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LOGISTICS, LOGISTICS, LOGISTICS: MODERNIZING THE ALCOHOL SUPPLY CHAIN

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INTRODUCTION

Logistics has become one of the go-to buzz words of our 21st century economy. Large shipping firms run ads touting their love for efficient logistics, and retailers the world over obsess about creating the most durable and responsive supply chains possible to ensure instantaneous availability of products.[1]

The emphasis on logistics is not misplaced. Logistics can be roughly defined as the process by which firms ensure that "the right type of product or service" is in "the right place, at the right time."[2] In other words, it involves the efficient and secure movement of products from one location to another in a commercial supply chain.

An efficient logistics operation can create immense monetary savings for firms, and ultimately for consumers as well. A quick glance at the numbers shows what is at stake. In 2018, businesses incurred $1.64 trillion in transportation and logistics costs, which represents over 8% of U.S. Gross Domestic Product.[3]

In order to create more efficient logistical networks, many retailing firms are increasingly focused on building out warehousing capacity for the products they sell, which reduces transportation costs while also ensuring a more consistent and robust supply of products on-hand. Other techniques such as transshipment between retail outlets—i.e., allowing one retail outlet to transfer products directly to another nearby outlet under common ownership rather than re-stocking via warehouses—have also created notable efficiencies and enhanced supply chain integrity.

While these technological and institutional improvements are embraced in nearly every industry, there are exceptions. The American alcohol market is perhaps the foremost exception, as it remains mired in outdated laws that handcuff the ability of alcohol retailers to modernize their logistical operations.

THE POWER OF LOGISTICS

To appreciate how innovations like increased warehousing capacity and transshipping can be beneficial, one merely needs to understand how supply chains normally function.

Most products are created by a manufacturer and sold via a retail outlet. Sometimes the retail outlet is affiliated with the manufacturer of the goods, but oftentimes it is not. In either situation, the location where the product is manufactured is rarely the same place where it is ultimately sold to consumers. For example, grocery stores sell dozens of different types of shampoo from dozens of different shampoo-makers spread across the globe. In order to stock those shampoos, the manufacturer sells the shampoo to the retailing company and carefully structured supply chains are used to transport the shampoo bottles to the store.

When store supplies start running low for a certain brand of shampoo, the retailer will naturally look to re-stock by purchasing more product. But the shampoo manufacturer is not always located nearby. If, say, the manufacturer produces its shampoo in France, an Alabama grocery store will have significant lag-time between placement of an order and arrival of the product in-store.

Hence, maintaining significant warehousing space can be critical. Instead of that store stocking only five bottles of the French shampoo on a shelf at a time, it can have hundreds, or even thousands, stored in a nearby warehouse, ready to restock low supply in mere hours rather than weeks or months. The potential cost savings are also immense since the transportation for every restock trip is reduced from thousands of miles to just a few. In the case of our French shampoo-maker, a trip across the ocean has been eliminated, along with associated time delays, extra costs and customer inconvenience.

Importantly, maintaining warehousing space is not just a benefit that accrues to large mega-stores. Smaller firms have increasingly looked to use third-party contract warehousing, in which several different retailers band together to share a common warehouse space.[4] This type of structure is similar to how different types of restaurants use warehouse stores to obtain many staple products that they are unable to store on-site.

But while the rising tide of warehousing would seem to lift all the ships in the retailing sea, alcohol sellers are often locked out of this innovative marketplace. Many states only allow alcohol retailers to store products at their actual retail premises—in other words, maintaining a separate warehouse location for storing their alcohol products is prohibited.

For example, Texas law specifically states that off-premise alcohol retailers cannot "own, possess, or store beer for the purpose of resale except on the licensed premises."[5] Furthermore, only licensed alcohol *wholesalers* can deliver beer to retailers, effectively banning centralized warehousing by retailers themselves.[6]

In the alcohol marketplace, wholesalers are required to be legally distinct entities from retailers on account of the so-called three-tier system for alcohol.[7] The three-tier system was implemented in nearly every state in the aftermath of Prohibition and requires alcohol manufacturers, wholesalers and retailers to all be legally separated. This not only forbids producers from operating their own storefronts to sell their products, but it also prevents retailers from engaging in operations like warehousing alcohol products since state laws often define this as the exclusive function of alcohol wholesalers rather than retailers.

In some states, the government itself is in charge of all alcohol warehousing. Ohio, like Texas, only allows retailers to store alcoholic products on their licensed retail premise.[8] But the government also owns and operates (via its JobsOhio program) the only two warehouses for distilled spirits in the state.[9] Restricted to these warehouses, which are tasked with supplying spirit retailers throughout the state, the brands and varieties of spirits available to Ohio liquor sellers is notably limited. For instance, the state only warehouses and stocks 96 brands of gin, which means that bars and stores are essentially prevented from obtaining and selling anything outside those offerings.[10]

Another innovation that is particularly salient in the post-COVID landscape is retail outlets that simultaneously operate as fulfillment centers or mini-warehouses for shipping products directly to consumers.[11] Stores like Best Buy have helped pioneer this strategy by essentially using their brick-and-mortar stores to do "double duty" as warehouses.[12] Unfortunately, many states still do not allow retail outlets to deliver or ship alcohol directly to consumers, thus foreclosing this option as well.[13]

In addition to enhanced warehousing capacity, some retailers have used transshipments between retail outlets as an additional means to create logistical efficiencies. In many cases, large, centralized warehouses are located in industrial parks or other areas where land is cheaper, whereas retail outlets are often clustered together in urban and suburban locales. The result is that a warehouse might be, say, 20 or 30 miles away from the retail outlets it normally supplies, but two retail outlets might be located only a mile or two apart.

In these situations, if one store unexpectedly runs low on a product, it may make more sense to re-stock it via transshipment from a nearby retail outlet, which has a surplus of that product on-hand, than via a faraway warehouse. The benefits of transshipments are not merely limited to reduced transportation costs. A so-called "stockout,"in which a store runs out of a product, is harmful because it "not only reduces retailers' profits, but also damages products' brand images" and erodes consumer value. [14] Transshipment often allows those products to be re-stocked quicker than they could be from a warehouse, a benefit that becomes even more valuable during crises that disrupt supply chains, like the COVID-19 pandemic.[15]

Once again, what is normal and possible in most sectors is often forbidden for alcohol. For instance, Illinois not only restricts alcohol storage to licensed retail premises, but it prohibits the direct transfer of alcohol from one licensed retail premise to another.[16] Oregon law similarly prohibits retail licensees from transfering alcohol between retailing locations.[17] Even more confusingly, some states distinguish between spirit type when it comes to what alcoholic products can be transshipped. For example, Washington state allows up to twenty cases of wine to be transshipped annually between retail locations under common ownership, but not beer or distilled spirits.[18]

That means that instead of transshipping to re-stock, the only re-stocks that are allowed are those that come through licensed alcohol wholesalers. Compounding the problem is the reality that alcohol wholesalers often operate as quasi-monopolistic entities within a state. In many cases, wholesalers are granted exclusive distribution rights over specific alcohol brands and within certain regions of a state, which means they enjoy the protected privilege of being the only game in town when it comes to warehousing and supplying alcohol to retailers.

In some situations, wholesalers will only make one or two deliveries a week to the retailers they supply, which inevitably causes significant supply chain disruptions and leads to retailers running out of products for several days at a time.

There is no shortage of recent examples of wholesaler-created supply interruptions in alcohol markets, underscoring the inefficiencies inherent in the current system.[19] It can also lead to near-comical situations, such as two retail outlets under common ownership that are located a few blocks apart actually having to send an alcoholic product back to the wholesaler—located many miles away—just for it to be transferred between stores. This legal structure allows the wholesaler to retain unnatural control over alcoholic products even after delivering them to retailers.

Instead of allowing a retailer to maintain its own warehousing operations, or allowing re-stocking via transshipment from another nearby retail outlet under common ownership, the industry remains captive to its strict three-tier system and an outdated set of laws that largely prevents these types of common-sense and customary logistical innovations.

FROM ELECTRONICS TO BOOZE

The question of *why* alcohol is cut out of marketplace innovations that could create logistical efficiencies for its commercial supply chains naturally arises. As ever, the argument often boils down to: Alcohol is different. In other words, what might be permissible for electronics at a store like Best Buy is not necessarily desirable for alcoholic products.

While this rationale can be appealing on the surface level, it fails to withstand serious scrutiny. To be sure, the government has clear and appropriate interests in ensuring that alcohol is not misused or sold in a way that undermines public health and safety. But this also acts as a limiting principle on government activity. If a law cannot be adequately justified on these grounds, it undermines the reason for its existence. As a recent Supreme Court case involving alcohol put it, a state's alcohol laws need to have a "demonstrable connection" to protecting public health and safety.[20]

Yet, when analyzing the legitimate governmental interests at play when it comes to alcohol it is clear that those governmental interests can be satisfied while at the same time allowing logistical networks to modernize.

For instance, alcohol regulators often cite "containment" as a key governmental interest—i.e., ensuring that alcohol products make it safely from point A to point B. But securely storing, transporting and tracking commercial products is the entire raison d'être of modern logistics networks. Efficient retailing companies already have world-class storage and tracking capabilities for the products they sell, supported by complex internal technological software that keeps track of every single product within the retailers' ambit. Modern grocery stores, as one example, now instantaneously track re-stocking and supply needs down to the individual item via sophisticated tracking software.[21]

The containment argument also glosses past a jarring logical disconnect. If a retailer has the authority to—and is judged to be competent at—legally selling alcohol to consumers who immediately take the product off-site to uncontrolled, unregulated locations, why can it not be entrusted with managing and controlling alcohol currently *on*-site?

Other skeptics point to the potential negative externalities associated with alcohol, such as drunk driving or alcohol abuse disorders. Those are good reasons for putting proper procedures in place to ensure alcohol is handled responsibly, but not for arbitrarily sabotaging logistical innovations altogether. Firms selling other types of products with negative externalities, and sometimes ones with far more extreme externalities than alcohol, such as pharmaceutical drugs or pesticides, are already permitted to operate warehouses and distribution centers as well as to transship products between stores. And importantly, laws against drunk driving and resources for those suffering from alcohol abuse have been in place for decades and can operate independently from any efforts to update alcohol logistical networks.

Another oft-cited governmental interest with alcohol is keeping it out of the hands of minors. But once again, procedures are already available for navigating this concern. If the concern is that minors could be handling alcohol shipments from warehouses to retail outlets, or between retail outlets, then rules can be put in place to address that. Of note, individuals under 21 already work at grocery stores and restaurants that sell alcohol but often are prevented from making any alcohol sales or working as a bartender, which provides a real-world example of how to protect governmental interests in a logical, nuanced way.

It is also important to take a step back and consider the incentives for alcohol sellers themselves when it comes to containing and properly tracking alcohol, as well as ensuring it does not end up in the hands of the wrong person. Retail outlets are engaged in the business of selling their products to generate profit. Each item that successfully arrives at a store is a product that can be sold, enhancing the business's bottom line. Alcohol sellers have a direct financial incentive to properly track their products, ensure they are delivered safely from a warehouse or another store, and are only sold to those who are legally entitled to buy it. Simply put, this is not the world of yesteryear when alcohol was occasionally "misplaced" (either accidentally or on purpose) and retailers would merely look the other way or be powerless to stop it.

Apart from the governmental interests at play, there are the interests of private actors to consider. Unfortunately, the nature of the three-tier system for alcohol distribution has carved out government-mandated monopolies or oligopolies at the wholesale level. By mandating that wholesalers have to be legally distinct entities from retailers or producers—and

then often granting them exclusive sales rights over a product or even a region—these firms are tremendously resistant to any changes that could undermine their government-enshrined role in the supply chain.

If a wholesaler has the exclusive rights to sell a certain brand of beer in county A, it will naturally resist any innovation that could undercut that arrangement. This means that if a store in county A runs out of that type of beer and could be re-supplied within hours by a sister retail outlet in county B, the wholesaler will likely argue that this infringes on their exclusive distribution rights for county A.

While this may be true, protecting monopolistic privileges is not a core governmental interest that is central to protecting public health and safety. If the public well-being can be ensured by transshipping between retail outlets from county A to county B, then such innovations should be permitted under the law. Of course, many wholesalers would likely argue that they are uniquely capable of safely and responsibly transporting products, but as noted above, experience in other industries has proven this to be untrue.

CONCLUSION

At a time when sophisticated logistics and the ever-relentless drive to create supply chain efficiencies are taking commercial markets by storm, alcohol remains stubbornly mired in the past. Innovations that would be utterly unremarkable in most industries, such as replenishing stock at one retail outlet with excess product at another nearby store under common ownership, are totally foreign in the world of alcohol.

Although the government has an undeniable interest in ensuring that alcohol is sold and accessed in a safe manner, it is clear that there is little public health and safety justification for banning basic logistical practices like central warehousing and transshipping. As COVID-19 continues to force policymakers to re-think supply chain integrity, a good place to start would be to allow the alcohol marketplace to realize the efficiencies of modernized supply chains.

ABOUT THE AUTHOR

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ENDNOTES

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