store regardless of its subsequent population growth.

Brownton, Gary, Graceville, Grove City, Hills, and Oklee. In addition, three cities which had two or more liquor operations closed at least one of their businesses. Four of the five cities that discontinued their liquor operations in 1996 reported net losses in 1995. Figure 1 shows the decline in the number of municipal liquor stores.



The Profitability of Minnesota's Municipal Liquor Stores

During 1996, Minnesota's municipal liquor establishments reported a third consecutive year of record sales totaling \$174.4 million. Total sales recorded in 1996 were up \$10.2 million or 6.2% over sales reported in 1995. The stores reported a net income of \$14.4 million in 1996, which was up 15.2 percent from net income reported in 1995. Total municipal liquor sales ranged from \$8,633 in Gary² to \$7.3 million in Richfield. Net income and losses for municipal liquor stores ranged from a loss of \$39,744 in Morgan to a profit of \$705,033 in Richfield.

Municipal liquor operations located within the Twin Cities metropolitan area are considerably larger and more profitable than their Greater Minnesota counterparts. Although only 21 of the 252 Minnesota cities (8.3 percent) that own and operate municipal liquor stores are located in the Twin Cities metropolitan area, they represent 36.5 percent of the total sales and 31.1 percent of the net income of municipal liquor operations.

Sales by metropolitan area establishments averaged \$1.4 million in 1996, compared to average sales of \$473,554 for Greater Minnesota municipal liquor stores.³ The average income of metropolitan stores was \$101,613 in 1996 compared to an average of \$42,324 for municipal liquor establishments in Greater Minnesota. All metropolitan cities except one reported profitable municipal liquor operations in 1996. Net income and losses among metropolitan liquor operations ranged from a loss of \$28,403 in Shorewood to a profit of \$705,033 in Richfield. Net income and losses among Greater Minnesota cities ranged from a loss of \$39,744 in Morgan to a profit of \$368,280 in Elk River. The municipal liquor establishments operated by 23 Minnesota cities reported net losses for 1996, compared to 30 cities in 1995. Twenty-two of the 23 cities with net losses are located in Greater

² The City of Gary discontinued its liquor store on March 1, 1996.

³ The 21 cities in the metropolitan area that have municipal liquor operations operated a total of 44 establishments selling liquor on-sale and/or off-sale. The 231 Greater Minnesota cities with municipal liquor stores operated a total of 234 establishments. Average sales and net income reflect calculations based on the number of stores rather than the number of cities.

Minnesota. The City of Shorewood (located in the Metropolitan Area) operates three establishments of which one store reported a net loss of (\$59,936). The Greater Minnesota cities reporting net losses each operated one store. Table 1 lists the cities and the amount of loss reported in 1996.

Table 1 - Municipal Liquor Store Operations With Net Losses

Name of City	Net Loss	Name of City	Net Loss
Morgan	(\$39,744)	Lafayette	(\$3,280)
Shorewood (Metro Location)	(28,403)	Trimont	(2,958)
Graceville	(28,328)	Sherburn	(2,933)
Elgin	(24,397)	Lake Benton	(2,361)
Frazee	(17,122)	Eagle Bend	(1,373)
Delavan	(12,439)	Mapleton	(1,304)
Maynard	(10,897)	Cottonwood	(1,228)
Cleveland	(10,675)	Kiester	(1,015)
Lewisville	(7,375)	Hanley Falls	(431)
Currie	(4,994)	Leroy	(331)
Cook	(4,431)	Proctor	(326)
Waldorf	(3,309)		

Liquor Store Profits Help Support Essential City Services

During 1996, Minnesota's municipal liquor stores transferred \$10.8 million of their profits to support essential city services. This represents a decrease of 8.6 percent from the total amount of transfers made in 1995. Liquor store profits that were not transferred to other municipal funds were used to bolster the fund balances of the liquor stores and purchase additional inventory. Cities that operate profitable municipal liquor stores and can transfer profits to other municipal funds are often able to hold down their property tax assessments for essential public services.

Municipal Liquor Operations Warrant Careful Scrutiny

City officials who are responsible for the operation of municipal liquor establishments must make certain that the operations are managed appropriately and continue to have a positive financial impact on the city. Minnesota law requires cities to hold a public hearing on the future of its liquor store(s) if the liquor operation has failed to make a profit in at least two of the past three years. Based on this statute, the following cities should have held a public hearing on their municipal liquor operations:

- | | | | | | | |
|-----------|------------|-----------|--------------|-----------|------------|------------|
| Avoca | Barnum | Cleveland | Currie | Delavan | Elbow Lake | Frazee |
| Goodridge | Graceville | Hadley | Hanley Falls | Kellogg | Lafayette | Lewisville |
| Lismore | Mabel | Okabena | Proctor | Shorewood | Trimont | |

In 1995, 14 cities were required to hold a public hearing on whether or not to continue to operate their municipal liquor stores. In 1996, the municipal liquor stores in 9 of those cities reported a profit; 3 of the cities discontinued operations; and 2 cities continued to operate at a loss.

Beyond the statutory responsibility of city officials to ensure that the liquor stores are making a profit, city officials also have a responsibility to ensure the liquor stores are managed efficiently and effectively. An analysis of the financial data for off-sale municipal liquor stores with similar levels of gross sales reveal large variances in total operating expenses. Table 2 highlights the variances in operating expenses for stores with similar levels of total sales.⁴

Table 2 - Off-Sale Liquor Store Total Sales and Total Operating Expenses

Off-Sale Municipal Liquor Stores With Total Sales Between	Number of Cities	Range In Total Operating Expenses
\$ 8,633 and \$ 150,000	7	\$ 1,703 to \$ 42,137
\$ 150,001 and \$ 200,000	3	\$ 36,910 to \$ 41,437
\$ 200,001 and \$ 250,000	7	\$ 42,801 to \$ 63,232
\$ 250,001 and \$ 350,000	5	\$ 38,305 to \$ 71,385
\$ 350,001 and \$ 450,000	4	\$ 52,248 to \$ 92,355
\$ 450,001 and \$ 650,000	17	\$ 72,138 to \$ 134,092
\$ 650,001 and \$ 950,000	11	\$ 90,922 to \$ 162,335
\$ 950,001 and \$ 1,350,000	9	\$ 138,525 to \$ 184,716
\$1,350,001 and \$ 2,000,000	11	\$ 148,412 to \$ 374,876
\$2,000,001 and \$ 3,000,000	12	\$ 200,112 to \$ 524,691
\$3,000,001 and \$ 7,344,538	7	\$ 503,678 to \$ 1,019,900

Data In Report Should Help City Officials

This report provides city officials with comparative data to help fulfill their responsibility to provide for the effective management of municipal liquor store operations. City officials should use this

⁴ A similar analysis for cities that operate both on-sale and off-sale liquor establishments is not possible. The operating expenses of on-sale establishments are generally considerably higher than the operating expenses of off-sale establishments. It would be inappropriate to draw comparisons between the total operating expenses of on-sale and off-sale establishments in different cities. Such comparisons would be flawed due to the potential for contrasting the operating expenses of a city with a small on-sale operation and a large off-sale operation with the operating expenses of a city with a large on-sale operation and a small off-sale operation.

report to compare their liquor store finances to the finances of municipal liquor stores with comparable levels of gross sales. Table 5, beginning on page 17, lists financial data for Minnesota's municipal liquor stores arranged by total gross sales of the stores. This table facilitates financial comparisons between liquor stores of similar sizes. Using the data in this manner, city officials can determine whether their gross profits (total sales minus the wholesale cost of sales) and operating expenses are appropriate. Cities with relatively low gross profits should consider whether the gross profits reflect their intended mark-up policies. If gross profits are well below the intended mark-up of inventory, excessive theft or breakage of inventory may be responsible. Likewise, if operating expenses are relatively high compared to similarly sized stores, city officials should look at stores with low operating expenses for ideas as to how they might operate more efficiently.

Table 3
Summary of 1996 Liquor Store Operations

On-Sale and Off-Sale

	1995		1996	
	Amount		Percent of Sales	
	1995	1996	1995	1996
Number of Cities	162	158		
Sales	\$ 55,855,276	\$ 56,442,420	100.0%	100.0%
Cost of Sales	33,333,745	34,158,840	59.7%	60.5%
Gross Profit	22,521,531	22,283,580	40.3%	39.5%
Operating Expenses	20,555,358	19,954,187	36.8%	35.4%
Income from Operations	1,966,173	2,329,393	3.5%	4.1%
Nonoperating Revenues	1,673,073	1,597,229	3.0%	2.8%
Nonoperating Expenses	277,202	258,716	0.5%	0.5%
Net Income Before Transfers	3,362,044	3,667,906	6.0%	6.5%
Transfers to Other City Funds	3,300,789	3,546,181	---	---

Off-Sale Only Stores

	1995		1996	
	Amount		Percent of Sales	
	1995	1996	1995	1996
Number of Cities	93	94		
Sales	\$ 108,324,419	\$ 117,961,934	100.0%	100.0%
Cost of Sales	82,630,959	89,940,870	76.3%	76.2%
Gross Profit	25,693,460	28,021,064	23.7%	23.8%
Operating Expenses	17,563,777	18,371,609	16.2%	15.6%
Income from Operations	8,129,683	9,649,455	7.5%	8.2%
Nonoperating Revenues	1,266,883	1,307,791	1.2%	1.1%
Nonoperating Expenses	281,888	250,434	0.3%	0.2%
Net Income Before Transfers	9,114,678	10,706,812	8.4%	9.1%
Transfers to Other City Funds	8,568,057	7,301,962	---	---

Total City Liquor Stores

	1995		1996	
	Amount		Percent of Sales	
	1995	1996	1995	1996
Number of Cities	255	252		
Sales	\$ 164,179,695	\$ 174,404,354	100.0%	100.0%
Cost of Sales	115,964,704	124,099,710	70.6%	71.2%
Gross Profit	48,214,991	50,304,644	29.4%	28.8%
Operating Expenses	38,119,135	38,325,796	23.2%	22.0%
Income from Operations	10,095,856	11,978,848	6.1%	6.9%
Nonoperating Revenues	2,939,956	2,905,020	1.8%	1.7%
Nonoperating Expenses	559,090	509,150	0.3%	0.3%
Net Income Before Transfers	12,476,722	14,374,718	7.6%	8.2%
Transfers to Other City Funds	11,868,846	10,848,143	---	---

Figure 2: City Liquor Stores Operating Income

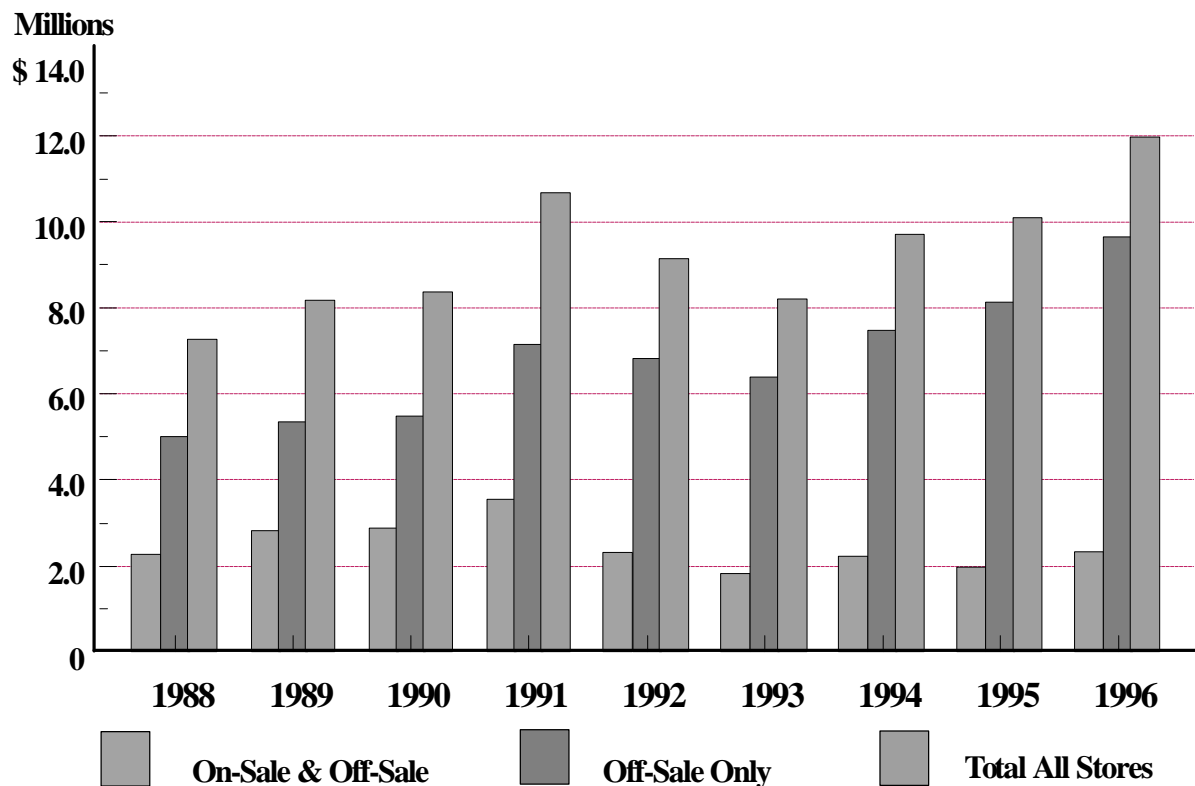
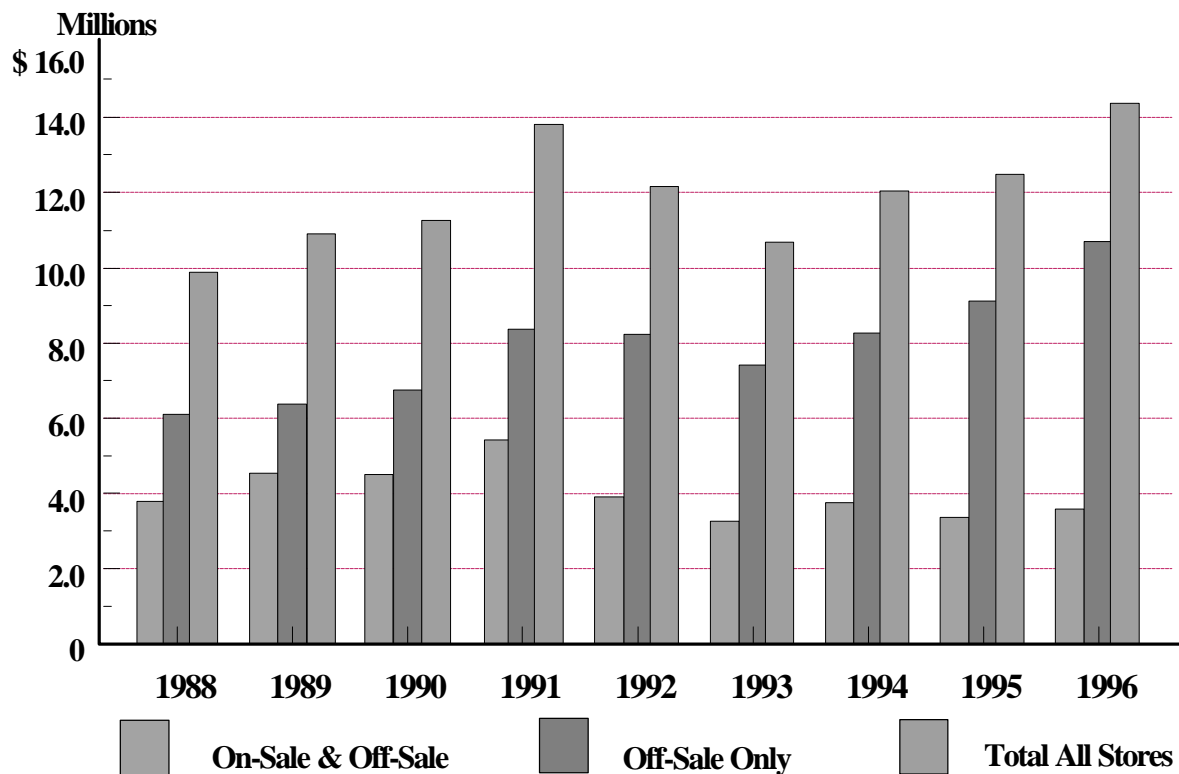


Figure 3: City Liquor Stores Net Income



Appendix 1

1996 Liquor Store Tables