STAFF TESTIMONY BEFORE THE PENNSYLVANIA MILK MARKETING BOARD
MINIMUM RETAIL PRICES HEARING – ALL MILK MARKETING AREAS
February 1, 2023

Good morning. My name is Gary Gojsovich. I am employed by the Pennsylvania Milk Marketing Board as an Audit Supervisor. This morning I will be giving testimony and offering exhibits in response to the Board's request to have the in-store handling costs updated which are a component of the PMMB's minimum retail prices.

Purpose

Board Staff conducted a study of a cross-section of stores in each of the Pennsylvania Milk Marketing Board areas to determine what the in-store handling costs is for each of the areas. These newer in-store handling costs should then replace the in-store handling costs currently being used in each corresponding Area.

Study

Board Staff elected to use the Kirkland method for our study with a small modification; the modification being the use of sales units instead of sales dollars for the allocation of Checkout costs to milk activity.

The Kirkland method was developed to determine how much it cost a store to handle a quart of milk from the moment milk is received from a dairy until it is sold to a customer. Along the way, milk is stored in a cold storage area, placed in refrigerated display areas and ultimately scanned for sale at a checkout area.

Exhibit 1 shows an example of the modified Kirkland method for a fictitious store. The modified Kirkland method has the total costs of a store grouped into four cost categories (Labor, Building, Equipment, and Other). The costs in each of these categories is then allocated to Milk Display and Checkout; labor costs are allocated using wages whereas the other cost categories are allocated using square footage. Checkout costs within each category are then further allocated to Milk activity using the percentage of milk units sold in relation to all units sold. The Milk Display costs and the Milk Checkout costs are then totaled for the store.

Total Milk Display costs are divided by the total quart equivalents of Milk sold for the period to derive the Milk Display portion of the in-store handling cost per quart for the store. Units are converted to quart equivalents so that larger sized containers are given more weight (e.g., a gallon is equal to 4 quarts) and smaller sized containers are given less weight (e.g., a pint is only equal to half of a quart). Total Milk Checkout costs are divided by the total Milk units sold for the period to derive the Milk Checkout portion of the in-store handling cost per quart for the store. The Display and Checkout in-store handling amounts are summed to derive the in-store handling costs for a quart-sized container of milk.

The in-store handling costs for the other sized containers sold by the cross-section stores (Gallons, Half Gallons, Pints, etc…) is calculated by extrapolating the Display costs of the Quart to the other sized container. For example, the in-store handling costs for a Gallon would be calculated by first multiplying the Display costs for a Quart by four and

then adding to that the same Checkout costs as that for the Quart. The assumption being that it costs the same to run a Gallon and a Quart through Checkout, whereas a Gallon takes up 4 times more space (and related costs) than a Quart in the Display areas.

A cross-section of stores was judgmentally selected for each Area using the following criteria. 1.) All stores selected are licensed by the PMMB. This was done to make it easier for us to gain compliance in obtaining data from any store. 2.) at three stores selected per Area with at least one being a convenience store. A minimum of 3 stores is necessary to prevent any one store from reverse engineering results to figure out underlying data of another store in the same cross-section. 3.) No two stores in an area can be owned by the same parent company. And 4.) Stores must be at least 25 miles apart and must be located in different Counties. See Exhibit 2 for a listing of the stores selected for each Area.

Each store selected was asked to complete a survey form by which they would provide sales and wage information for the month of March 2021. Each store also provided a profit and loss statement for the month of March 2021. Board staff visited each store to obtain square footage measurements of various areas of the interior of the store. Exhibit 3 shows an example of a blank survey form.

Sales and wage data per the survey forms was verified by Board Staff. The profit and loss statements were also reviewed by Board Staff for completeness and adequate detail such that costs could be grouped into the four categories (Labor, Building, Equipment and Other).

Using the costs, sales, wage and square footage data for each store, an in-store handling worksheet (refer to Exhibit 1) was completed for each store being studied.

Results

For each area, for each container size, the in-store handling costs of each store were weighted based on each store's milk sales in relation to the total milk sales of the cross-section dealers for an Area. For example, if Store A sold 100 Gallon containers of milk, and the total of Gallon container milk sales by the cross-section was 200, then Store A's in-store handling costs for Gallons would be weighted by 50% (where 100 divided by 200 equals 50%).

Since the study was only conducted for those container sizes which were sold by the stores in the cross-section (those being gallons, ½ gallons, quarts, pints and ½ pints). For the other container sizes not sold by the cross-section dealers (i.e. 12 ounce, 10 ounce, 4 ounce and dispensers), the in-store handling costs for those size containers was calculated by using the next larger size container. For example, to calculate the in-store handling costs for a 12 ounce container, the in-store handling costs for a Pint was divided by 16 and then multiplied by 12.

Also, due to the lag in time between our getting the store financial data and the holding of this hearing, we updated our results using the Consumer Price Index for all urban consumers (CPI-U). See Exhibit 4 for listing of CPI-U for the period January 2021 through November 2022.

The results for each Area can be found in Exhibits 5 through 10. For each Area, we have shown what the in-store handling costs for each container size was as of March 2021 (column C), what those in-store handling costs would be if updated to November 2022 using the CPI index (column D), what the existing in-store handling costs are per

the January 2023 PMMB Retail prices (column E), and lastly what the variance is when comparing our proposed numbers in column D to the existing numbers in column E (columns F and G).

The variances for container sizes smaller than a quart are quite large for all Areas. These large variances are attributable to our current study being inclusive of all container sizes sold by the cross-section stores (i.e., Gallons, Half Gallons, Quarts, Pints and Half Pints), whereas the prior study was only inclusive of Gallons, Half Gallons and Quarts. For the prior study, the in-store handling costs for Pints and Half Pints were calculated by first calculating the actual in-store handling costs for Gallons, Half Gallons and Quarts and then extrapolating the result for those sized containers to the Pints and Half Pints (as well as to the 12 Ounce, 10 Ounce and 4 Ounce). Therefore, the calculation of the in-store handling costs for Pints and Half Pints (and 12 Ounce, 10 Ounce and 4 Ounce) is much different under the current and prior studies. Board Staff believe the prior study was flawed by having excluded Pints and Half Pints and that the current study provides more accurate results by including Pints and Half Pints.

Conclusion

Board staff recommends that the Board replace the in-store handling costs currently being used in each PMMB area for Retail pricing with those per column D ("Weighted In-Store Handling Costs per Unit (updated to NOV-2022)" of the corresponding Staff Exhibits.

Staff further recommends that these in-store handling numbers be adjusted monthly using the CPI-U as part of the Resale Priceday process which is consistent with current practice.

Thank you. I'd be happy to answer any questions pertaining to my exhibits.