INDUSTRY PROFILE

Industry, Science and Technology Canada
Industrie, Sciences et Technologie Canada

Brewing

Canada

INDUSTRY PROFILE

BREWING

ACXU

1988

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

Robert de Cotret

Minister

1. Structure and Performance

Structure

The brewing industry is composed of establishments primarily engaged in the steeping, boiling and fermenting of malt and hops to manufacture malt beverages. The industry produces a variety of beer, lager, ale, porter and stout, in bottles, cans and draught for the consumer market and the hospitality industry. Beers are categorized as premium (often imported), regular and discount (or low-priced) brands, each with a different price range. Brand loyalty and product image are key determinants of market success.

The main inputs to the brewing industry are barley malt and packaging materials. Barley malt accounts for more than 20 percent of the cost of production. The price of domestic malting barley is set by the Canadian Wheat Board (CWB) as part of the controls related to the marketing of domestic wheat, oats and barley. Packaging materials account for more than 45 percent of the cost of production. The bottles produced for the beer industry account for 15 to 20 percent of the volume of glass manufactured in Canada.

In 1986, the brewing industry shipped almost 23 million hectolitres of product valued at $2.19 billion. Direct employment in the industry is approximately 14 000 in all regions of Canada. An additional 6250 are employed by distribution companies and retail agencies in jobs that are directly related to the sale of beer but which are not included in this profile.

The Canadian industry is heavily influenced by federal and provincial government regulations and practices. For example, provincial government policies require brewers to maintain production facilities in the province if their products are to be marketed on a price-competitive basis in that province. As a result, the Canadian market is divided into separate provincial markets served by brewing operations in each province. Thus, there are 53 establishments across Canada, of which approximately 40 are operated by the major companies. In addition, regulations have influenced pricing through price mark-ups, the setting of minimum prices in some jurisdictions and the requirement for uniform pricing throughout a province. Regulations govern the packaging allowed and generally favour returnable-refillable bottles. Advertising and promotion are also closely controlled. These regulations vary by province.

World trade in brewery products is not substantial because brewery products are large-volume, low-value products with a relatively short shelf life. The products traded are generally brands which serve a small market segment and command premium prices. In the North American trade in brewery products, the proximity of markets makes transportation costs less important considerations than production, marketing costs and market access.

The industry has developed export markets for approximately nine percent of its output or $189 million in 1986, most of which is sold in the premium market in the United States. In contrast, direct imports of U.S. beer to Canada account for only one percent of the domestic market, although U.S. brands produced in Canada under licence account for an estimated 14 percent of the domestic market.

Canada

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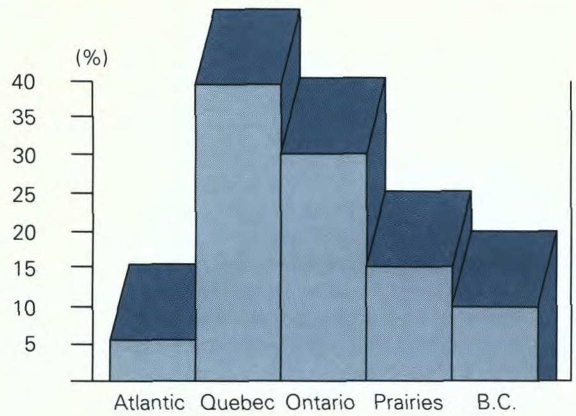


Employment by region. Average for the last 3 years (total 13 652)*

** Estimate for 1986.*

The Canadian brewing industry is dominated by Labatt Brewing Company Limited, Molson Breweries of Canada Limited and Carling O'Keefe Breweries of Canada Limited which, together, hold a 97-percent share of the domestic market. Both Labatt and Molson are Canadian-owned, while Carling O'Keefe was recently purchased by the world's sixth-largest brewing company, Elders IXL Limited of Australia. The remainder of the market is held by smaller regional brewers such as Moosehead Breweries Limited, which is Canadian-owned, and Amstel Breweries Canada Ltd, which is wholly owned by Heineken of the Netherlands. Micro-breweries which serve a local area play a small role in the Canadian market. Two of the major breweries jointly own one domestic malt company. There are no corporate links between the brewing industry and packaging suppliers.

Performance

Since the mid-1970s, the domestic market has been essentially flat. This decline has been attributed to a number of factors, including changing demographics, changing attitudes toward the consumption of alcohol, greater competition from other beverages (alcoholic and non-alcoholic) and higher levels of excise and sales tax.

Federal and provincial taxes account for 47 to 62 percent of the retail price of a brewery product. The industry has taken the position that the level of taxation and the frequency of increases have reached a point where consumer price resistance may reduce opportunities for growth even more than they have to date.

Imports to Canada have accounted for only one percent of the domestic market, with the exception of those years in which major brewery strikes have occurred. Foreign brands have, instead, been made available to Canadian consumers through licensing agreements with foreign brewers. The major U.S. brewers have licensing arrangements with Canadian brewers to produce and market U.S. brands domestically. These agreements enable U.S. brands to be available in Canada and to take advantage of "spillover" advertising from U.S. sources. Under these arrangements, Canadian breweries have been able to maintain domestic production volumes. U.S.-licensed brands have now captured an estimated 14 percent of the domestic market. Some European brands are brewed in Canada under similar arrangements.

Worldwide, breweries have excess capacity, in part because their capacity is based on meeting peak seasonal demand. Capacity utilization in the Canadian brewing industry is about 85 percent, as compared to the U.S. brewing industry which is operating at 75-percent overall capacity. The growth in the number of establishments in Canada is primarily due to the increase in the number of micro-breweries which have captured a small market-niche for specialty beers and premium products.

Because consumption has been stable, competition for market share has become more intense. Consequently, advertising and promotion are placing greater demands on the operating budgets of companies than in the past. Companies are pursuing marketing strategies which differentiate their product from other brands. This differentiation has led to a shift in packaging, from the brown stubby bottle which had been an industry standard, to a variety of packaging shapes and sizes and twist-off tops. Package variety, however, comes at the expense of transportation and storage efficiencies, which had been possible with the standardized bottle.

While foreign brands are produced in Canada under licence, Canadian brands are now also being produced under licence in more distant markets, such as Europe. This arrangement has enabled Canadian brewing companies to increase their international presence while maintaining corporate revenues through licensing rights.

2. Strengths and Weaknesses

Structural Factors

In the brewing industry, important factors influencing international competitiveness in an open market are economies of scale, the price and quality of the ingredients, transportation costs and image. However, pressures to achieve and maintain international competitiveness are often muted in a highly regulated environment. In the current Canadian context, provincial policies generally limit competition to non-price factors. In jurisdictions such as British Columbia and Alberta, where pricing policies have been liberalized, particularly with respect to minimum prices, the underlying disadvantages faced by the Canadian industry vis-à-vis low-priced imports have become more evident.

The economies of scale available to the industry are not being achieved since provincial policies requiring brewers to operate a brewing facility in each province prevent the establishment of national-scale plants. The current minimum plant scale necessary for cost-minimization in beer production is about four to five million hectolitres per year. Canadian plants produce from 250 000 hectolitres to 2.8 million hectolitres annually — well below the cost-minimization point. The Canadian brewing industry uses modern production techniques and there are no technological disadvantages facing the industry if opportunities to scale up facilities arise.

In the United States, it has been predicted that, in order to support the costs of promotion, the minimum viable corporate size for brewing companies wishing to market nation-wide will soon be 26 million hectolitres of output per year. This volume compares with a total Canadian output of about 23 million hectolitres per year, most of which originates from the three major companies. Canadian brewers could thus find it difficult to compete in some segments of a continentally integrated market.

In addition to the scale factors, domestic brewers face higher input costs than their U.S. counterparts. The domestic grain-pricing policy, supported by import controls, results in a barley malt price for Canadian brewers which is much higher than that for U.S. brewers. For example, in 1986, the average barley malt price paid by Canadian brewers was more than 60 percent higher. In Canada, the availability of lower-priced, lower-quality malt is limited compared to that in the United States. As a result, Canadian brewers have less flexibility to lower costs of production through the use of lower-priced ingredients.

Provincial government policies favour the use of returnable-refillable glass bottles and impose limitations on the use of cans for a variety of reasons. Almost 80 percent of brewery products are sold in glass bottles, 12 percent in cans and eight percent in draught. By contrast, in the United States, cans account for 65 percent of the market. Cans cost less than glass containers; they can be handled at higher production speeds and are less fragile and costly to transport. The cost of using returnable-refillable glass containers is reduced because they are generally refilled about 12 times, but they impose practical limitations on the market area which can be served from one location.

Trade-related Factors

Tariffs on brewery products are not significant factors in overall trade. The Canadian tariff is C$0.15 per gallon plus an excise duty equivalent to the excise tax applied to domestically produced brewery products. Tariffs in the United States are US$0.06 per gallon plus an amount equivalent to the excise duty paid by U.S. brewers.

Under the Canada-U.S. Free Trade Agreement (FTA), tariffs on brewery products will be reduced to zero in equal increments over a ten-year period. In addition, tariffs on important inputs such as packaging materials will also be eliminated. Further, the FTA also provides that once Canadian and U.S. producer-support levels for certain grains, including barley, become equal, import permit requirements for these grains and their products will be eliminated. Trade in brewery products was exempt from all other provisions of the FTA, including national treatment. Given this exemption, changes to existing Canadian provincial government practices relating to listing, distribution or pricing of brewery products will not be required under the FTA. The United States did, however, maintain its GATT rights in this area.

After a formal complaint by the European Community (E.C.) regarding the pricing, distribution and retailing practices of the provincial liquor control agencies, a GATT Panel found these practices to be inconsistent with international trading rules. The panel report has been adopted and Canada has been asked to report back to GATT Council by the end of 1988 on the measures taken to comply. In a separate, but related initiative, a working group of the Intergovernmental Committee of Ministers on Internal Trade was established to take steps to reduce or remove barriers to interprovincial trade caused by liquor board marketing policies and practices.

Technological Factors

Research and development in the brewing industry is generally driven by the need for new-product development to respond to changing consumer tastes. Product innovations have included low-calorie beer, low-alcohol beers and beer coolers. These new-product introductions closely mirror changes taking place in the U.S. market.

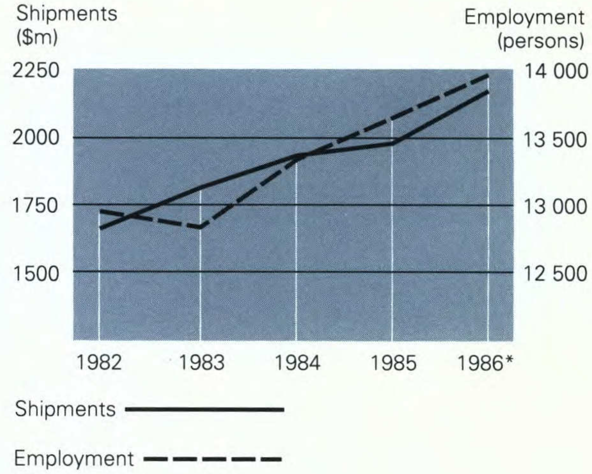
The Canadian brewing industry is as technologically advanced as any in the world. Much research and development has been carried out in Canada, particularly in the important areas of microbiology and biotechnology. Developments to date have included yeast strains which can produce low-calorie beers, but retain the mouthfeel characteristics of regular beers and yeasts which are more alcohol-tolerant. Work is proceeding on developing yeasts which would synthesize other chemicals recovered from the spent yeast, and thus increase the value of the fermentation by-products.

Process technology is up to date and, to the extent new technology is required, it is readily available.

3. Evolving Environment

The future outlook for the brewing industry will be determined by the shifting importance of various demographic age groups, social attitudes towards the consumption of alcoholic beverages and pressures for the removal of barriers to trade.

For brewers, the most important market segment is the age group between 21 and 35. This segment is becoming smaller — a shrinkage which will continue to restrict growth prospects severely. A decline in consumption has already begun; annual per capita consumption of beer has fallen from a high of 87 litres in 1979 to 82 litres in recent years. Within the beverage industry as a whole there has been a gradual shift toward non-alcoholic beverages, while within the alcoholic beverage segment there has been a shift towards coolers, light beers and wines. These trends are expected to continue. Moreover, public concern about drinking and driving, together with increased penalties, are likely to moderate consumption of all alcoholic beverages, including beer.



Total Shipments and Employment

* *Estimate.*

Product differentiation through promotion, advertising and packaging will continue to be one of the most important factors in maintaining or increasing market share in the domestic market. A greater internationalization is evolving in the brewing industry worldwide as major beer-producing countries are also experiencing flat or declining domestic markets. To counter this decline, these producers are seeking direct exports to other countries. They are entering into licensing agreements in other markets to promote specific brands and they are being receptive to licensing agreements in their own markets in order to maintain production volumes. As domestic exports declined marginally in 1987, indicating that export-volume growth may have peaked, domestic brewers are expected to follow this trend to licensing.

The elimination of tariffs on brewery products under the FTA is not expected to have a major impact. The elimination of tariffs on packaging materials, however, is expected to be beneficial in lowering some input costs. If and when producer support levels are equalized and import permits on barley and malt are removed, Canadian brewers could benefit from competitive malt prices.

2. Strengths and Weaknesses

Structural Factors

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International interest for improved access to Canadian markets will continue. With the adoption of the GATT Panel report, our trading partners are looking to Canada to implement changes to provincial listing, pricing and distribution practices relating to alcoholic beverages. The Canadian government has indicated that it is not prepared to implement changes to beer marketing practices in the foreseeable future. However, the Committee of Ministers on Internal Trade is currently working towards an agreement on the removal of the interprovincial trade barriers.

In a more-open trading environment, achieving greater economies of scale by rationalizing on a national basis, and gaining access to competitively priced malt inputs will be important factors in achieving international competitiveness. In the event of rationalization, more attention would be paid to transportation costs. This would likely favour the use of one-way containers which could be recycled.

Given the nature of potential adjustments to more liberalized trade in this area, an adequate transition period would be important.

4. Competitiveness Assessment

The Canadian industry operates in a highly regulated environment. The industry, as it is currently structured, would not be competitive in an open trading environment. The Canadian industry is characterized by large companies with excellent management and marketing skills and, given an appropriate transition period, could be expected to adjust to a more liberalized trading environment both nationally and internationally.

The FTA is expected to have only a limited impact on the brewing industry through the elimination of tariffs on brewery products and packaging inputs. In the longer term, however, lower malt prices are also a possibility.

International pressure for improved access to the Canadian market for brewery products will continue under GATT.

For further information concerning the subject matter contained in this profile, contact:

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PRINCIPAL STATISTICS

SIC(s) COVERED: 1131 (1980)

	1973	1982	1983	1984	1985	1986e
Establishments	42	40	38	39	41	53
Employment	10 507	12 938	12 804	13 318	13 656	13 982
Shipments ($ millions)	532	1 667	1 819	1 904	1 985	2 190
Shipments (million hl)	19.0	22.8	22.5	21.9	21.8	22.8
Gross domestic product (constant 1981 $ millions)	729.8	688.4	668.7	676.1	666.1	694.9
Investment ($ millions)	55.0	112.7	174.4	251.9	180.4	150.0
Profits after tax ($ millions)	42.1	80.8	100.9	150.5	N/A	N/A
(% of income)	6.5	5.1	5.6	7.7	N/A	N/A

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986e
Exports ($ millions)	15	132	141	159	165	189
Domestic shipments ($ millions)	517	1 535	1 678	1 745	1 820	2 001
Imports ($ millions)	3	13	19	17	54	20
Canadian market ($ millions)	520	1 548	1 697	1 762	1 874	2 021
Exports as % of shipments	2.7	7.9	7.8	8.4	8.3	8.6
Imports as % of domestic market	0.6	0.8	1.1	1.0	2.9	1.0
Canadian market (million hl)	18.8	20.4	20.7	20.9	20.3	20.6

Source of imports (% of total value)		U.S.	E.C.	Asia	Others
	1982	32	61	2	5
	1983	47	46	2	5
	1984	47	43	2	8
	1985	75	22	1	2
	1986	45	44	3	7
	1987e	56	33	3	9

Destination of exports (% of total value)		U.S.	E.C.	Asia	Others
	1982	99.6	—less than 1%—		
	1983	99.7		"	
	1984	99.6		"	
	1985	99.3		"	
	1986	98.5		"	
	1987	99.1		"	

(continued)

REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	Prairies	B.C.
Establishments – % of total	17.8	7.6	28.8	30.5	15.1
Employment – % of total	5.0[e]	39.5	30.4	15.0[e]	10.1
Shipments – % of total	4.2[e]	28.1	41.1	17.0[e]	9.6

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Labatt Brewing Company Ltd.	Canadian	All regions
Molson Breweries of Canada Ltd.	Canadian	All regions
Carling O'Keefe Breweries of Canada Ltd.	Australian	All regions

e Estimate.
N/A Data not available

Note: Statistics Canada data have been used, to the greatest extent possible, in the preparation of this profile.

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