

Virginia ABC Efforts to Identify and Address Retail Shrink.

May 31, 2023

Introduction

Virginia ABC is placing renewed emphasis in reviewing its operations and how we serve our customers and our teammates, in this dynamic retail environment. Focusing on the “why we exist” – our customers and “how we exist” - our teammates, Virginia ABC will continue to undergo its positive transformation as an Authority for the benefit of all Virginians.

As part of our review of operations, Virginia ABC is examining how it handles and tracks retail shrink. Retail shrink is the loss of inventory through process control failures, theft and damages. Increasing retail shrink is a current trend throughout all retailers in America from which Virginia ABC is not immune. Shrink must be addressed through better processes and monitoring of results. In some ways, Virginia ABC has greater exposure to shrink caused by theft due to the products we sell. According to the National Retail Federation, items most frequently targeted for theft in retail environments are CRAVED: concealable, removable, available, valuable, enjoyable and disposable. Distilled spirits fit within these six categories, posing a unique challenge to how Virginia ABC will operate in this environment.

Retail shrink impacts both Virginia ABC customers and teammates in how our organization provides services and maintains operations. We must maintain a safe and enjoyable experience for our customers and teammates while finding ways to deter and detect theft and other aspects of shrink. While shrink will likely never be eliminated from the retail market entirely, Virginia ABC is taking steps to better track shrink and manage inventory to empower our decisions and the actions that follow for the benefit of Virginia.

Overall Shrink at Virginia ABC

Shrink related to **process control failures, theft, and damages** is collected from reports generated through Virginia ABC’s data reporting system, Oracle BI, and reported out through manually maintained spreadsheets for both the Distribution Center (DC) and Retail Operations. Shrink numbers are reported weekly for Retail and daily for the DC. Under previous processes, all shrink was tracked as a combined number, without reference to the cause of the shrink.

The table below provides historic numbers on net shrink, accounting for overages as well as shorts, as a combined number from activities in retail stores and the distribution center.

Year	Total Shrink	Gross Alcohol Sales	Percent of Sales
FY 2023 as of 04/30	\$1,127,449*	\$1,198,907,081	0.094%
FY 22	\$1,528,488	\$1,369,654,840	0.112%
FY 21	\$2,828,253	\$1,329,826,387	0.213%
FY 20	\$2,205,666	\$1,173,498,688	0.188%

* Based on physical inventory count at March 31, 2023

Virginia ABC's shrink numbers compare favorably to the overall retail market. According to the National Retail Federation, the average retail shrink for fiscal year 2021 was 1.4% of total retail sales with about 18% of retailers reporting shrink at .49% or lower.

To better track and report on shrink, Virginia ABC is creating a centralized dashboard. The dashboard will contain total shrink as a percentage of sales. Shrink will also be tracked by location, to include the distribution center, in-transit and in the retail stores.

To enable the Authority to approach loss prevention more proactively, a dedicated Loss Prevention function supported by two additional staff members is budgeted for next fiscal year. The Loss Prevention function will focus on establishing a loss prevention strategy, developing supporting processes and initiating continuous monitoring activities to safeguard assets and improve loss prevention.

Inventory Activity

Periodic inventories provide insight into where shrink may be occurring. During the month of March, Virginia ABC initiated a full physical count of its stores and distribution center. The goal with this effort was to establish a clearer understanding of our inventory position and identify opportunities for improvement. Overall inventory results for both retail stores and the distribution center compare favorably to industry expectations for shrink. However, there are process gaps and improvements that were identified during the effort that can help to reduce both overages and shorts, thereby reducing the value of adjustments being made.

Retail Store Inventories

The Retail team completed 394 store inventories in 38 days. Inventories began in stores February 24 with the last store inventory being completed March 31.

The inventory showed 237 stores with an overage and 158 stores with a shortage. In total, the physical inventory accuracy (% of items with accurate inventory amounts compared to system of record) for all stores as of 3/31/2023 was 89.7%. Total net retail shrink/swell was -0.114% of sales.

Distribution Center (DC) Inventory

The new Virginia ABC Distribution Center, in Hanover County, underwent its first full physical count in March 2023. The Distribution Center inventory took three days to complete, beginning March 23 and finishing March 25.

Staff counted 1,027,763 cases, and 42,027 loose bottles in each of the distribution center's 16,029 locations. Inventory was conducted manually due to the tight deadline to complete a full physical count.

The inventory resulted in a 5.37% adjustment rate for the distribution center. The bottle or case count showed an overage of 0.013% equating to net adjustments of adding 160 cases to inventory and a reduction of 96 bottles for a monetary value of \$13,680.

A good inventory count (based on the calculation of the difference in value at the end of the count versus the original book value of the total inventory) is regarded as anything above 97%. Best in class is considered to be 99.5%. Virginia ABC achieved 99.987% within the Distribution Center.

The DC inventory management system was configured according to industry best practices to maintain accurate inventory. Training, coaching, and accountability to adhere to inventory procedures along with system driven processes, rather than manual, were instrumental to a strong inventory result.

External Theft at Virginia ABC Stores

In recent months, Virginia ABC teammates are reporting more brazen attempts at shoplifting, a trend that is reflected throughout the retail environment. Ranging from the individual actor to coordinated groups, retail larcenies pose a challenge to safe and efficient operations. Local jurisdictions such as Virginia Beach, Chesapeake, Portsmouth, Newport News and Richmond are reporting large increases in larcenies from Virginia ABC stores that are impacting overall crime statistics. In order to address these increases, Virginia ABC is utilizing both retail and enforcement resources.

With public safety resources stretched thin, providing local jurisdictions with actionable information within targeted areas is imperative to achieving beneficial results. We are instructing our teammates on how to safely gather information that increases the likelihood of solvability when they see a theft taking place, always placing their safety and the safety of our customers as a priority. Virginia ABC is currently working with numerous jurisdictions on assessing stores utilizing Crime Prevention Through Environmental Design (CPTED) principles. Efforts are currently underway to review various aspects of high shrink stores to implement changes that will assist in deterring and detecting theft. Actions include emphasizing interaction with customers, minimizing the number of high shrink products that are placed on shelves at any one time, moving products for maximum visibility, lowering inventory levels at stores, adding personnel, installing additional cameras and checking effectiveness of placement, installing height strips and height strip cameras.

While Virginia ABC is fortunate to have a Bureau of Law Enforcement with fully sworn officers, the primary mission of our special agents is the licensing, regulation and compliance of ABC licensees. In that mission, we've built and maintain impactful relationships with local law

enforcement across the Commonwealth. Virginia ABC is working with local law enforcement to identify stores experiencing higher levels of theft and targeting them with greater resources. Activities will include visits by local officers at times when shoplifting most frequently occurs. ABC is also working with jurisdictions to enhance reporting capabilities, attend local jurisdiction meetings to discuss crime statistics and encourage greater interaction between store personnel and patrol officers.

ABC Enforcement and local police have also executed planned operations designed to apprehend individuals suspected of retail larceny immediately. A total of 17 joint operations were conducted in the first four months of the year: eight operations in Chesapeake, four operations in Virginia Beach, three operations in Richmond and one operation in both Portsmouth and Newport News. Arrests occurred as part of four of the operations – two in Chesapeake, one in Portsmouth and one in Virginia Beach. Even when an arrest does not occur, we believe the operations have a deterrent effect on acts of crime at our stores.

Internal Theft

According to NRF, internal theft accounts for close to 30% of retail shrink. These activities can be difficult to detect and quantify due to the very nature of individuals knowing the processes and vulnerabilities to theft in the retail environment, allowing them to hide criminal behavior. The key to deterring and detecting internal theft is to maintain clear and consistent operating procedures for teammates to follow and to review activities for compliance with these procedures. Challenges with maintaining up to date standard operating procedures (SOPS) and frequently changing procedures, often due to quickly emerging situations (most recently responses to COVID) can make it hard for teammates to maintain consistency. Going forward, Virginia ABC is placing a greater emphasis on maintaining SOPS at the store level.

COVID-19 made it difficult for Virginia ABC Internal Audit to visit stores as frequently as was the case in prior years. Additionally, implementation of a new point of sale system (POS) meant that audit procedures need to be adjusted to account for the new system and processes used in its operation. After redesigning the store audit and testing it with select stores, Internal Audit will initiate store audits across the fleet in the coming months. These audits will help to identify risks and vulnerabilities that can be addressed by Virginia ABC.

One such system vulnerability was already identified and addressed by Virginia ABC. On April 11, 2022, a Retail District Manager notified ABC Enforcement, ABC Human Resources and his direct supervisor of the potential abuse of the vulnerability at Store 289. His report described how the vulnerability was exploited and provided evidence of the activity. ABC Enforcement assigned an agent to investigate the matter that same day. No other actions were initiated following the initial report.

On May 5, 2022 ABC Enforcement contacted Internal Audit regarding the criminal investigation. Internal Audit had not been contacted previously regarding the vulnerability. When contacted by Enforcement, Internal Audit confirmed it would initiate its own investigation to examine any controls that either failed or were non-existent that allowed for the exploitation to occur.

On June 1, the Special Agent in Charge of the Roanoke area contacted Internal Audit and Retail personnel to notify them that pending charges against three employees were to go before the Roanoke City Grand Jury on Monday, June 6, 2022. Internal Audit was aware of the Enforcement investigation. Internal Audit was continuing its analysis to determine how the vulnerability was utilized, examining control and process breakdowns that allowed the theft to occur, with a goal of preventing or detecting the activity earlier. The resulting internal audit report was not issued to Authority leadership by Internal Audit until February 14, 2023 due to a failure in the process to issue the report.

Misuse of the vulnerability was reported at a different store in February 2023, when the existence of the report came to light. Following this discovery, a joint effort was initiated between Enforcement and Internal Audit to review system and process vulnerabilities to determine if there were other instances of this behavior.

Using the outputs from a risk assessment methodology, store visits were made to review video from February 25 – March 5. The investigation encompassed 34 stores, 149 operators and the review of 1,100 video transactions. Suspect transactions were referred to Internal Audit for determination of whether a theft occurred.

Based on our investigation, a total of 7 stores experienced theft through the identified system and process vulnerability over the last 12 months. As a result of the ABC Enforcement investigation, the three employees who were the subjects of the criminal investigation were ultimately terminated, convicted and ordered to pay restitution. Six stores remain where transactions are under investigation.

As a result of this investigation, Virginia ABC has enhanced tracking and reporting of all POS transactions, and will utilize employee training and Internal Audit functions to prevent any recurrence.