MINISTRY OF FINANCE FINANCIAL IMPACT ASSESSMENT ADVICE TO THE MINISTER

Subject: Liquor Policy Review

Submission Date: December 18, 2013 (P&P); Minute to January 15, 2014 Cabinet

Cabinet Message: The fiscal plan impact of the Liquor Policy Review recommendations, including allowing liquor retail in grocery stores require Treasury Board review.

Issue Summary:

- The Ministry of Justice (JAG) is providing an overview of the Liquor Policy Review results and an overview of BC's liquor retail market as it relates to a report recommendation to allow liquor retail sales in grocery stores.
- In November 2013 government announced that the Liquor Policy Review included a recommendation to allow liquor retail in grocery stores while maintaining the existing cap on the total number of retail outlets.

Key Points:

- The current fiscal plan includes approximately \$2.6 billion in Liquor Distribution Branch (LDB) net income. s.13
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Financial Impact:

s.13

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Date: December 17, 2013

Liquor Policy Review



PRIORITIES AND PLANNING DECEMBER 18, 2013

Final Report



The Liquor Policy Review final report is a direct reflection of what British Columbians told us they want to see:

- Modernize liquor policies
- Increase convenience for consumers
- Balance health and safety
- Lessen the regulatory burden for manufacturers and licensees.

Final Report



73 recommendations in the areas of:

- Health, safety and social responsibility;
- Retail and convenience;
- Economic growth, jobs, tourism and marketing;
- Licensing and cutting red-tape;
- Change management.

Final Report



My conclusion: Today's retail model has not kept pace with consumer's expectations. While British Columbian's respect the need to protect health and safety, they feel we need greater balance to convenience. I believe making liquor available in grocery stores with the appropriate safeguards is an important step to finding this balance.

Key elements of grocery retail recommendations:

- Continue to restrict the total number of retail outlets;
- liquor should be separate from grocery products, ensuring continued restricted access to alcohol for minors;
- adopt a phased-in approach to the new retail model.

Context - Retail Players



BC has over 1000 liquor stores — most have located close to major grocery retailers to benefit from this proximity. As a result, the majority of grocery stores in the province have a liquor store within 1km.

The Players:

- 670 Private Retail Stores (LRS)
- 221 Rural Agency Stores (RAS)
- 195 Government Stores (GLS)
- 61 Wine Stores

Context - Sources of Government Revenue

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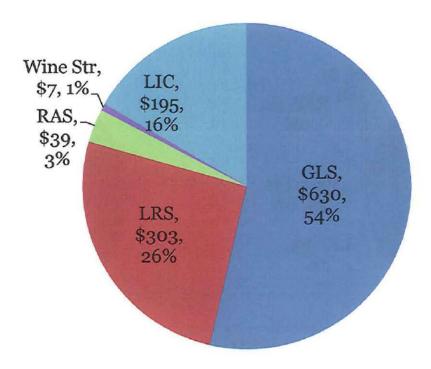
Although not the biggest seller by volume, Spirits are the largest contributor to government revenues.



Context - Sources of Government Revenue Cont.

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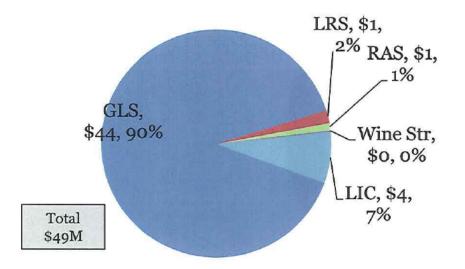
GLSs are the largest contributor to government revenues.



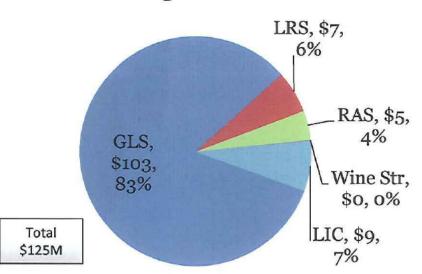
Context - BC Wine Retail Channels

Almost \$50M in VQA Wines are distributed by LDB, 90% of which are sold by GLS \$125M in non-VQA BC wines are distributed by LDB, of which 83% are sold by GLS

VQA Wines (\$M)



Non-VQA BC Wines



NOTE: LDB distributed sales represents approximately 25% of total VQA sales. Remainder is distributed markup free direct to LRS, Licensees etc.*

*Additional estimates available in Value Chain Analysis and Strategy in the Okanagan Wine Industry, Cartier, 2013

Context – BC is Unique



 B.C. has the only full hybrid model in Canada – allowing both private and government retailers to sell all product lines: beer, wine and spirits

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- Considering the ratio of population / number of stores across Canadian jurisdictions, s.12, s.13
 - Only two provinces (Alberta and Newfoundland) have a higher ratio of retail stores by population – BC is near Alberta's s.12, s.13
 - o BC − 1:3836, Alberta − 1:2753, Ontario − 1:7340 o^{s.12, s.13}

Key Attribute Considerations



Implications of Licences transferred to grocery

Greater convenience to the BC consumer

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 Permit licence relocation throughout the province (Currently restricted)

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The Key Risks - Mitigation



- Analysts are working on strategies to address these risks including the use of multiple policy levers.
 - o pricing
 - o 1km rule
 - Flexibility of grocery model for BC industry
 - Level playing field for LRS and LDB retail

Conclusion & Next Steps



 Liquor in grocery provides a significant opportunity to improve convenience for BC consumers.

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- On January 29th
 - RFLs for LCLA and LDA
 - o Crown model
 - Pricing Leveling the playing field

Liquor Briefing

PRESENTATION TO PRIORITIES AND PLANNING COMMITTEE

JANUARY 27, 2014

Agenda



- LDB Pricing Models
 - o Overview
 - o Wholesale Options
- Beer Pricing Policy

BC Liquor Pricing—Context

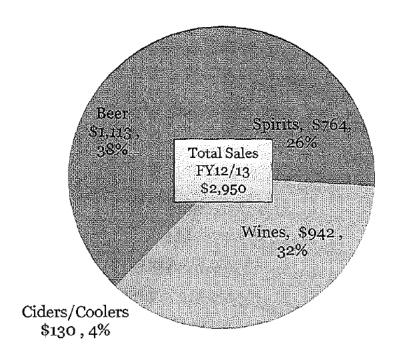


What products do we sell?



- Annual liquor sales in BC are approaching \$3B
- ► Although declining over time, beer continues to be the biggest seller, followed by wines and then spirits.

Sales (\$M)



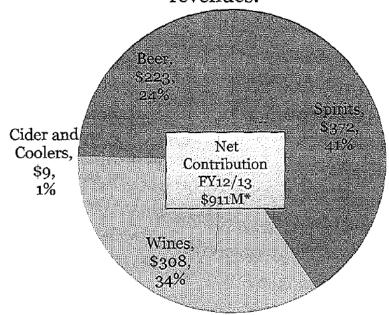
* Pie chart does not show sales of Miscellaneous/Special Order since amount is not significant ~\$1.4M.

Breakdown of Liquor Sales by Product Type (\$M)*

Which products make money for government?

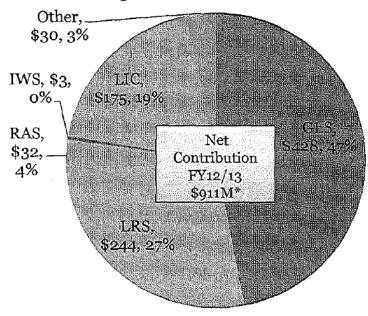
(5)

Although not the biggest seller, spirits are the largest contributor to government revenues.



Net Contribution to Government by Product Type (\$M)**

As the largest spirits and wines retailer, GLS's are the largest contributor to government revenues.

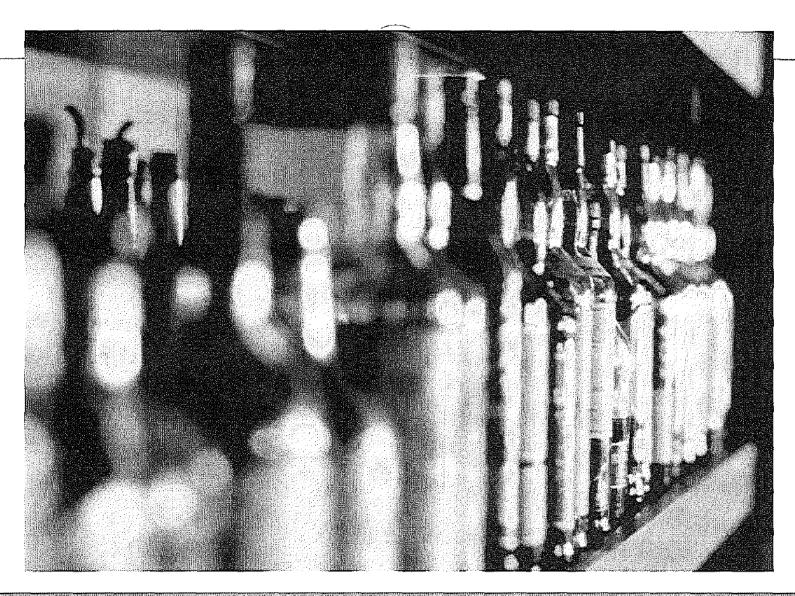


Net Contribution to Government by Channel (\$M)

^{*} FY12/13 report net income is \$929M. Figures above do not include contribution from non-alcohol products and Other Income.

^{**}Net Contribution by product type is not reported by LDB. It has been estimated by allocating LDB operating costs based on litres sold by GLS and litres distributed by LDB.

BC Liquor Pricing Today – Complexity!



Who sells liquor in BC?



10 retail channels with 5 discount rates

All Product Retailing

- 195 Government Liquor Stores (GLS) – sell to consumers and licensees
- 221 Rural Agency Stores (RAS)
- 670 private Licensee Retail Stores (LRS)
- 11 Duty-free shops
- 8,000 Licensees (Restaurants, Bars, Pubs etc.)

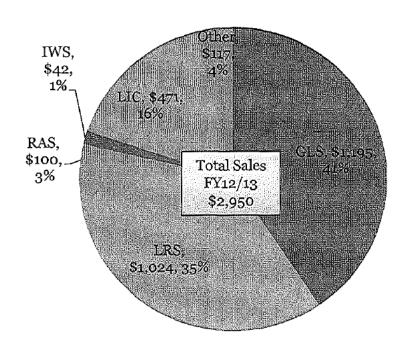
Dedicated Wine Retailing

- 321 on-site manufacturer stores
- 19 off-site manufacturer stores
- 21 VQA Stores
- 12 Independent Wine Stores(IWS)
- × 1 Tourist Wine Shop

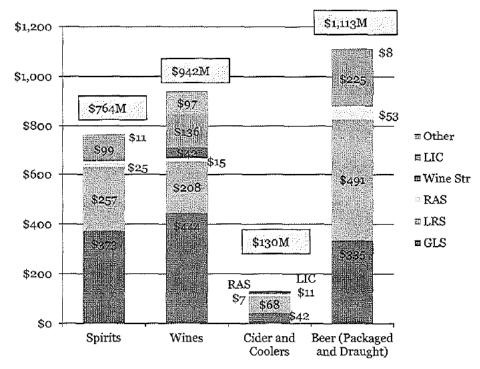
Retail Channel Market Share

41% of sales come from GLS stores, while LRS account for 35% of all sales.

Spirits and wines are sold predominantly by GLS. LRS are the main channel for beer and ciders and coolers.



Breakdown of Liquor Sales by Channel (\$M)



Breakdown of Liquor Type by Channel (\$M)

How are prices set? Two Steps...

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Step One

The Government Store Retail Price is Set

- LDB applies a formula for mark-up of liquor based on product category
- Manufacturers and suppliers set their price for sale to LDB to generate their target government store (GLS) retail price
- Generally markups are above 100%
- All prices in the retail system stem from this GLS retail price

Example: LDB Mark-up for Retail Price of Spirits and Beer

GLS prices are set by applying various markups such as:

- volume (\$/litre)*
- percentage
- Distribution charge (\$/litre)

Mark-ups vary depending on:

- product type (e.g. beer, wines, spirits)
- product cost
- product origin (Imports, domestics)
- size of manufacturer (S,M,L)
- packaging (e.g. draft)

Colour Key



Percentage mark-up**

Volume mark-up (\$/L)

LDB distribution charge (\$/L)

Product Costs

*Volume mark-up is a rate charged per ml of product. Rates vary between product category and vary further within the beer category

- **Spirits percentage mark-up is applied to per litre product costs based on the following graduated model:
- first \$21 100% of 163% mark-up
- next \$8.20 75% of 163% mark-up
- next \$8.20 50% of 163% mark-up
- above \$37.50 35% of 163% mark-up



Examples of Product Prices in GLS (before sales taxes & recycling fees)

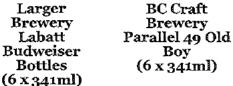
Smirnoff Red Label 0.75L

High Selling Spirit

PRICE \$21.36



High Selling Beer

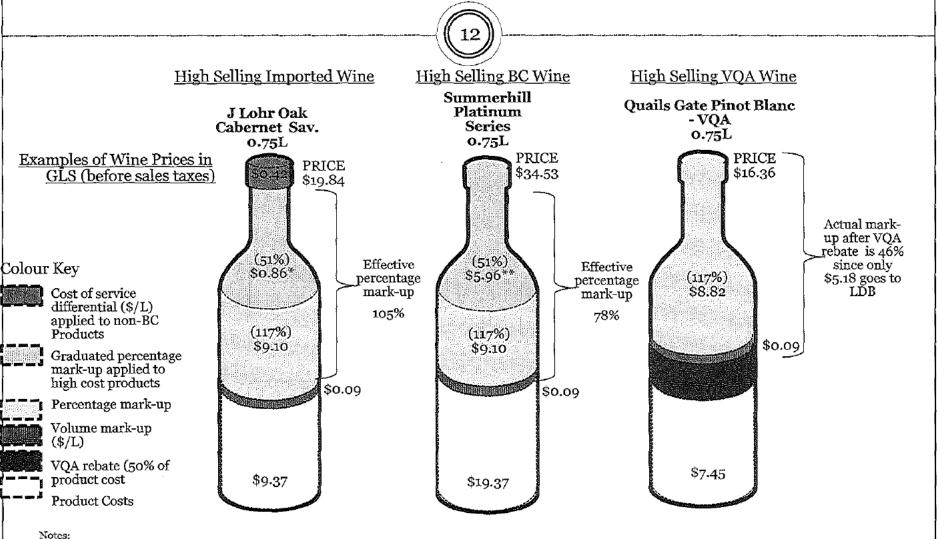








Example: LDB Mark-up for Shelf Price for Wines



* * VOA manufacturers receive from LDB as a rebate a 50% premium over the manufacturers product costs.

^{*}Wine percentage market of 117% is applied to the first \$10.25/litre. Product costs above \$10.25/litre receive only 51% mark-up

HOW ARE PRICES SET?



Step Two

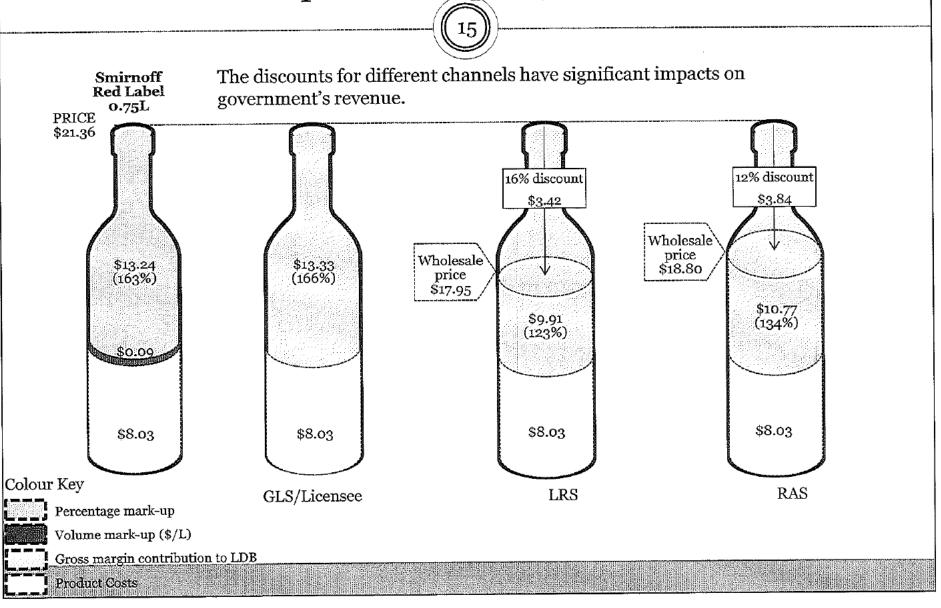
Different discount rates are applied to the GLS retail price for each retail channel

- Product is sold to retail sellers based on a percentage discount of the GLS retail price
- Retailers can sell for any price but not less than the price they paid (no loss leaders)
- Rural agency stores are agents of the LDB however, they can sell up to 10% above or below LDB display prices.

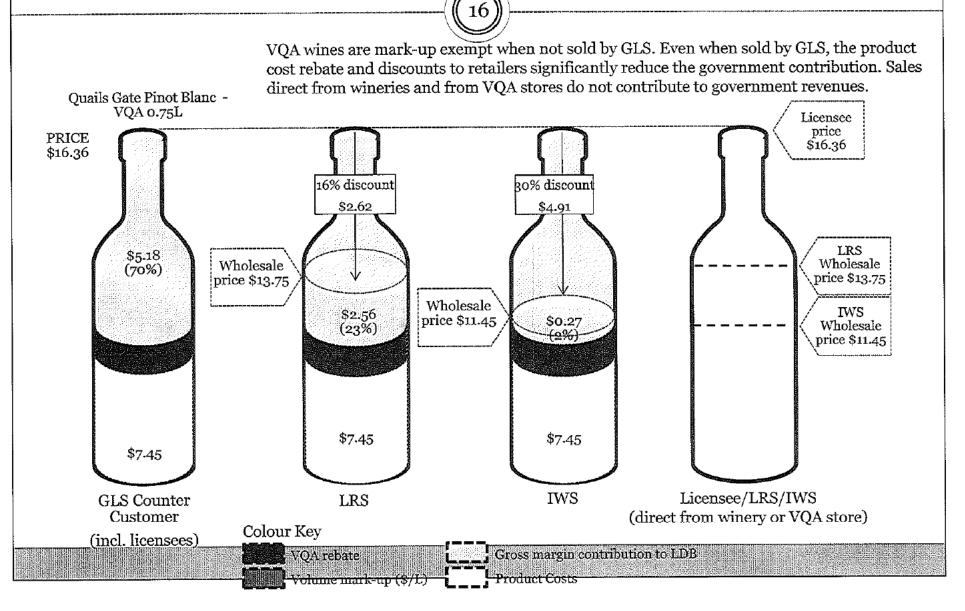
Who gets what discount?

Government Stores (GLS)	Retail price
Licensed Liquor Store (LRS)	16% Discount
Rural Agency Stores (RAS)	12% Discount
Licensees (Restaurants, Bars, Pubs etc.)	No Discount
Tourist Wine Shop	10% Discount
On-site manufacturer stores	100% Discount on 100% BC Wine and Spirits (No Mark-up) 30% Discount on non 100% BC wine*
Off-site manufacturer stores (Wine Only)	100% Discount on 100% BC (No Mark-up) 30% Discount on non 100% BC wine*
VQA Stores	100% Discount (No Mark-up)
Independent Wine Stores	30% Discount
Duty-free shops	Exception: Not discount based — Receive mark-up on in bond cost for liquor based on category

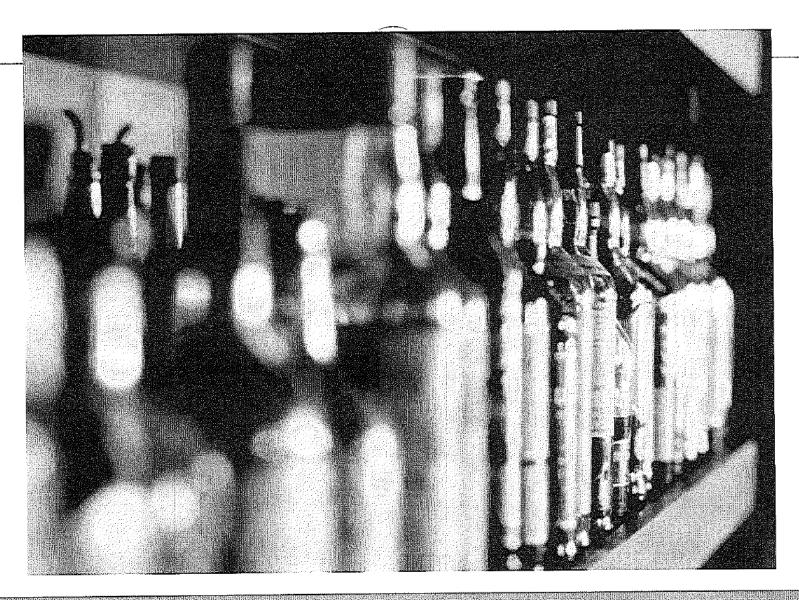
Current Model Wholesale prices example by Retail Channel



Current Model Wholesale prices – VQA examples

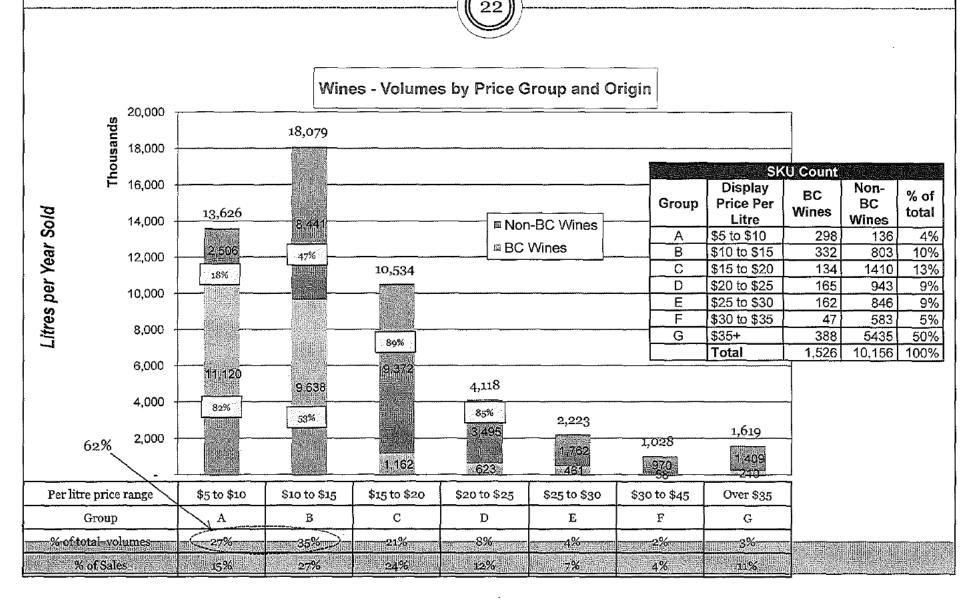


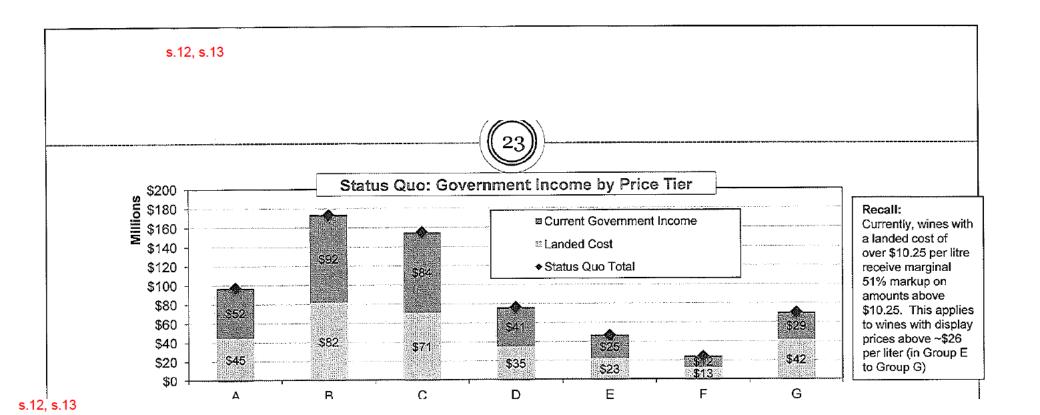
Wholesale Pricing

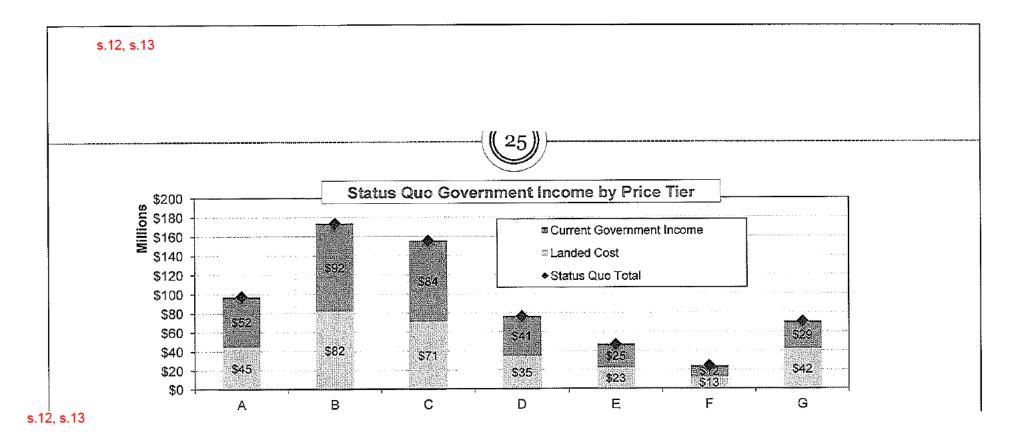


Breakdown of Wines

Volumes by Price Range and Origin







Beer Mark-up - Context



• BC currently has a volume tax on beer (not indexed) with three tiers where two have lower rates to support smaller brewers

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AGENDA FOR JAN 29th



- Decisions on:
 - o Crown model and role of LDB;
 - o Decisions on Liquor Policy Review report;
 - ★ Includes direction on retail;
 - o Pricing model for liquor
- Timing and implementation

Liquor Policy Review

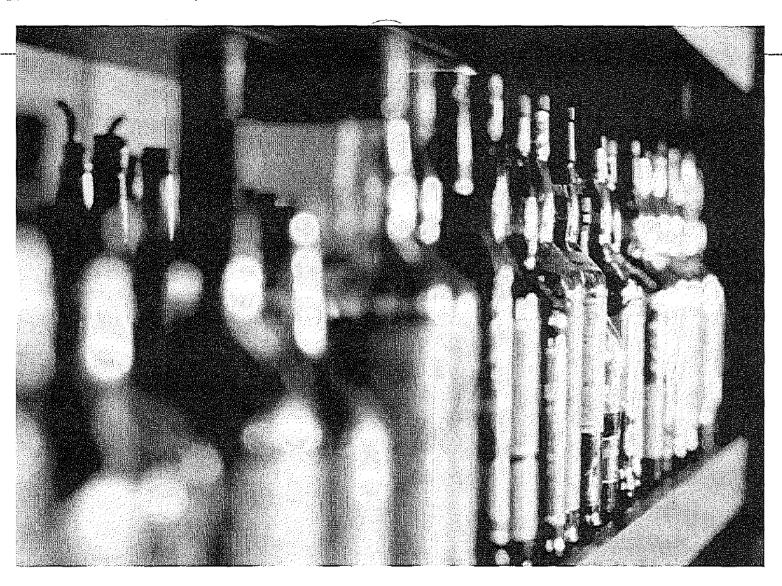


Agenda



- Liquor Policy Review: Recommendations and Implementation
- Liquor in Grocery
- Liquor Distribution Branch: Governance and Operations
- Liquor Pricing

Liquor Policy Review (LPR)



LPR: Themes

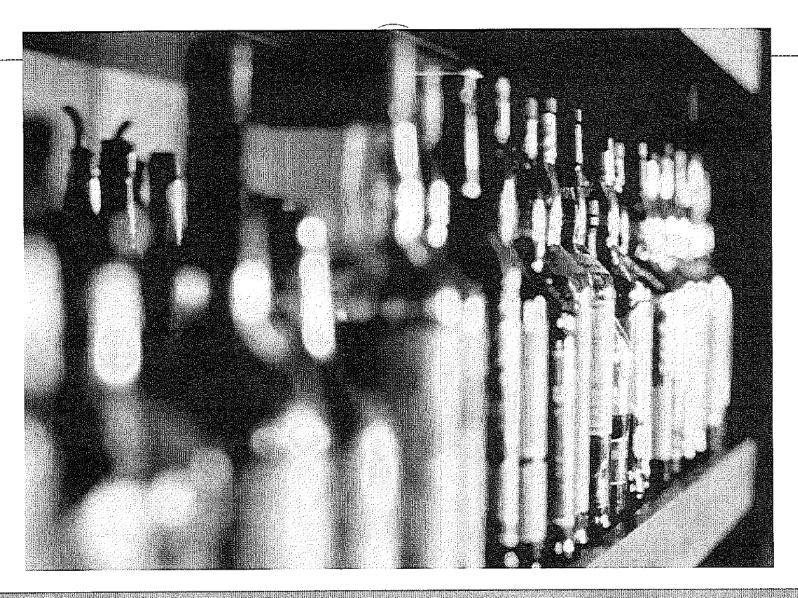


Responses to the consultation generated 73 recommendations under 5 broad themes:

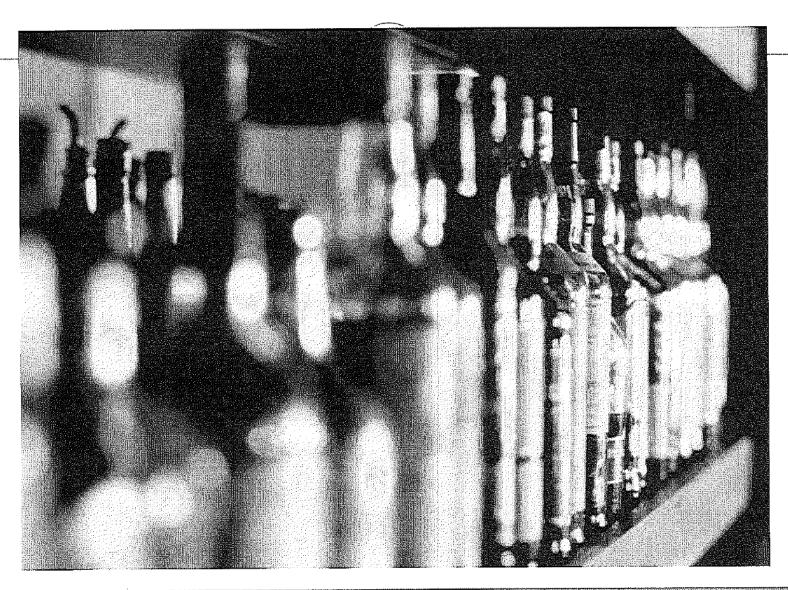
- ⋆ Health, Safety and Social Responsibility
- ➤ Economic Growth, Jobs, Tourism and Marketing
- ★ Licensing and Cutting Red Tape
- × Change Management

Report recommendations endeavor to create a balanced approach of often competing interests

BC Liquor Pricing



Beer mark-up



Beer Mark-up - Recap



- BC currently has a volume tax on beer (not indexed) with three tiers where two have lower rates to support smaller brewers
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Discussion

