



## The Economic Value of Wine and Spirits Wholesalers (Updated July 1, 2009)

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Before Prohibition alcohol manufacturers either directly owned or had contracts with individual taverns to sell only their products. These “tied-houses” resulted in marketing practices that encouraged intemperance.<sup>1</sup> After the repeal of Prohibition, Congress and the general public believed that alcohol manufacturers should be separate from retailers. In order to ensure that this was the case state and federal governments adopted laws and regulations that created a three-tiered system of alcohol distribution.<sup>2</sup>

Following the adoption of the 21st Amendment, Congress passed the Federal Alcohol Administration (FAA) Act, which protected retailers from manufacturers by interposing wholesalers, thus the three-tier system was born. The FAA Act established strict limitations to ensure separation of these three tiers, such as limiting manufacturers’ ownership interest in retailers and by prohibiting manufacturers from giving “gifts” to retailers - including items such as bar equipment and merchandise.<sup>3</sup>

Following the Supreme Court’s *Granholm v. Heald* decision, some states have started to allow for the direct shipment of wine and spirits from manufacturers to retailers, in some cases undermining the three-tier system. Even though some of these “direct ship” sales are of high-end specialty wines, some suppliers and retailers have attempted to further break down the three-tier alcohol distribution system by assuming the role historically occupied by the wholesaler.

While there may be specific cases where retailers or product manufacturers could also serve a wholesaling function; however, this analysis shows that the existing three-tier system not only serves a public purpose, but also adds value to both production and retail operations – value that would unlikely be generated without the existence of wine and spirits wholesalers. In fact, virtually all of the cost of wine and spirits wholesaling operations directly benefits consumers.

### Background:

Economic analysis has long shown that wholesalers fulfill the valuable role of lowering transaction costs and search costs for consumers. They do this by providing both product manufacturers (in this case wine makers and distillers) and retailers with a wide range of services, including the maintenance of inventories, providing sorting and breaking of large lots, even climate control storage. These benefits can potentially save producer’s labor and other overhead expenses, and retailers the capital investment that would be required to provide physical space for these activities.<sup>4</sup>

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<sup>1</sup> The name comes from a practice in England where a bar may be tied, by ownership links or contractual obligations, to a specific manufacturer.

<sup>2</sup> Fosdick, , Raymond B., and Albert L. Scott, *Toward Liquor Control*, (Harper & Brothers: New York), 1933,  
<sup>3</sup> *Code of Fair Competition for the Distilled Spirits Industry* (Washington, D.C., 1935).

<sup>4</sup> Martin, Stephen, *Structure and Performance of US Wholesale Trade*, Managerial and Decision Economics, Vol 5, No. 3, September 1984.

Wholesaling is a large part of the American economy. In fact, in 2007, sales of all products by wholesale distributors reached nearly \$5.8 trillion<sup>5</sup> and distributors employed one out of every 23 people in the US labor force.<sup>6</sup> Wholesale distribution contributed significantly to gains in productivity in the US economy over the past decade, benefiting consumers, retailers and product manufacturers by keeping wholesale costs, inventory carrying costs and retailer price lower.<sup>7</sup>

In the case of beverage alcohol products, the nation's 4,100 wine and spirits wholesaler locations are an integral part of the distribution process, providing a wide range of services. For restaurants, wholesalers conduct tasting seminars for wait staff, develop and print wine lists, suggest food/wine pairings and train bartenders in the newest cocktail recipes. They also help organize special events at bars and restaurants, develop advertising and promotional programs to complement local events and act as the local representative for vintners and distillers. Wholesalers stock retailer shelves, develop optimum shelf placements for brands and types of alcohol, and help store operators conduct wine tasting events, all functions that myriad alcohol beverage manufacturers would otherwise have to do themselves.<sup>8</sup>

To perform this wide range of services, the nation's wine and spirits wholesalers directly employ nearly 68,900 people paying \$2.8 billion in wages. All told, America's 4,100 wine and spirits wholesaler locations generate \$4.7 billion in economic activity. Wine and spirits wholesalers add value to every product they handle. In fact, every \$1.00 spent on wine and spirits wholesaling generates an additional \$1.47 in economic activity as well as \$0.22 in Federal and nearly \$0.24 in state and local tax revenues. This does not even include the nearly \$5.6 billion in Federal and \$2.8 billion in state and local excise taxes on the products themselves that are collected by wholesalers.

### **The Importance of Wine and Spirits Wholesalers for the Nation's Beverage Alcohol Manufacturers and Retailers:**

While wine and spirits wholesalers serve a number of important "qualitative" functions, they also generate significant value for product manufacturers and retailers. For every \$1,000 worth of wine or spirits sold to the consumer, the cost of products from wineries and distilleries is \$477.79. Wholesalers add another \$103.40 in value.<sup>9</sup> Of this, over 34.9 percent (\$36.10) goes toward goods and services purchased by wholesalers that would otherwise have to be paid for by manufacturers or retailers including:

- ❖ \$6.63 for warehousing and storage;
- ❖ \$0.58 for financial carrying costs;
- ❖ \$2.21 for transportation costs;
- ❖ \$0.36 for legal and accounting services;

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<sup>5</sup> See *Estimated Sales and Inventories of U.S. Merchant Wholesalers:2002 through 2007*, US Department of Commerce, Bureau of the Census, on-line at: [http://www2.census.gov/wholesale/xls/awts/2007\\_awts\\_salesinv.xls](http://www2.census.gov/wholesale/xls/awts/2007_awts_salesinv.xls)

<sup>6</sup> See: *Current Employment Statistics (CES)*, Bureau of Labor Statistics, on-line at: [www.bls.gov/ces/](http://www.bls.gov/ces/)

<sup>7</sup> Wholesale productivity has been growing at a rate of 3.3 percent per year. See: *Productivity and Costs by Industry: Wholesale Trade, Retail Trade, and Food Services and Drinking Places Industries, 2007*, US Department of Labor, Bureau of Labor Statistics, August 21, 2008, on-line at: <http://www.bls.gov/news.release/prin1.nr0.htm>.

<sup>8</sup> This would be rather difficult when one considers that there are nearly 200 distillery operations in the country and about 3,270 wineries.

<sup>9</sup> Data come from an input-output model of the United States maintained by the Minnesota Implan Group.

- ❖ \$0.48 for communications;
- ❖ \$0.45 for displays and other promotion materials;
- ❖ \$1.20 for advertising services;
- ❖ \$0.23 for inventory control; and
- ❖ \$0.43 for insurance.

In total, wholesalers reduce operating costs throughout the supply chain by \$49.01 for every \$1000 spent on wine and spirits by consumers. This is because wholesalers help to lower overall labor costs. Product manufacturers in particular have high-cost in-house labor. Wholesalers assist manufacturers by performing a number of important functions ranging from stocking stores to product rotation to erecting store displays. This can lead to higher productivity and reduced costs for consumers. Looking at these savings on a national basis, wine and spirits wholesalers save manufacturers and retailers as much as \$7.72 billion in direct operating costs.<sup>10</sup>

By covering so many of the costs associated with bringing beverage alcohol products to consumers, wine and spirits wholesalers are an important partner to both retailers and producers. Without wholesalers, manufacturers would need to hire additional employees to do things like stock retail shelves, and maintain inventory control systems. Retailers would be forced to manage excise tax collections for the various state and local governments that levy those taxes. Performing additional functions would be particularly difficult for retailers since they have generally very low profit margins. For example:

- ❖ Private liquor stores have average profit margins of about 11.3 percent; and
- ❖ Convenience stores have an average profit margin of 10 percent;
- ❖ Grocery Stores have an average profit margin of just 4.9 percent
- ❖ Restaurants and bars have an average profit margin of only 1.4 percent;

### **Conclusions:**

Congress and state governments recognized as far back as 1933 that alcohol sales should be conducted under a three-tier system that gave specific responsibilities to beer, wine and spirits wholesalers including the collection of taxes and the promotion of a fair and honest system to ensure that adult consumers have access to a wide range of products.

One benefit of the three-tier system has been that wholesalers help product manufacturers to lower their operating costs. Nationally, wine and spirits wholesalers save the other two tiers as much as \$7.72 billion – close to 5 percent of total retail sales. They do this not only by using their economies of scale and specialized labor to provide services more productively than can either manufacturers or retailers themselves, but also by covering specific costs including financial carrying costs, storage costs, even display and stocking costs.

The 68,900 people working for the nation's 4,100 wine and spirits wholesaler locations save the other two tiers as much as \$49.01 for every \$1,000 spent on quality wine and distilled spirits products.

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<sup>10</sup> Based on total on- and off-premise retail sales of \$157.5 billion.



## The Value of Wine & Spirits Distributors to the Nation's Wineries, Distillers and Retailers

The nation's 4,100 wine and spirits wholesaler locations are the crucial part of the responsible and efficient distribution system that provides adults with access to a wide variety of quality products from around the world. In addition to helping ensure that only responsible adult consumers have access to beverage alcohol products wholesalers fulfill the valuable role of lowering transaction and search costs for consumers. In fact, wholesale distribution contributed significantly to the gains in productivity in the US economy over the past decade, benefiting both consumers and retailers.

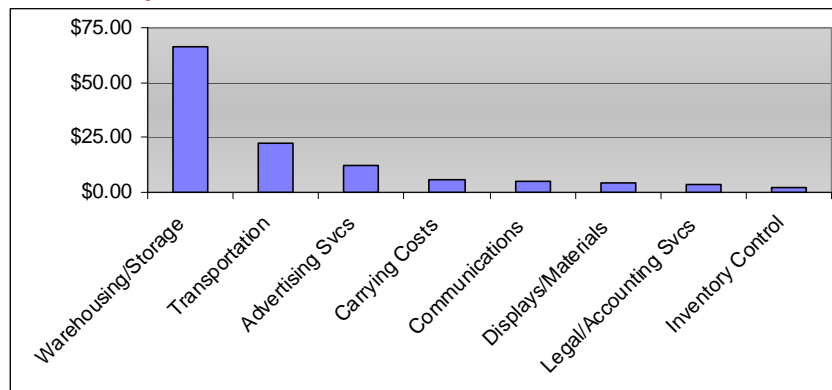
### The Nation's Wine and Spirits Wholesalers Provide Manufacturers with Specialized Services:

- Wine and spirits wholesalers provide a wide range of services. Wholesalers conduct tasting seminars for restaurant wait staff, develop and print wine-lists, suggest food/wine pairings and train staff in the newest cocktail recipes. They act as the local representative for vintners and distillers.
- Wholesalers also provide services to manufacturers at the retail level such as stocking shelves, developing optimum shelf placements for products and helping conduct wine tasting events.

### The Nation's Wine and Spirits Wholesalers Generate Value for Retailers:

- For every \$1,000 spent on the services of Wine and Spirits Wholesalers, \$361 goes toward goods and services purchased on behalf of manufacturers or retailers, including \$66.30 for warehousing and storage, \$5.80 for financial carrying costs and \$12.00 for advertising services (see chart below):

#### Expenditures by Wholesalers on Behalf of Wineries, Distillers and Retailers



- In total, wholesalers reduce operating costs for the other two tiers by \$49.01 for every \$1000 spent on wine and spirits by consumers. This is because wholesalers assist manufacturers by performing a number of important functions ranging from stocking to product rotation to erecting store displays.
- Services provided by wholesalers lead to higher productivity and reduced costs for consumers. Nationally, wine and spirits wholesalers save wineries, distillers and retailers as much as \$7.7 billion in operating costs each year.

### The Nation's Wine and Spirits Wholesalers Generate Value for the Economy:

- The nation's wine and spirits wholesalers directly employ nearly 68,900 people, paying \$2.8 billion in wages and generating \$4.7 billion in economic activity.
- Wine and spirits wholesalers add value to every product they handle. Every \$1.00 spent on wholesaling generates an additional \$1.47 in economic activity as well as \$0.22 in Federal and nearly \$0.24 in state and local tax revenues. This does not even include the nearly \$5.6 billion in Federal and \$2.8 billion in state and local excise taxes on the products themselves that are collected by wholesalers.