RETAIL PROFILE

WINNING AT MONOPOLY

Since its inception in 1927 after eleven years of Prohibition, Ontario's alcohol monopoly has become one of the strongest wine distributors in the world. As Tony Aspler reports, it is also an attractively profitable business.

Andrew S. Brandt, the outgoing CEO of the Liquor Control Board of Ontario, LCBO, had a lot to crow about in his final annual report last year. "The LCBO increased its dividend to government for the eleventh straight year in fiscal 2004–5," he wrote in his last chairman's message. "At Canadian $1.115 billion (€747m), it was our tenth straight record dividend and second-ever of more that $1 billion." In that year the LCBO chalked up CAD 3.5 billion from the sale of wine, spirits and beer as well as from income generated by promotional services to suppliers in its stores and advertising in its glossy quarterly magazine, *Food & Drink*.

The LCBO is the beverage alcohol retailer to Ontario, Canada's largest province with a population 12.5 million; but the board, now chaired by Phil Olsen and managed by Bob Peter, prefers to call itself the world's largest single buyer of beverage alcohol. To peddle its wares the organisation employs 3,352 staff and runs 597 stores, yet it doesn't like to hear itself referred to as a monopoly. In his fifteen years at the helm Andrew Brandt was quick to cite competition from stores owned by Ontario wineries that sell direct to the public and The Beer Store chain owned by Canadian brewers Labatt, Molson and Sleeman, which provides retail and distribution services for cottage, micro and large breweries through its 441 stores. But if you want to bring wine, spirits or premium beers into Ontario you have to deal with the LCBO. So, too, do the local wineries and it's the LCBO alone that chooses which wines consumers can buy in their stores.

The Liquor Control Board of Ontario was created in 1927 after eleven years of Prohibition in Canada. The emphasis then and now is on "control". From its birth, the Board, a Crown Corporation, has regulated the sale and distribution of alcoholic products in the province and, in spite of several moves over the past couple of decades to privatise, it has survived because of its perceived money-making potential for the provincial treasury – and the aggressive lobbying of a trade union that goes into high gear whenever a new government suggests that it's time to put the alcohol business into private hands.

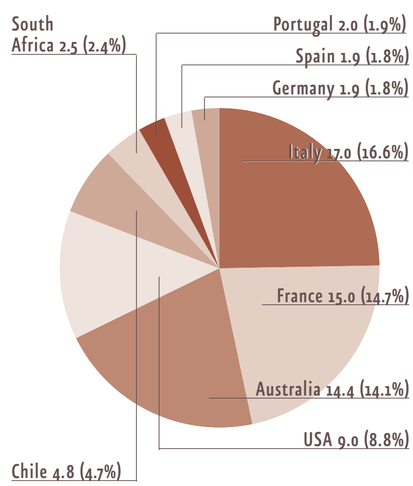
In the 1970s, shopping in an LCBO store was rather like entering a betting shop. There were no bottles on display, just printed lists of wines on the walls like railway time-tables. You wrote down the product number on a slip of paper and handed it to a clerk, who disappeared into a back room and returned with a bottle in a brown paper bag. He would slide it out of bag to show you the label and then slip it back as if you were purchasing pornography.Heaven forbid you should be seen carrying a bottle!

Today the shops are bright, well laid-out and inviting, decorated in pastel shades to attract the female customer. The top executives of the new LCBO were head-hunted at supermarket chains and department stores and it is their experience in marketing and consumer spending habits that is responsible for the huge profits the Board hands to the provincial government. It is therefore unlikely that Ontario will privatise any time soon.

1 Top Ten Selling Wines at the LCBO

	Product	Format	Price in CAD	Origin
1	Yellow Tail Shiraz	750mL	$11.95	Australia
2	L'Epayrie Blanc	1,500mL	$12.95	France
3	Jackson Triggs Sauvignon Blanc	1,500mL	$15.95	Cellared in Ontario
4	Lindemans Bin 65 Chardonnay	750mL	$10.95	Australia
5	Peller Estates French Cross Vidal	1,500mL	$12.45	Ontario
6	Wolf Blass Yellow Label Cabernet Sauvignon	750mL	$16.95	Australia
7	Yellow Tail Chardonnay	750mL	$10.95	Australia
8	Pasqua Soave	1,500mL	$14.85	Italy
9	Kressmann Selectionne Blanc	1,500mL	$12.95	France
10	Two Oceans Sauvignon Blanc	750mL	$9.00	South Africa

2 Imports by Country in Volume



Volume in million litres

SOURCE: LCBO, 2006

Not content with the status quo, though, the board's strategic plan calls for growing annual sales from $3.6 billion in 2005–2006 to $4 billion in 2007–2008 and increasing profit "by reducing expenses as a percentage of net sales and by improving our supply chain to drive excess costs out of the system". Many fear that a further reduction in the already meagre range of product available to consumers in Ontari0 will be one of the results.

With its enormous purchasing power the LCBO can squeeze producers, but the savings are not generally passed on to the consumer. There are floor prices below which wines will not be sold. Profits for the province are generated by mark-ups and taxes. Consider a wine that is sold – including the agent's commission of up to ten percent – to the Board ex-cellars for $10 a bottle. Add to this freight and insurance costs, excise duties, a flat tax, a mark-up that averages 63 per cent, an environmental tax, Ontario sales tax and the GST of the federal government. When that bottle reaches the shelf it will cost the consumer $23.15.

Each province sets its own prices based on taxes. Although the above calculation may appear high, of all the provincial monopolies, Ontario has the lowest prices. Alberta, being privatized, has Canada's lowest. While it may lower their margins, producers set the shelf price with their ex-cellar quote and can thus hit price points if they chose to do so. Although many wines are more expensive in Ontario, some products are cheaper at the LCBO than in the States or in Europe.

Divide and conquer

The LCBO is divided into three major sales divisions: The General Purchase List, Vintages as well as Private Stock and Consignment. The General Purchase List has as its base many of the moderately priced wines of the world, generally produced in relatively large quantities. Currently the General Purchase department lists 3,556 SKUs.

Once a year, the department that governs the General Purchase List advises the importing agents of the categories of wines that it wishes to consider, their retail price points and other factors. Recently, for example, they asked agents to offer no more than two Australian wines for consideration. Close to 1,000 samples were presented and it is likely that no more than five or six of these will actually be listed.

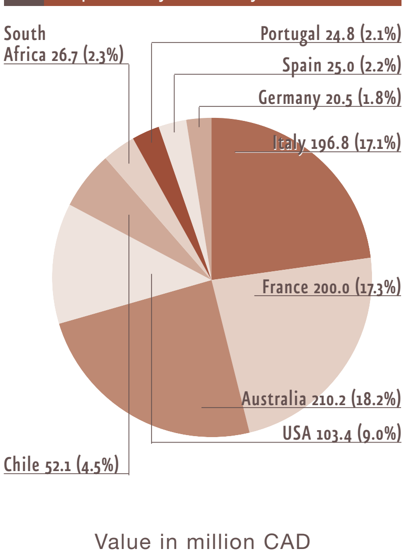
If a wine is listed and maintains a satisfactory rate of sales, it continues to be ordered. If not, then it is dropped with a financial penalty to the supplier, which generally means that it is sold off at 25% discount at the supplier's expense. Compared to other markets, where special offers are the rule, virtually all discounting in Ontario is done only because a product has not met quota or is deteriorating in quality within a poor supplier cooperation.

The fine wine division of the LCBO, Vintages, offers more interesting wines from all corners of the world and publishes its needs to agents quarterly. Unlike the General List, which runs regular lines, Vintages tends to sell "one-offs". Successful wines are not usually reordered unless they are deemed "essentials", so producers, importers and enthusiastic Ontario wine drinkers have to live in the vague hope that sometime in the future the department might order a wine from a subsequent vintage. Vintages makes two offers a month and annually releases close to 6,000 products that include wine, beer and spirits. Vintages' *Classic Catalogue* – featuring collectors' wines – is published three times a year and contains 200 to 250 highly priced products per issue.

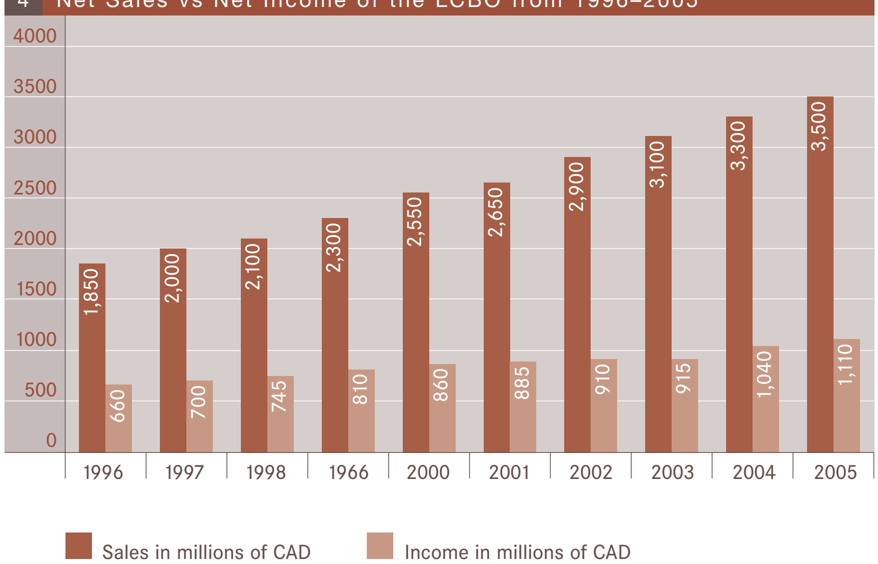
Vintages also offers suppliers the opportunity to participate in its merchandising initiatives. So, for a fee, you can obtain space on the cover of its release price booklet, which will display a bottle shot of your wine; you can offer "Air Miles"; you can, if chosen, pay a $3,000 fee to be one of its "Wines of the Month", for which you can expect an order of 1,000 to 1,200 cases of the selected wine.

The only opportunity for importers to bring in wines that are not considered appropriate for the LCBO General List or Vintages comes in the form of the Consignment Programme, under

3 Imports by Country in Value



4 Net Sales vs Net Income of the LCBO from 1996–2005



SOURCE: LCBO, 2006

which the LCBO permits agents, under supervised control, to order in stocks of wines from their suppliers. The wine never goes into the retail store system. It remains in the LCBO's own warehouse and is released in case lots only to the agents upon proof of orders from licensees or consumers for their own use. There is a disincentive, however, to this programme. The LCBO pays the supplier 30 days after the last case of a particular product has sold through. This means that instead of being reimbursed, say, 90 days after shipping to the General Purchase List or Vintages, suppliers may well have to wait 180 days or more depending on the time it takes for the product to sell out.

The LCBO uses the following price categories to monitor wine sales, which are 35% of the monopoly's business: Under \$8, \$8–10, \$10–12, \$12–15, \$15–20, \$20–25, \$25–30, \$30–35 and \$35+. The \$10–\$12 and \$12–\$15 currently show greater than average growth, around 9 per cent per year. Licensees account for 12 per cent of value sales. The Board responds to consumer purchase preference by shelf-space prominence, giving top performing brands the best display. And how does a brand achieve this prominence? Steven Trenholme, a marketing consultant for the international wine trade, says that in order to successfully launch a brand, "the supplier or producer has to find a suitable partner in the market, that is an agent who has the same goals and aspirations. Whether the goal is to sell 100,000 cases or 500, you still have to find an agent who is capable and prepared to work within a collaborative effort." There are about 200 importing agents in the Ontario market from the large national companies such as Maxxium, Pernod Ricard and Corby's to the tiny hobbyists who bring in a few hundred cases of a specialty product.

Some agents have discovered that it is best to move beyond the bottle business into the receptacle business – bag-in-box, aluminum cans, PET bottles and the like – as the monopoly seems to be more concerned with the receptacle than the quality of the product. In fact, one of the most successful launches in the LCBO's history was a Boisset product in Tetra Paks, French Rabbit. Although the launch was heavily subsidized by the LCBO for environmental reasons, some critics maintain that the LCBO has a commercial agenda in pushing the Tetra Pak in order to bring in cheap wine in bulk and selling it as 'premium' wine to maximise their profits.

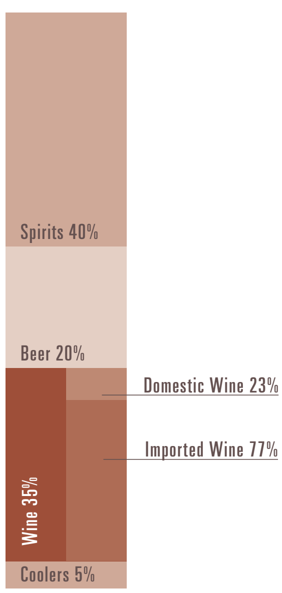
Because of the large Italian population in Ontario, with over 600,000 in Toronto alone, Italian restaurants proliferate with large numbers of Italian wines on their lists. Australia and Chile, because they offer easy-to-understand wines at popular price points, are riding high. While South Africa, driven by a couple of strong Distel brands, is gaining ground, most Old World suppliers are suffering.

Domestic wines, though, still account for some 43 per cent of total sales; but this figure is misleading because only about 16 percent of that volume is truly locally grown, carrying the Vintner's Quality Alliance (VQA) label. The rest is blended with off shore wines that are imported in bulk and labelled 'Cellared in Canada.' The LCBO's projection is that Canadian wine sales will increase 7.3 per cent in the coming financial year, amounting to sales of \$248 million.

Offering a high-quality, well-packaged, fairly priced wine is far from enough to get you into the market here. Like commercial retailers in the UK and US, the LCBO prefers to work with strong partners who make a commitment to their brand and are prepared to make significant investments to launch and drive their products. Powerful suppliers with multiple brands, sufficient resources to fund in-store promotions and full-time dedicated sales teams are what the LCBO looks for. Advertising will be helpful but it is not enough; hands-on contact and public relations have a major part to play too. Those producers who visit the market and hold media events tend to be the most successful. Consumers rely on recommendations from the wine press and they arrive at stores with articles clipped from newspapers and magazines. Success breeds success. So if a producer wants to enter this market, he should come to the table with an agent who has a proven track record, a bunch of cash to promote his brand and a willingness to show his face once a year to the consumers of Ontario. ■

5 LCBO Sales 2005 by Value

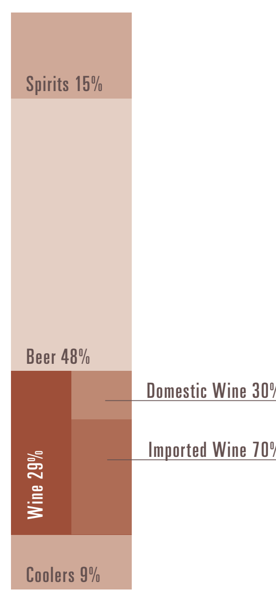
	Value in '000s CAD
Spirits	1,391,741
Domestic Wine	284,158
Imported Wine	945,402
Beer	705,063
Coolers	168,024
Total	**3,505,383**



Although wine accounts for only 29% of total volume, it provides 35% of value

6 LCBO Sales 2005 by Volume

	Volume in '000s litres
Spirits	54,944
Domestic Wine	32,528
Imported Wine	75,150
Beer	181,501
Coolers	32,282
Total	**376,406**



The Annual Report of the LCBO can be found under "about us" on www.lcbo.com

SOURCE: LCBO, 2006

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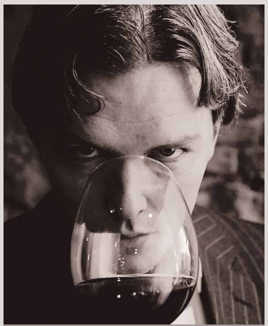

Sommelier Andreas Larsson on Sweden's alcohol monopoly Systembolaget

Systembolaget was founded in 1850 as a not-for-profit body, whose aim was to reduce the problems associated with alcohol consumption. For years, the state-owned Vin & Sprit was Sweden's only alcohol importer, and thus the only distributor to the monopoly. When the monopoly on imports ceased in 1995, there were 169 licensed importers, a number that today has grown to around 450. Unlike some monopolies, the Swedish model allows the on-trade to buy freely from any licensed importer, which allows upscale restaurants to assemble lists of fine wines that are unavailable in shops.

People wanting to drink at home, however, have to use the 400 or so increasingly self-service Systembolaget shops. Despite the latter's claim to offer "the greatest assortment in the world", there is a big difference between the quality of the wine on offer from the importers and the monopoly. Most shops have around 430 wines, but three – in Stockholm, Malmö, and Gothenburg – offer ranges of 2,900 wines. However, throughout the chain, wines are often out of stock. When it comes to fine wine, I believe the Norwegian monopoly has a much better assortment and a higher degree of service.

›› Upscale restaurants assemble lists of fine wines that unavailable in shops ‹‹

In 2002, scandal surrounded the monopoly when five store managers were found to have received "bonuses" from importers for pushing particular wines. An investigation followed in which 50 people were convicted of corruption and bribery. Apart from suspending its own staff, the Systembolaget took sanctions against the importers and terminated agreements. The scandal hurt the monopoly and led to increased calls for its abolition, but its supporters point out that it is legal under European law and has 73% support among Swedish alcohol buyers.

Systembolaget works for a "healthy drinking culture in which everyone can enjoy the beverages they sell without doing harm to themselves or others". It ostensibly does not attempt to maximise profit, and is brand-neutral – it cannot discriminate between suppliers or products. Much effort goes into spreading knowledge on subjects such as food-and-wine matching and alcohol and health, as well as into opting for quality rather than quantity. This last aspect is, however, contra-dicted by the fact that 54% of wine sales are bag-in-box and 9% are in Tetra Pak.

In Sweden, companies combine the roles of importer and distributor, and range from one-man-band hobbyists and specialists to the huge Vin & Sprit. The larger distributors include international groups like Pernod Ricard and Rémy Martin, and Nordic groups like Bibendum and Philipson & Söderberg, which belongs to the Finish Altia group, as well as local firms such as Fondberg and Oenoforos. All have products listed with the monopoly and good distribution to the on-trade.

According to the Systembolaget, the purchasing process begins with an "annual launch strategy" based on "a comprehensive analysis of sales and market trends in Sweden, and of trends and developments internationally". Tenders – of which, in 2005, Systembolaget received 17,773 and sampled 11,859 – are then invited from licensed importers. These might be for a "red 2005 Côtes-du-Rhône with good primary fruit but without oak influence in a 75cl bottle to retail for SEK69", or a "modern white grape blend from Argentina in a 75cl bottle to retail for maximum SEK89". Samples are blind-tasted by an experienced panel, who rate the wine partly on a value-for-money basis. Though smaller quantities of fine wine may skip this process, wines that have been selected are then submitted for a laboratory analysis.

As of January 2006 the duty for wine between 8.5–15% alcohol is SEK22.08 per litre, to which VAT of 25% will be added. Importers' normal margins vary between 15–50 %, depending on the price range and availability, but can be as little as SEK1 per bottle in the case of wines sold in big quantities to the monopoly. The monopoly adds a sales margin of 25.5%, so that a wine that sells for €1–2 ex-cellar might – after shipping, importers' margins, tax, VAT, and Systembolaget margins – end up at anything between SEK55–85 (€6–9.50). Fixed duty rates mean that while bottles retailing for SEK50 (€5.50)might be subject to 53.1% tax, the percentage on one selling for SEK500 (€55) would be 23.3%. Thus, compared to southern and continental European pricing, cheap wines are fairly expensive. Expensive wines are more comptetively prices. A bottle of spirit that retails for SEK220, however, is taxed at 83.8 %.

The monopoly's range is broken down into the "fixed product" range, updated twice annually, with the least-popular items being delisted; the "temporary listings", updated nine times a year with smaller quantities of limited-production; and seasonal wines – sold as long as stocks last. Then there is the "order" range, which contains wines that the importers have in stock and that can be ordered via the Systembolaget, a process that can take anywhere from just a few days to as much as a few weeks. In 2005, Systembolaget carried 2,361 brands with an additional 3,882 in the order range.

In 2005 Systembolaget, sold 143 million litres of table wine, excluding fortified wines, mostly from Spain and France, which are the leaders in volume and value, respectively, followed by Italy. But New World countries such as South Africa are growing in importance, albeit more slowly than elsewhere. Red wine (83 million litres) sells better than white (46 million litres).